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Mercantilist Development in Russia: The Legitimacy of State Power, State Identity, and the Energy Charter Regime (1990 - 2010)

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Mercantilist Development in Russia: The Legitimacy of State Power, State Identity, and the  
Energy Charter Regime (1990 – 2010)

By  
Boris Barkanov

A dissertation submitted in partial satisfaction of the  
requirements for the degree of  
Doctor of Philosophy  
in  
Political Science  
in the  
Graduate Division  
of the  
University of California, Berkeley

Committee in charge:

Professor George W. Breslauer, Chair  
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## Abstract

Mercantilist Development in Russia: The Legitimacy of State Power, State Identity, and the Energy Charter Regime (1990 – 2010)

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Boris Barkanov

Doctor of Philosophy in Political Science

University of California, Berkeley

Professor George W. Breslauer, Chair

This dissertation investigates the creation, adaptation, and demise of international regimes. Specifically, I ask why international regimes sometimes fail to fulfill their original purpose. Empirically, I examine the evolution and eventual failure of the Energy Charter (ECH), a multilateral regime that governs the Eurasian energy economy. Modeled after the European Steel and Coal Community, the original goal of the regime was to capitalize on economic complementarities in energy to integrate Gorbachev's reforming USSR (later Russia) with Europe and promote pan-European cooperation and peace. By 2010, integration had failed, and the regime itself had become a source of conflict. To understand this outcome, I focus on the foreign energy policy of Russia, a central state within the ECH, which actively participated in designing the regime in the 1990s but two decades later decided that it was no longer in its interest.

Using data collected from interviews and archival searches during field research in Russia, Brussels, and Paris, I find that under President Yeltsin, **low domestic sovereignty** meant the state could not integrate key domestic players into ECH policy-making. This led Russia to conclude a bargain that it could not implement domestically. Under President Putin, **high domestic sovereignty** meant the state had sufficient capacity to corral these recalcitrant actors. However, the new policy that emerged compelled Russia to attempt to modify the ECH in ways that violated previously accepted norms, thereby alienating its European partners and undermining the regime.

This study supports Hegemonic Stability theory which suggests that we can expect regime failure after major shifts in the distribution of power produce changes in the interests and policies of key states. I extend this finding by showing that Russian state power increased due to **changes in elite conceptions about the legitimacy of state power**. I demonstrate this by using over time comparisons between most similar cases, tracing the process through which ECH policy evolved, and examining intervening variables – state building strategies and elite identities vis-à-vis the state – that changed over time in unexpected ways. The shift in elite beliefs had a transformative effect on the structure of domestic politics, generating new patterns of authority, a higher level of state domestic sovereignty, and enhanced state power. Finally, state domestic sovereignty was associated with state capacity to organize domestic groups, behave as a unitary actor, and follow through on international commitments.

To capture these developments, I use the concept of state identity which combines the level of domestic sovereignty (high or low) with elite beliefs about the state's role in the international system (regime maker or regime taker). This generates a typology of four state identities – master, pretender, disciple, and apprentice – that can be used to understand regime outcomes more generally. In political economy, I use the term mercantilist instead of master to connect my research with realist insights about the role of power in international political economy. I propose the term “mercantilist development” which refers to a state that attempts to fundamentally change the structure of the international economy in order to accumulate capital. Thus, mercantilist development helps us understand the micro-mechanisms through which the structure of the international system changes. Finally, I explore the factors associated with successful regime adaptation to accommodate rising powers, an especially pressing contemporary concern given that the balance of power is expected to shift considerably in the twenty-first century.

To my father, Vladimir Barkanov, who kindled in me this interest in politics; and to my mother,  
Galina Barkanov, who always encouraged me to learn.

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## Acronyms and Abbreviations

BA – Basic Agreement  
CP – Contracting Party  
EC – European Commission  
ECH – Energy Charter Regime  
ECT – Energy Charter Treaty  
EEC – European Economic Community  
ENP – European Neighborhood Policy  
EU – European Union  
FSU – Former Soviet Union  
GATT – General Agreement on Tariffs and Trade  
IAP – Industry Advisory Group  
IEA – International Energy Agency  
IEF – International Energy Forum  
IG – Investment Group  
KRG – Kurdistan Regional Government  
LTCs – Long Term Contracts  
MAI – Multilateral Agreement on Investment  
MERT – Ministry of Economic Development and Trade  
MFN – Most Favored Nation  
MGIMO – Moscow State Institute of International Relations  
MID – Ministry of Foreign Affairs  
NEP – New Economic Policy  
NT – National Treatment  
OECD – Organization for Economic Co-operation and Development  
OPEC – Organization of Petroleum Exporting Countries  
OSCE – Organization for Security and Co-operation in Europe  
PA – Provisional Application  
PCA – Partnership and Cooperation Agreement  
RAO UES – Unified Energy System Russian Stock Company (former electricity monopoly)  
REIO – Regional Economic Integration Organization  
RSFSR – Russian Soviet Federative Socialist Republic  
SCM – Socialist Market  
SG – Strategy Group  
SS – Strategic Sector  
ST – Supplementary Treaty  
TP – Transit Protocol or Protocol on Transit  
UNCITRAL – United Nations Commission on International Trade Law  
UNECE – UN Economic Commission for Europe  
USSR – Union of Soviet Socialist Republics  
WG – Working Group  
WTO – World Trade Organization

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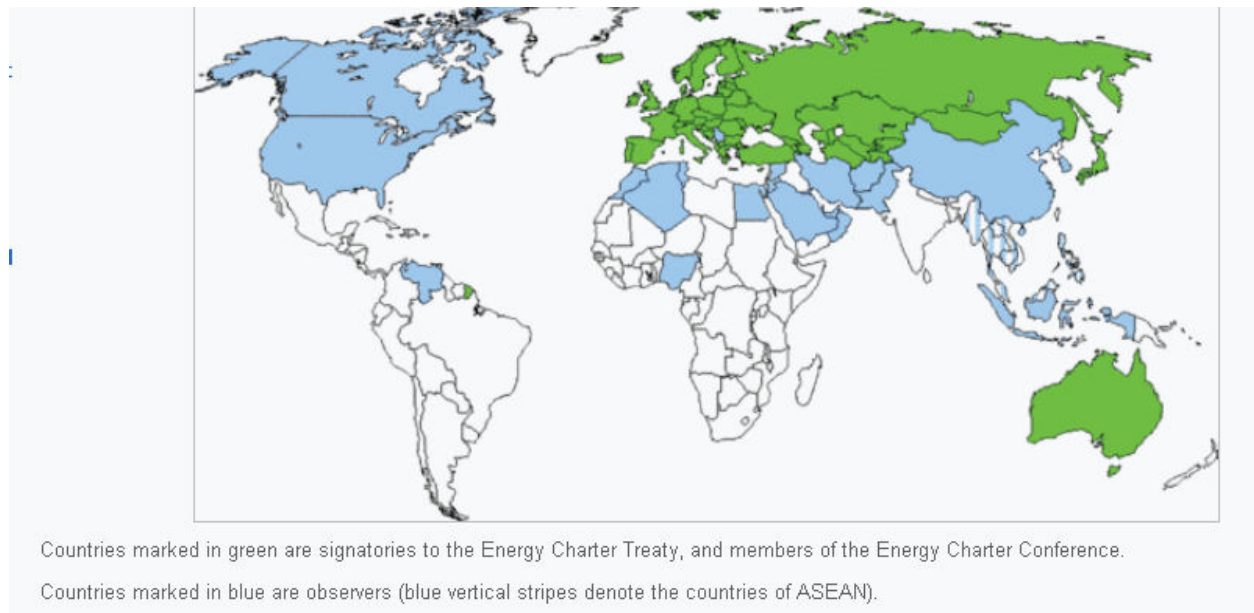


## CHAPTER ONE: INTRODUCTION

### Russia and the Energy Charter regime

The Energy Charter (hereafter ECH) is a multilateral regime governing the Eurasian energy economy. It is comprehensive, addressing all the functional areas of the energy economy: investment, trade, transit, dispute settlement, energy efficiency, and related environmental issues. It is broad: it encompasses all sources of fuel, energy, and related equipment. Finally, its geographic scope is truly global, with 52 members in Europe, Asia, and Australia and 24 observer states, which include key energy states from North and South America, the Middle East, and Africa. Figure 1-1 displayed below shows the members and observers in the regime. A list of members and observers is provided in Appendix A

**Figure 1-1 : Members and Observers of the Energy Charter regime**



Source: <http://www.encharter.org/index.php?id=61>

The main decision-making body is the Energy Charter Conference (hereafter the Conference), which brings together the member states once a year.<sup>1</sup> The regime has a small secretariat – the Energy Charter Secretariat (hereafter the Secretariat) – located in Brussels. The centerpiece of the regime is the Energy Charter Treaty (hereafter ECT or the Treaty), which was signed on December 17, 1994, and came into effect in April 1998. The treaty is remarkable in that it allows foreign investors to take states into binding international arbitration and recover damages if they prevail. It also has some teeth to enforce decisions against states. More generally, the regime is interesting because its philosophy and design reflect the neo-liberal consensus that emerged during its creation.

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<sup>1</sup> In 2005, the Conference began meeting annually. Previously, it had met two to three times a year.

The key states within the regime are Russia and the European Union (EU). All members of the EU are full members of the regime and have full rights as such. As of 2007, the EU-27 comprised 52 percent of the states that were members of the regime. However, the EU negotiates as a single block. This study focuses on Russian policy and how it has shaped the development of the ECH. The EU and the national states are obviously a very important part of the regime, and the sources of their policies merit attention in future research. However, in this dissertation, the EU and the national states are discussed exclusively through the lens of their interaction with Russia.

The ECH started as a European initiative when in May 1990, the prime minister of the Netherlands, Ruud Lubbers, proposed to the European Council the creation of a European Energy Community that would integrate Western European states with Gorbachev's reforming USSR and the eastern bloc states. His inspiration was the European Steel and Coal Community, which brought together former adversaries France and Germany as economic partners and allies after World War II and ultimately became the core of what is now the EU. The broad idea was to take advantage of the economic complementarities between energy consumers (Europe) and energy suppliers (USSR) to create pan-European economic integration, which would be the foundation for an enduring peace in Europe. In addition, Europe would diversify its sources of energy away from the volatile Middle East.

The project was renamed the Energy Charter by the British, whose interest was piqued after the outbreak of the first Gulf War in the early fall of 1990. The opening conference in July 1991 was permeated with the enthusiasm and optimism characteristic of the early post-Cold War period. A draft proposal by the European Commission was the starting point for negotiations. The Soviets submitted a counterproposal. Despite the good will, observers speculated that negotiations would be difficult.

By 1991, Soviet foreign policy had become very concessionary. Nevertheless, despite partaking in the enthusiasm, optimism, and general good will, the Soviets still had their own vision of what the regime should look like, and they were preparing to bargain. Not surprisingly, the Soviet proposal provided an important role for the state in the energy sphere. Historically in Europe, energy had been a state-dominated business, and so the Soviet position was not unlike those of other key European states: Germany, France, Italy, the Netherlands, and Norway. Thus, the Soviet proposal could have been the focal point for a coalition that did not accept the neo-liberal economic consensus in energy preferred by the United States, United Kingdom, and the European Commission.

As a consequence of the August 1991 coup, the president of the RSFSR (the Russian union republic within the Soviet Union), Boris Yeltsin, came to power in Moscow, and by the end of the year his government took over negotiations for Russia (which had been previously represented by the soon-to-be defunct USSR). The Russian delegation had a very different approach from their predecessors. They embraced the vision proposed by the competing coalition (the European Commission, United States, and United Kingdom), and this pushed the design of the regime along a neo-liberal track.

The Russians signed the Energy Charter political declaration in December 1991 and were very active in negotiations on the ECT, which lasted from 1992 to 1994, much longer than expected. Russia signed the Treaty in December 1994. By contrast the United States, after having shaped the agreement in fundamental ways, did not sign the agreement and so became an

observer to the regime. The Russian government began provisional application of the Treaty immediately in anticipation of ratification by the parliament, the State Duma. The Chernomyrdin government submitted the Treaty for ratification in 1996-1997, but it was turned down by the legislature.

Interestingly, the state-owned gas monopoly, Gazprom, opposed ratification even though the government supported it and the prime minister was the company's founder. Gazprom is the global leader in natural gas production<sup>2</sup> and has the largest proven reserves of natural gas in the world.<sup>3</sup> It is Russia's largest company, accounting for roughly 10 percent of GDP in 2008.<sup>4</sup> It is the biggest single contributor to the state budget and the largest earner of foreign currency. In May 2008, its market capitalization was third largest in the world after ExxonMobil and PetroChina.<sup>5</sup>

In 2000, the Kasyanov government under President Putin submitted the Treaty for ratification a second time, but it was blocked, again by Gazprom. This time, Russia made future ratification contingent on addressing Gazprom's concerns. In 2004, Gazprom joined negotiations within the ECH; for the first time it was a constructive rather than destructive participant in the process. In advance of the 2006 G8 summit in St. Petersburg, Russia proposed a bargain to the EU that linked ratification to Gazprom's ability to invest in the EU. In addition to putting forth a second pre-condition for ratification, Russia began a complex maneuver to pressure the EU to accept the deal. For the first time, Russia was using sticks and carrots to shape outcomes related to the regime. However, the EU declined the proposal.

By then, the EU was growing increasingly frustrated by Russia's prolonged non-ratification of the agreement. Frustration turned to insecurity after January 2006 saw the first gas war between Russia and Ukraine, which raised urgent concerns about energy security and Russia's reliability as an energy partner in the EU. As a result, the EU began pressuring Russia to ratify the ECT. This irritated Russia, which had clearly set forth pre-conditions for ratification. Whereas the original ECH project aimed to leverage the energy trade to create peace in Europe, the ECH was now becoming a source of conflict in the EU–Russia relationship. Moreover, the interaction between Russia and the EU increasingly resembled a dialogue between the deaf and the blind.

In retrospect, the G8 turned out to be a seminal moment in Russia's foreign energy policy when it began actively shaping the international framework for energy cooperation. After the summit, it became clear that Russia was broadly dissatisfied with the regime in its current form and wanted to modify it to suit its interests. Between 2006 and 2008, Russia actively tried to adapt the regime. Its proposals went against the grain of regime principles, norms, and rules, and in many ways its tactics disregarded established decision-making norms. Although Russia was able to change the debate and come to agreement on several issues, overall it was unable to modify the regime.

After the second, more severe gas war between Russia and Ukraine in January 2009, Russia made it clear that its faith in the ECH had been bankrupted due to the regime's inability to

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2 In 2008, Gazprom produced 17% of the world's marketed natural gas. *Gazprom in Figures 2004 – 2008 Factbook*, accessed February 8, 2010, <http://www.gazprom.com/f/posts/71/879403/3se.pdf>.

3 In 2008, Gazprom owned 17% of the world's proven natural gas reserves. *Ibid.*

4 *Ibid.*

5 "Gazprom Has Third Largest Capitalization," *Kommersant*, May 9, 2008.

prevent or attenuate the conflict. As a result, it proposed to create a new regime, which later turned into the Draft Convention on International Energy Security. The proposed regime was similar to the ECH in many respects, but it contained important differences. Russia began promoting its new regime proposal in a variety of different international venues that included the ECH.

Finally, in the fall of 2009 Russia announced that it was abrogating its provisional application of the Treaty, undertaken in 1994. The most proximate cause appears to be developments in the Yukos case (a now defunct Russian oil company previously owned and managed by the imprisoned former oligarch Mikhail Khodorkovsky). The shareholders of the nationalized oil company had taken the Russian state to international arbitration under the auspices of the Treaty and demanded compensation estimated between \$30 and \$100 billion, making this the largest damages claim in the history of international arbitration.<sup>6</sup> In late spring of that year, it became clear that Russia, which had agreed to participate in the proceedings, would lose the first round, and this was the death knell of provisional application (hereafter PA).

Despite abrogating PA, Russia is still a member of the ECH regime. Two decades after the ECH was conceived as a vehicle for promoting peace between Western Europe and the USSR/Russia, it is clear that it has not fulfilled its original purpose. To the contrary, rather than integrate Russia with the EU and promote peace, the ECH has become a source of conflict between the parties.

## **Research questions and thesis**

Why does an international regime fail to fulfill its original purpose? More generally, what are the factors associated with regime creation, adaptation, and failure? This research shows that the ECH regime was unable to fulfill its original purpose largely because the behavior of a key state within the regime (Russia) changed.<sup>7</sup> This is consistent with Hegemonic Stability theory in IR, which has pointed to shifts in the behavior of powerful states as an important factor in explaining international regime outcomes. But why and how does state behavior change?

The primary claim of this dissertation is that variation in patterns of state behavior can be understood by examining state identities. Following this logic, an international regime may fail to fulfill its promise when a core state experiences an identity transformation. Shifts in state identity have both direct and indirect effects that shape state behavior in ways that are consequential for regime outcomes. One way in which state identities change is that a state can develop a different identity in terms of its self-conception connected to relations between itself and other states. This refers to how a state understands its role in the international system: does it create the international system, or is it constrained by it? State behavior towards a regime can vary depending on which identity emerges. This points to a direct effect of state identity change on state behavior and is consistent with the finding in IR literature that ideas shape state behavior.

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6 Yevgeny Kiselyov, "Yukos Could Bankrupt the Kremlin's Reputation," *The St. Petersburg Times*, April 24, 2009.

7 The flip side is that other states within the regime – particularly the EU – have not accommodated Russia's change in behavior. The behavior of the EU is an important part of the story. However, this dissertation focuses on the changes in the Russian state and its consequences for the ECH regime. Understanding the sources of EU behavior is largely outside the scope of this dissertation but can be the subject of future research.

However, changes in state identity can also be a product of changes in its identity related to domestic society. This refers to how a state understands its relationship to domestic society: can it intervene to promote a public interest or should it withdraw to make way for private interests? The identity that emerges vis-à-vis domestic society can have important consequences for the structures of domestic politics (patterns of authority, societal identities), domestic political dynamics, and the decision-making process and it can precipitate different types of state foreign policy. In this respect, changes in state identity can have indirect effects on state international behavior and regime outcomes. The indirect relationship between ideas and international behavior – through their effects on domestic structures and the domestic political process – has received much less attention in IR.

This dissertation examines how changes in both types of identity – international and domestic – came together in the Russian case to produce contrasting patterns of state behavior toward the ECH in Moscow at the turn of the 21<sup>st</sup> century (1990-2010). My main argument is that elite ideas about the state's international and domestic role in Russia changed twice – when Russian President Boris Yeltsin replaced Soviet President Mikhail Gorbachev in 1991 and when Yeltsin was in turn replaced by President Vladimir Putin in 2000 – and this produced a transformation in Russia's state identity. This helps us understand why Russian policy toward the ECH has changed and why the ECH has not fulfilled its original purpose of promoting peace and cooperation between Russia and Europe.

## **State identity**

*State corporate identity: sovereignty and legitimate state authority*

One prominent scholar who has investigated state identities is Alexander Wendt.<sup>8</sup> Because he has theorized the substance of state identity, Wendt's work is useful as a starting point for my study. Wendt's framework for understanding state identities includes four categories of identity: corporate, type, role, and collective. This discussion will focus only on corporate and role identities.<sup>9</sup>

Corporate identity refers to “certain essential properties [that concern] this kind of identity.”<sup>10</sup> When he speaks about the state as a corporate identity, Wendt is referring to the fact that a state is a state and not, for example, a university department, a tree, a bowling team, or something else.<sup>11</sup> A corporate identity is exclusive – a state cannot be a state and a tree at the same time – and serves as a platform for identities that belong to the subsequent categories.<sup>12</sup>

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8 Alexander Wendt, “The State as Person in International Theory,” *Review of International Studies* 30 (2004): 289–316.

9 Given the aims of this research project, the question of collective identity (when corporate actors identify with other corporate actors) need not concern us here. In addition, Wendt has not adequately distinguished between role and type identity. This is a subject for another paper.

10 Wendt, “The State as Person,” 202.

11 Ibid., 213, 201-2. These contrasts come from Wendt. Although he acknowledged that “in principle states can have ‘fuzzy’ boundaries,” (italics in original) he insisted that “there seem to be significant constraints on what we can plausibly call a state.”

12 In his conceptualization of corporate identity, we recognize the dictionary definition of identity: “The sameness of a person or thing at all times or in all circumstances; the condition or fact that a person or thing is itself and not

Wendt has not explicitly examined the sources of state corporate identity, so this work builds on his contribution by exploring this important question.

To understand corporate identity, it is necessary to know what it is exactly that makes a state a state and not something else. Following a well-established tradition in both IR and comparative politics, I suggest that what is uniquely characteristic about the state is that it is a sovereign actor. In *Sovereignty: Organized Hypocrisy*, Stephen Krasner identifies the different ways in which sovereignty has been used:

The term sovereignty has been used in four different ways – international legal sovereignty, Westphalian sovereignty, domestic sovereignty, and interdependence sovereignty. International legal sovereignty refers to the practices associated with mutual recognition, usually between territorial entities that have formal juridical independence. Westphalian sovereignty refers to political organization based on the exclusion of external actors from authority structures within a given territory. Domestic sovereignty refers to the formal organization of political authority within the state and the ability of public authorities to exercise effective control within the borders of their own polity. Finally, interdependence sovereignty refers to the ability of public authorities to regulate the flow of information, ideas, goods, people, pollutants, or capital across the borders of their state.<sup>13</sup>

For the purpose of this study, I am interested primarily in domestic sovereignty (which I think subsumes Westphalian and interdependence sovereignty) and legal sovereignty.

Krasner's definition of domestic sovereignty is useful because it points our attention to the questions of authority and control; however, it also raises some conceptual and theoretical issues. First, for Krasner, sovereignty is associated with authority that is concentrated spatially in the state and understood as an organization or set of institutions. This leads to an atomistic view of both the state and authority as conceptually disconnected from society. Second, sovereignty is related to the functional control that is associated with authority (that is, by public authorities), but this raises an important theoretical question: how and why does state authority lead to control over society? Because authority is exclusively a property of the state, this definition does not really give us traction on the problem by itself. Either other factors have to be invoked (such as how the state projects authority), or we have to reconsider how we understand authority and the role it plays in connecting the state with society.

To remedy this dilemma, I define sovereignty in terms of authority understood as a relational concept. Authority refers to a hierarchical relationship characterized by commands from the top of the hierarchy being obeyed by those below. State authority means that the state exists in a hierarchical relationship relative to society in which society is subordinated to the state and obeys state orders. Authority leads to control because it is legitimate and thus elicits compliant behavior. Therefore, sovereignty is a hierarchical relationship between the state and society that is based on the legitimacy of state authority. It is characterized by functional control because legitimate state authority generates societal compliance with commands from the state.

Theoretically, this hierarchical relationship and control can also be produced through coercion. In such cases, sovereignty is based not on legitimate authority but on naked power and

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something else; individuality, personality.” *Oxford English Dictionary* in James Fearon, “What Is Identity (as We Now Use the Word)?” Stanford University, accessed November 4, 2011, <http://www.stanford.edu/~jfearon/papers/iden1v2.pdf>.

13 Stephen D. Krasner, *Sovereignty: Organized Hypocrisy* (Princeton, NJ: Princeton University Press, 1999), 3-4.

violence. Unfortunately, history is riddled with instances of states that have relied on violence to generate compliance and control. However, even the most despotic states – for example the USSR under Stalin, the German Third Reich, and North Korea – cannot survive without a modicum of legitimate authority. At a minimum, some legitimate authority is necessary for the state’s henchmen (the state apparatus that deploys violence and is therefore the ultimate source of sovereignty) to comply with state commands. If violence is the only basis for state sovereignty, then presumably the well-being of those who do the dirty deeds is also in jeopardy. Under such circumstances, the basis for sovereignty is very fragile, and it may not be long before the central figures on whom sovereignty rests stop obeying and jump ship to save their skin. In fact, even in the odious cases mentioned, violence depended on some legitimate authority based on material incentives for elites, a powerful mobilizing ideology, or both.

Obviously, sovereignty is an ideal type. Not all historical states have this kind of relationship to society. For real states, this relationship ranges from high to low sovereignty. In states with low sovereignty, hierarchical relations are displaced by heterarchical relations because state authority is lacking. Without legitimate state authority, the basis for the state’s being above other actors in terms of command and obedience is absent. Authority is diffuse across many actors (including the state) that compete with one another for control. Domestic sovereignty is elusive.

However, a state with low domestic sovereignty is still a state if it enjoys legal sovereignty. As we read above, for Krasner legal sovereignty “refers to the practices associated with mutual recognition, usually between territorial entities that have formal juridical independence which comes from recognition by the international community.” A state with low domestic sovereignty is still a state because of its recognition as such by other states.<sup>14</sup>

The extent to which sovereignty exists in the real world can be ascertained empirically; however, since it is based on legitimate authority, it is produced through subjective factors. In other words, the individually held belief that state authority is legitimate leads to compliance with state commands and state control.

To summarize, one characteristic of states is that they are sovereign. This is the basis of what Wendt refers to as their corporate identity. Sovereignty refers to a hierarchical relationship between the state and society that is based on legitimate authority. It results in functional control by the state because legitimate authority supports societal compliance with state commands. Sovereignty is an ideal type that varies empirically in the real world. States with greater (high) sovereignty will have hierarchical relations with society, while states with less (low) sovereignty will have heterarchical relations with society. States with low sovereignty are still states, however, if they are recognized as such by the international community.

Whether sovereignty exists is an objective fact that can be discovered through empirical research. By the same token, state corporate identity, which I am defining in terms of state sovereignty, is an objective phenomenon, although the sources of sovereignty – legitimate authority – are subjectively held. Finally, although violence is an important source of control for which we also need to account, sheer power without some legitimate authority is not a stable

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<sup>14</sup> Legal sovereignty is analytically independent of domestic sovereignty. A state can have legal but no domestic sovereignty or domestic but no legal sovereignty. Usually, the two are related empirically: a state that has legal sovereignty can leverage this to create domestic sovereignty, and a state that has domestic sovereignty presents a compelling case for legal recognition.

basis for sovereignty, and there are very few if any historical cases of state sovereignty that rested on violence alone.

This definition is useful for the purpose of this study because it allows us to understand the consequences of variation in sovereignty for foreign policy and international regime outcomes. In addition, it allows us to explore the subjective factors that make state authority legitimate and produce sovereignty.

*Role identity: regime maker vs. regime taker*

Wendt's second category of state identity is role identity, the definition of which he borrowed from James Fearon. Role identity refers to "labels applied to people who are expected or obligated to perform some set of actions, behaviors, routines, or functions in particular situations."<sup>15</sup> For both authors, the meaning of role is located in the expectations of others. For the purpose of this project I will take the opposite position on this question: role identity refers to expectations that the self has about the self and its relationship to others.<sup>16</sup>

For Wendt, an actor can have multiple role identities that correspond to different contexts. Since this project is concerned with the development of international regimes, the specific role identity – expectations about the self relative to others – that is most relevant is whether the state sees itself as a "regime maker" or a "regime taker." A state with a regime maker role identity has a self-conception that provides for building new regimes or altering existing regimes in fundamental ways. The self-conception of a state with a regime taker role identity does not include this possibility. For regime takers, this is the role of other states. All states raise demands and bargain. But promoting state interests within the context of a regime proposed by others is one thing while advancing state interests by changing regimes in basic ways or building new ones is a different matter entirely.

State role identity is an idea and thus subjective. However, ideas can become institutionalized into the state (I will discuss this shortly). From this perspective, we can think of state role identity as a property of the state. In this sense, it is also an objective phenomenon the presence or absence of which can be determined through empirical research. This conceptualization allows us to explore the relationship between role identity as an objective phenomenon associated with the state and regime policy outcomes. At the same time, acknowledging that it has subjective origins as beliefs held by individuals also creates an opportunity for understanding how such a role identity emerges and changes.

*Typology of state identities*

State identity has two dimensions. The first dimension is corporate identity, which I equate with state sovereignty understood as hierarchical relations between the state and society

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15 Fearon, "What Is Identity?" 17. Unlike the definition of corporate identity, this definition contrasts with the dictionary definition and is more resonant with how we use identity in social science.

16 Fearon's definition is not wrong. The key issue is that role identities can be based on others' expectations of the self (what is his/her role?) and also the self's own self-expectations (what is my role?). These are separate empirical phenomena, roles conceived from different points of view. They can, but do not always, converge. In this project I am interested in how the state conceives of its own role.



where commands from the state are followed by societal actors. In the absence of sovereignty, heterarchical relations prevail; the state is not above other actors but just one actor among many. Moreover, societal actors do not comply with state commands.

The second dimension is role identity. This refers to the state's self-conception with respect to the development of regimes. A state can see itself as a regime maker; this refers to creating new regimes or changing existing ones in fundamental ways. Alternatively, a state's role conception can be that of a regime taker; this refers to making demands and promoting state interests within the context of existing regimes or regime building projects by other states. By combining the two dimensions, we get four state identities: master, disciple, pretender, and apprentice, as shown in Table 1-1

**Table 1-1 : Typology of state identities**

**Role identity:**  
*(self conception about state's role in the development of international regimes)*

		<b>"Regime Maker"</b>		<b>"Regime Taker"</b>	
		<b>Master</b>			<b>Disciple</b>
<b>Corporate identity</b> <i>(relationship to society)</i>	<b>high sovereignty (hierarchical relations)</b>				
	<b>low sovereignty (heterarchical relations)</b>	<b>Pretender</b>			<b>Apprentice</b>

**Outcomes**

Different state identities are associated with different outcomes that relate to international regimes. I am interested in four related outcomes: 1) state capacity to act as a unitary actor; 2) state capacity to follow through on commitments; 3) agenda positioning; and 4) the use of sticks and carrots to shape the cost-benefit calculations of other states.

Unitary actorhood refers to whether all the agents and institutions of the state act in concert or at cross purposes. Following through on commitments is context specific; what constitutes following through depends on the type of deal. In this study, following through refers to ratification of the ECT after signing it.<sup>17</sup>

Agenda positioning relates to agenda setting but goes beyond it. All states try to set the agenda to a certain extent. This is consistent with making demands and bargaining. What is especially interesting is whether an agenda setting demand is consistent with other agenda claims

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17 Obviously in this example, following through on commitments relates to unitary actorhood. However, although they overlap empirically in this study, they are still analytically distinct. Unitary actorhood can lead to outcomes other than living up to commitments, but whether commitments require unitary actorhood depends on the specific deal and commitment.

or a radical departure from it. Therefore, to understand agenda positioning we have to compare an agenda from any particular state to other agendas from other states. The added value of agenda positioning over agenda setting is that it is a relational concept taking into account the fact that all states try to set the agenda and differentiating between controversial agenda setting attempts (major departure from previous agendas) and conventional ones (agenda changes that are marginal).

Finally, using sticks and carrots to shape the incentives of other states refers to tactics during state interaction. Some states just bargain. Other states try to put pressure on their counterparts by manipulating the costs and benefits of various decisions to make a particular decision more attractive.

We can develop expectations concerning the relationship between state identity and these various outcomes. A mapping is found in Table 1-2

**Table 1-2 : Relationship between state identity type and outcomes**

		Outcomes			
		capacity to act as a unitary actor	capacity to follow through on commitments	agenda positioning	use of sticks and carrots
State identity type	Master	HIGH	HIGH	CONTROVERSIAL	YES
	Pretender	LOW	LOW	CONTROVERSIAL	UNSUCCESSFUL
	Disciple	HIGH	HIGH	CONVENTIONAL	NO
	Apprentice	LOW	LOW	CONVENTIONAL	NO

To measure these outcomes, I use event level data. Data related to a state’s capacity to act as a unitary actor, agenda positioning, and the use of sticks and carrots come from various accounts of state interactions in the ECH setting. Data related to a state’s capacity to follow through on commitments come from reports concerning signing and ratification of the Treaty. These data come from a variety of sources: ECH archives, media accounts, secondary literature on the ECH regime, and interviews with participants and observers.

**Key concepts and mechanisms**

My main argument is that elite ideas about the legitimacy of state power lead to changes in state identity and are associated with these outcomes. How exactly do ideas about the state produce these outcomes? This section elaborates the mechanisms through which these ideas produce the outcomes in which I am interested.

*The first image reversed*

The starting point is ideas about the state<sup>18</sup> that inform the thinking of top political leaders. This is contrary to the conventional wisdom concerning the mechanics of state behavior in IR and political science, which posits that incumbents of the state look out objectively at the world – at both international and domestic politics – as they make decisions. In fact, when confronted with important decisions, leaders can also gaze within and call up beliefs about their own state. This image of their own state then shapes their subjective assessment of domestic and international politics and informs their policy choices.

I call these ideas the first image reversed. This is the first image because the unit of analysis is individuals in key decision-making positions, such as the head of state. It is reversed because rather than looking out into the international system as they make decisions about state policy, these leaders are looking inward and making assessments about their own state. These ideas concern both dimensions of state identity: the state's relationship to other states and its relationship to domestic society. Finally, for the leader, these ideas are legitimate for any number of reasons. In the Soviet/Russian cases that I examine, they were legitimate because the causal logic that underpinned them (states cause/prevent economic development and wealth) was consistent with achieving pre-existing goals (make Russia powerful again).

The next step is to look at the leader's actions that are motivated by these ideas about the state. I am interested in two actions in particular. The first is the public articulation of these ideas about the state. I am calling this the ideological line. The second is the leader's state-building project.

*What is the ideological line?*

The ideological line is first a set of ideas. Although the potential number of ideas in the ideological line is in principle infinite, I am interested in two sets of ideas: the legitimate relationship between the state and domestic society (specifically in the economic sphere) and the legitimate relationship between the state and other states (specifically in terms of regime making). I will refer to substantive ideas as approaches, for example, the neo-liberal approach under Yeltsin or the strategic sector (hereafter SS) approach under Putin. These approaches posit particular ideas about these two relationships (state-domestic, state-state/international), and I am interested in what they say specifically and the consequences for domestic politics, state identity, and state international behavior.

The source of the ideological line is the top political authority that articulates it publicly; thus, the ideological line is also a vehicle for projecting these ideas over space and time. How it is received in society is important. For those who find it legitimate, it creates identities and delineates the boundaries of acceptable behavior and discourse. For those who find it illegitimate, it informs their resistance and also shapes their identities, behaviors, and discourse. Therefore, the ideological line structures political and economic activity because it shapes societal identities and behavior both for those that find it legitimate and those that do not.

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<sup>18</sup> I will use "ideas about the state" and "ideas about the legitimacy of state power" interchangeably in this study.

Finally, the ideas in the ideological line become institutionalized into the official roles of the state to the extent that the political authority that articulates it is legitimate. Within a government, the ideas of the ideological line shape the behaviors and discourses of government officials. Government officials comply not necessarily because they think that the substance of the ideological line is good or correct, but because it is their job to do so. This works because for government officials the political authority is legitimate; it is their boss.

If the political authority is legitimate outside the government, for example in the legislature, then the ideas in the ideological line can become institutionalized there as well. However, if the political authority is not legitimate, the ideological line is likely to be contested, and institutionalization is less probable.

Finally, since the ideological line contains ideas about state to state relations, and since it shapes the discourse and behavior of state officials (or at least in the government), it can also be a vehicle for the state to signal its identity, goals, and intentions to other states and the international audience.

*Societal reactions: the ideological line, legitimacy, and elite identity*

Now our attention turns to society. The ideological line is an important factor in constituting societal identities. By articulating the relationship between the state and societal actors, it is telling societal actors what their role is with respect to the state. It makes particular roles available. I am focusing on two possible roles: servant or master. However, which identity actually emerges and the interests and behaviors that result depend on whether the posited role is legitimate for societal actors. If we combine the two possible roles (servant or master) with two possible reactions (legitimate or illegitimate), we get four possible sets of identity and behavioral outcomes. This is represented in Table 1-3.

**Table 1-3 : Identity (and resulting behavior) of societal actor with respect to the state**

		posited role with respect to state as articulated in ideological line	
		servant	master
Reaction of societal actor to posited role (relationship to leader)	legitimate ("loyal")	<b>servant (compliance)</b>	<b>master (competition)</b>
	illegitimate ("disloyal")	<b>master (resistance)</b>	<b>master (resistance)</b>

The unit of analysis is a hypothetical, individual, elite actor. To the extent that the posited relationship is legitimate, societal actors embrace these roles, which become their identity and shape their interests and behavior. More generally, they are loyal to the regime and accept the ideological line. If the servant role is legitimate, the resulting identity is that of a servant of the state, and behavior expresses compliance with state commands. If the master role is legitimate, master identities emerge. Since it is legitimate, it does not lead to resistance. However, according to the logic of being a master, it does not produce compliance, either. A society made up of masters results in competition, both among societal actors and between societal actors and the state. If everyone is a master, the key motive for behavior is personal interest.

If the roles are illegitimate, they create master identities and general disloyalty to the leader. Resistance is the result, but for different reasons. When the posited role is servant and it is illegitimate, master identities emerge because they are legitimate. (This is true by virtue of the logic of this framework. If there are only two possible roles – servant and master – and being a servant is illegitimate for an elite, then the elite identifies as master.) The resulting behavior is resistance. When the posited role is master and it is illegitimate, it also produces master identities. Master identities emerge because the ideological line and authority of the political leader are illegitimate. This is not because the servant role is illegitimate, but because, given the ideological line, that role is not available. Therefore, societal actors become masters in protest of the ideological line and the leader that articulated it. Behavior is characterized by resistance to the state because the leader's authority is illegitimate.

### *The ideological line, state building, and violence*

Now we return to the leader's state-building project, which is also shaped by the image of the state the leader holds and should be consistent with the ideological line. Having articulated the master role for societal actors, we would expect a state-dismantling project. By contrast, if the ideological line proposes servant roles in society, we would expect state building.

If the roles articulated by the leader are legitimate, the ideological line is realized in society; actors embrace these roles, which become their identities with respect to the state. However, if the roles are not legitimate, the leader has to enforce the ideological line to produce the desired relationships. The leader can offer inducements, use violence, or both.

When the leader proposes servant roles for societal actors, using inducements and violence is consistent with the ideological line. After all, the state is master. However, when the leader proposes master roles for societal actors, using inducements and especially violence are contrary to the ideological line. For the leader the state is not a master, so this type of dynamic, and especially state violence against societal actors, is illegitimate. However, inducements and violence might be used eventually and could become legitimate (as a short term expedient) for a leader who needs to overcome resistance to enforce the ideological line.

### *Legitimacy and political dynamics*

So far we have talked about individual elite actors, but we are also interested in the reaction of society as a whole. The balance of opinion in society on the roles as articulated by the ideological line can vary, and this has important consequences for the dynamics of domestic

politics and the fate of state-building projects. We can imagine three ideal typical societal reactions: 1) consensus in support of the ideological line (broad legitimacy); 2) consensus in rejection of the ideological line (broad illegitimacy); and 3) no consensus with respect to the ideological line (society is divided). If we combine societal reactions with the two roles, we get the typology in Table 1-4.

In Table 1-3 and Table 1-4 we are interested in how individual elite reactions to the roles posited by the ideological line aggregate at the level of society. The first two rows (broadly legitimate and illegitimate) are easy since there is full consensus and all behavior is identical. The political dynamics are an extension of individual elite behavior, which we saw earlier.

However, since we are examining society in aggregate, we have to add a third reaction, one that is mixed. In other words, what happens when different actors have contrasting reactions and there is no consensus in society concerning the legitimacy of the posited role? In this case, we expect a mix of behaviors depending on individual reactions. Some will be loyal (accept the ideological line), while others will be disloyal (reject the ideological line as illegitimate). The key point is that under such circumstances we expect polarization.

**Table 1-4 : Political dynamics (and fate of state building)**

		posited role with respect to state as articulated in ideological line	
		servant	master
Aggregate societal reaction to posited roles	broadly legitimate	<b>compliance (successful)</b>	<b>competition (successful -)</b>
	broadly illegitimate	<b>resistance (unsuccessful)</b>	<b>resistance (unsuccessful)</b>
	no consensus	<b>polarization: compliance &amp; resistance (mixed +)</b>	<b>polarization: competition &amp; resistance (mixed -)</b>

The fate of state-building projects when there is consensus in society (first two rows) is also straightforward. When there is broad resistance, they tend to be unsuccessful since they are illegitimate. When there is broad compliance, they are successful since they are legitimate. The more complicated case is when master roles in society are broadly legitimate. Since this leads to competition rather than compliance, state-building projects tend to be successful insofar as they are consistent with the personal interests of masters in society. In this case, the probability of success is lower (indicated by a minus) than when servant identities are broadly legitimate since the latter case produces compliance and conflicts of interests between the state and servant elites are less salient.

When there is no consensus in society, state-building results are likely to be mixed. Either way there is resistance from disloyal elites who find the roles illegitimate. Therefore, the outcome depends on the political support that the leader is able to mobilize to advance the

project: To promote the state-building project, the leader needs support from loyal elites for whom the roles are legitimate. Servants comply because doing so is legitimate. Masters will support the leader to whom they are loyal insofar as this promotes their personal interests. Unless there is a perfect coincidence of interests between the leader and master followers in society, we can expect that leaders who propose servant roles will have more political support and their state-building projects will tend to be more successful (indicated by +) than leaders who propose master roles.

### *The political environment and policy making*

The political dynamics just mentioned constitute an important part of the policy-making environment. When there is broad resistance, policy making is impossible; it becomes a victim of the general rejection of the leader. Under polarization, it is also very difficult because policy becomes subordinated to the more fundamental question of state-society relations, for which there is no consensus. Policy debates are less about policy than they are about the battle between “us” and “them,” which is a fundamental cleavage in society.

Broad acceptance of the proposed roles is most conducive to policy making. Since there are no fundamental disagreements in society, policy is about policy. When there is consensus on master identities in society, policy making is competitive. Whether it is effective depends on private interests and the political process. To the extent that there is a harmony of interest, policy making is effective. However, even when interests conflict and different masters have different visions of the policy question, the political process is still conducive to compromise and persuasion since the policy question is not subordinated to more fundamental and polarizing questions. In this sense, the structure underlying the political process is favorable to effective policy making. Deliberation is possible, and policy making can be effective. Again, this depends on the process.

Policy making is most effective when there is broad agreement that societal actors are servants of the state. If debate is allowed, it is grounded by the idea of the state interest and characterized by deliberation. Ultimately, the substance of the state interest is decided by the state (the top political leadership), and this is not contested unless debate is re-opened. Once a policy decision is made, it is final. This means that domestic political questions and foreign policy questions can be resolved.

### *State corporate identity: state-society relations and sovereignty*

From the preceding we can deduce that how the substance of the ideological line interacts with its reception in society (in particular, whether it is legitimate and for whom) produces different types of state-society relations and different levels of sovereignty. These can be seen in Table 1-5.

The highest domestic sovereignty obtains when servant identities are broadly legitimate (top left). The legitimacy of state authority and the identities that emerge by themselves constitute hierarchical relations between the state and elite societal actors. When the posited role is broadly illegitimate (second row), this produces very low sovereignty. Regardless of the role that is proposed, if it is illegitimate and rejected by society, relations are heterarchical.

**Table 1-5 : Level of sovereignty (type of state-society relations)**

		posited role with respect to state as articulated in ideological line	
		servant	master
Aggregate societal reaction to posited roles	broadly legitimate	<b>HIGH</b> (hierachical)	<b>VARIABLE</b> (depends on personal interests and political process)
	broadly illegitimate	<b>VERY LOW</b> (heterarchical)	<b>VERY LOW</b> (heterarchical)
	no consensus	<b>LOW +</b> (depends on success of state-building project)	<b>LOW -</b> (depends on success of state-building project, private interests of loyal masters)

When master identities are broadly legitimate (top right), the consequences for sovereignty are variable. High state sovereignty and hierarchical relations will occur if there is a harmony of private interests or the political process, which is conducive to compromise and persuasion, leads to convergence on a single state interest and policy. Conversely, if such a convergence does not take place, that political field will be dominated by personal interests, heterarchical relations, and low state sovereignty.

Finally, when there is no consensus, state sovereignty will depend on the leader’s ability to implement the state-building project, that is, to project authority and power by other means (inducement or violence) to make the disloyal faction loyal. Again, this is more likely when the loyalist is a servant, who is more reliable as a political supporter, than a loyal master, who follows personal interests.

If state building is successful, then we will have essentially moved to the top row. When the ideological line articulates master identities (top right), the level of sovereignty and the type of state-society relations that emerge depend on the pattern of interests and the political process. However, if the ideological line articulates servant identities (top left), sovereignty and hierarchical relations will result regardless of personal interests.

*State role identity: the ideological line and the state’s relations with other states*

Above we have examined the ideological line from the perspective of the state’s internal relations with domestic society. However, the ideological line can also posit a particular relationship between the state and external actors, such as other states. I am interested in the relationship between this idea (state’s relationship to other states) and policy making.

Ideas concerning the international role of the state are a background factor for the policy-making process that tells policy makers about the state’s capacity. If the ideological line posits that the state is a regime maker, this makes tactics available for promoting goals that are not available if the ideological line posits that the state’s international role is that of a regime taker.



In addition, it makes possible substantive goals that go outside existing frameworks promoted by other states.

### *Ideational interactions*

Yeltsin's embrace of the neo-liberal approach had important consequences for his view of the state. The image of the state implicit in the neo-liberal approach (ineffective, corrupt) and the causal theory that this image motivated (retrenchment leads to free markets and growth) implied an exceedingly limited role for the state. In fact, the neo-liberal approach explicitly prescribed a singular function to the state: making and enforcing domestic laws and international treaties but also being subject to these laws and treaties once they are in effect.

However, this was not just an academic question since these ideas motivated policy and had important political consequences. The neo-liberal approach informed a particular type of state building and also legitimated specific identities (entrepreneurs as masters). This changed state-society relations, creating heterarchy, and in effect produced low sovereignty. Neo-liberal beliefs not only painted a particular view of the state but also made low sovereignty a real world fact that produced a particular type of state identity. In addition, because the implications of the neo-liberal approach for the state were so controversial in the Russian context, this led to polarization and a very dysfunctional political process that made effective, let alone concerted, foreign policy making very difficult.

There is a deep irony here, which becomes clear if we look at the Russian state's relationship to Gazprom. Under Yeltsin, the state abdicated authority and control over economic actors, including energy companies, as suggested by neo-liberal. However, this very autonomy meant that Gazprom could be against the ECH regime and its neo-liberal principles in spite of state priorities. Moreover, Gazprom was able to block ratification partly because of its power as a large, autonomous monopolistic firm, but also because it could take advantage of polarization to thwart government policy. For both reasons, Russia was not able to commit to the Treaty through ratification even though it had signed it, begun provisional application, and manifestly wanted to do so.

These kinds of paradoxes are likely if we do not look carefully at how different ideas interact. Without looking at the relationship between neo-liberal economic ideas and the idea of sovereignty, it is possible to recommend massive state retrenchment and the creation of powerful economic and social groups and simultaneously assume that the state can still make laws, enforce them, and follow through on international commitments (in addition to collecting taxes).

In short, the neo-liberal perspective assumed sovereignty as legal sovereignty without critically examining what sovereignty is, where it comes from, and the difficulties of ensuring even this limited form of sovereignty in the context of radical state retrenchment against the wishes of large segments of the political class and society as a whole.

The important interaction between neo-liberal ideas and the idea of state sovereignty and the case of Russian ECH policy are an instructive example of the conceptual blind spots that emerge when we ignore how different ideas interact. As I will argue shortly, this is most relevant for the literature on norms in IR. The next step for this research program is to look at how norms interact and in particular how they interact with norms like sovereignty that are fundamental because of how they shape political structures.

## **The ideological lines in Moscow (1990-2010)**

There are four main ideological lines of interest in this study. The neo-liberal line was dominant during the Yeltsin period. It portrayed the state in negative terms as an obstacle to economic efficiency and development, and prescribed that economic activity be delegated to a large number of private market actors who would compete with each other. The main area of state activity was to create domestic laws that protected a distinct economic sphere in which firms were autonomous decision makers. States would also create and commit to international treaties which together with domestic laws would minimize political risk, understood as arbitrary state encroachment upon the economic realm, for firms. All states were subjects of the international laws that they collectively crafted and were all equal participants in international relations. The clearest articulation of the neo-liberal line in Russia can be seen in the works of Dr. Andrei Konoplyanik, deputy minister of energy in Yeltsin's first government; Dr. Igor D. Ivanov, former deputy minister at the Ministry of Foreign Affairs; and in the statements made by ECH representatives.

The socialist market (SCM) line was based on reformist Marxist-Leninist thinking and prevailed during the late Soviet period. According to this perspective, the state played an important, positive role in economic activity. This approach did not see a ubiquitous state presence in the economy, whether through universal ownership or plan administrative methods. Nevertheless, the state was an important economic decision maker. It could intervene using a variety of direct or indirect instruments to promote the interests of society. In the energy sphere, this entailed ensuring energy security and protecting workers from exploitation by financial capital. The most obvious expression of this thinking can be found in the works of Dr. Leonid Abalkin, a top economic official in Gorbachev's last government.

The strategic sector (SS) line emerged when President Putin came to power. It was not a total rejection of the neo-liberal line of his predecessor in that it still saw economic activity as the primary preserve of private actors and acknowledged the importance of laws and treaties. It differed in that it had a more positive view of the state which would play an important role in certain economic sectors deemed strategically important. In the energy sphere, the state could intervene using any number of direct and indirect methods, and would engage in bargaining with private actors to shape sectoral developments. This meant that although the interests of private firms were taken into account and could be accommodated, ultimately it was the state that was the final decision maker. In terms of international relations, this view held that Russia was a great power that could engage in tough bargaining with other states to promote its interests and vision for organizing the international economy. This view was most clearly expressed by Valery Yazev, deputy chair of the Duma Committee on Energy, Transport, and Communications.

The dependency ideological line was embraced by the communist and nationalist parliamentary opposition. This approach saw the international economy as a source of exploitation. It portrayed the ECH regime as an instrument that promoted the interests of the economically advanced but resource poor Western states by organizing the extraction of raw materials from Russia.. A common refrain was that Russia needed to protect itself from becoming a raw material appendage of the West. This perspective can be clearly seen in the statements of Vladimir Zhirinovskiy, a radical nationalist Duma deputy. Of the four ideological lines, the dependency approach receives the least attention in this work

## **Mercantilist development and the transformation of international economic structures**

### *Mercantilism as a state identity: the master in political economy*

I trace the evolution of Russian identity – from apprentice to master – and the attendant consequences for policy from 1991 to 2010. The mercantilist is the incarnation of the master in the realm of political economy.<sup>19</sup> One of the goals of this study is to connect the constructivist study of identity with the realist interest in mercantilism to advance our thinking about the concept of mercantilism. Mercantilism captures an important dynamic in international political economy – the realist insight concerning state power and regime making – but the careless and unsystematic use of the term has diluted its analytical utility.

I argue that mercantilism is best understood as a state identity that refers to the master state in international political economy: a state with high sovereignty that sees its role as being a regime maker. This identity takes different expressions in different contexts. Capturing this variety is part of the reason for the proliferation of meanings with respect to this term. While establishing the essential core of mercantilism — a sovereign state that sees itself as a regime maker – the identity perspective allows us to assign an analytically proximate place to motives and instruments that are context specific expressions of the identity and should be considered, but need not be included in the core.

Not only is my conceptualization clearer and simpler than those that appear in the literature, it is also novel because it conceptualizes mercantilism *as an identity*. The significance of identity is that it points to beliefs and meanings in addition to sovereignty and power. This conceptualization of mercantilism gives us the analytical tools necessary for a more accurate and richer understanding of the phenomenon than rationalist usages of the term allow. In the remainder of the study I will use mercantilist rather than master to denote this type of state identity.

### *Mercantilist development: Russia and the ECH*

When Russia emerged as a state in the early 1990s, it had very low sovereignty. This was an artifact of late Soviet politics under Gorbachev and was exacerbated by Boris Yeltsin's neo-liberal revolution from above. At the same time, under Yeltsin Russia embraced norms and rules promoted by other states, which meant that Russia had a regime taker role identity.<sup>20</sup>

When Vladimir Putin came to power at the turn of the century, he began to rebuild the state. This was motivated by his statist beliefs and made possible by the new coalition that he

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19 I do not want to use just mercantilist because I contend that my typology is applicable beyond political economy, which I treat here. If this is true, it is odd to speak of a mercantilist outside of political economy. You can get the strange formulation of “North Korea was giving the IEA the runaround because it considered itself the regime maker; it was a mercantilist.” Although North Korea is certainly interested in the economic dimension of nuclear energy, its primary concern is security. The issue of a North Korean nuclear program is first, one of security, and secondly, one of economics. Thus, outside of political economy, the term master works better than mercantilist. However, I do not want to use just master across the board, particularly in political economy because I want to connect to the literatures, specifically the IR realist literature, on mercantilism.

20 This is consistent with the discursive structure “New Western Russian” identified by Hopf, *Social Construction of International Politics*.

was able to craft. Among other things, his state-building project entailed a very different relationship with society, notably big businesses. As a consequence, the state acquired a much higher degree of sovereignty. Under Putin, Russia also turned away from norms and rules promoted by other states, preferring instead to propose its own rules and norms. In this respect, Russia became a regime maker.

I argue that we can begin to understand the processes related to the transformation of the architecture of the international energy economy through the emergence of what I call “Mercantilist Development” in Russia. I demonstrate that Russia has become a mercantilist state. To address the question of developmental states, I borrow from Peter Evans, who has defined them as states that are involved in economic transformation.<sup>21</sup> One area in which a developmental state participates is the accumulation of capital. The second is in shaping the transformation. The Russian state qualifies as a developmental state because it is accumulating capital by participating in the international energy economy and extracting that wealth through direct revenues and taxes on energy companies.

Whether Russia is shaping transformation is a more difficult question. On one hand, the state’s role in domestic transformation, which is Evans’s focus, is questionable.<sup>22</sup> However, I argue that the Russian state since Putin has tried to effect transformation in international markets, and thus the architecture of the international system. This is most clearly seen in Russia’s attempts to transform the ECH regime. Thus, change in the international energy economy (particularly natural gas) emerges from Russia’s identity as a mercantilist, a regime maker with high sovereignty.<sup>23</sup> Thus mercantilist development is a lens for understanding how the structures of the international economy change.

## Case Studies

The empirical portion of this dissertation applies this framework to the Russian cases under Yeltsin, Putin, and Medvedev. Due to the small number of cases, several of the expectations associated with cells in the above typologies cannot be tested. This study is a plausibility probe. If the explanation works in the cases I examine, that suggests that the number of cases can be expanded as part of future research.

### *Yeltsin’s Russia: the apprentice*

Yeltsin’s ideological line deprecated the state and legitimated entrepreneurs as masters. However, this was hotly contested within the elite. This led to polarization and a state-building project that had mixed outcomes relative to its goals. It was successful when the president could

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21 Evans, *Embedded Autonomy*.

22 The data suggest that the Russian economy has experienced less economic transformation than hoped. Exasperated Russian leaders are coming to the same conclusion. From this perspective, the Russian state is not developmental.

23 Evans does not discuss state identities explicitly, and the states he examined are not mercantilists. Thus, analysis of state effects on international structure was absent from Evans. Because the Russian state is attempting to be a regime maker in the international energy economy and is accumulating capital from the energy economy, I argue that this is a developmental state of the mercantilist variety and portends a potential transformation of the structure of the international energy economy.

mobilize support from loyal elites to overcome opposition; however, this was difficult since loyalists (for example, oligarchs) often pursued their own interests, which did not always coincide with those of Yeltsin.

Yeltsin was able to destatize Gazprom because it was in the management's interests, and the opposition in the Duma was not powerful enough to object and could be partly induced to accept this arrangement due to the tremendous material benefits Gazprom could offer. However, he was unable to force Gazprom to pay taxes regularly or be transparent with the government because this went against the interests of the managers, and they allied with the disloyal elites to block this policy.

Ultimately, the results of state building were negative in terms of establishing state authority and power. By articulating the neo-liberal line, Yeltsin's Russia found itself in the lower right quadrant of table 1.6 (polarization, largely unsuccessful state building), and this was not conducive to effective policy making, problem solving, or unitary actorhood. In terms of sovereignty, Russia was in the lower right quadrant of table 1.2, characterized by low sovereignty and heterarchical relations between the state and elites, and stayed there through the 1990s.

Therefore, its state corporate identity was a product of the neo-liberal ideological line that Yeltsin articulated, which created master identities among societal elites (loyal and disloyal), polarization, unsuccessful state building, low sovereignty, and ineffective policy making (inability to act as a unitary actor and follow through on commitments).

Russia's role identity according to the ideological line was regime taker. The ideological line was not accepted anywhere Yeltsin's authority did not extend. Thus, the Russia parliament, the State Duma, resisted it. However, it did become institutionalized into the official roles within the government over which Yeltsin had authority. The idea was that Russia was sending a signal internationally to be accepted by foreign investors and other states, and this was its approach to integration under Yeltsin. Furthermore, government officials followed the ideological line because of their position; it was their job to do so even when this went against their personal beliefs.

In the context of policy making, the idea of being a regime taker was a background factor that informed Russian policy. It constrained policy in that Russia could not make demands outside the neo-liberal framework or use controversial tactics. In this way, the ideological line constituted the role identity directly. However, the role identity did not cause Russian policy decisions. Rather, both the role identity and Russian policy decisions were a direct product of the ideological line that posited Russia as a regime taker and was an environmental factor that shaped foreign policy making.

### *Putin and Medvedev's Russia: the mercantilist*

When Putin came to power he inherited Yeltsin's domestic politics and foreign policy, placing Russia in the lower right quadrant of tables 1.6 and 1.7 in terms of political dynamics and state-building prospects, sovereignty and state-society relations, and the policy-making situation. However, in articulating the SS ideological line, he posited elite actors as state servants in strategic areas of the economy. This was broadly legitimate, so it moved Russia to the top left quadrant in both tables.

With the new approach, the line between disloyal and loyal moved dramatically. A different and much broader elite coalition became possible since it could include some of the disloyal elites who rejected the old ideological line but found the new ideas about the state (and their own societal role) legitimate. Polarization went down. State building became effective.

Therefore when Putin clamped down on Gazprom, the CEO Rem Vakhirev could not mobilize support in the Duma because the communists and nationalists were no longer available as allies. They were part of the president's new coalition and not interested in interfering with his policy, which they supported. By contrast, under Yeltsin, Vakhirev could mobilize Duma support against the liberal government not because the Duma supported Vakhirev's policy (everyone knew he was stealing), but because of a general rejection by the Duma of Yeltsin, his neo-liberal line, and his liberal governments. The Duma was disloyal. Vakhirev and the Duma allied by the logic of "the enemy of my enemy is my friend." This logic was no longer available under Putin.

Ultimately, Putin was able to project state authority over a much broader segment of the elite than Yeltsin could. This created a favorable environment for policy making, which became grounded by a single concept: the state's interest. Moreover, the substance of the state's interest was decided by the state. Policy debates were characterized by deliberation, but decisions that were made by the state were final. The state developed high sovereignty over energy policy and a new corporate identity. At the same time, Russia developed a coherent ECH foreign policy based on a single state interest, the capacity to act as a unitary actor, and the ability to follow through on its commitment.

At the same time, the new SS line also portrayed Russia as a regime maker. This became a background factor that suggested that Russia had certain capacities associated with being a great power. The new self-conception became a resource for policy makers that made possible an array of goals that were not necessarily consistent with existing regimes or the visions of other states. It also made available certain new, controversial tactics. As a result, Russian agenda positioning changed, and it began deploying sticks and carrots in negotiations. Finally, there is little indication that either Russia's identity or its foreign policy have changed significantly under President Medvedev. Although there are some changes, for the most part Russia demonstrates significant continuities under Putin's successor.

## **Overview of empirical study**

This dissertation argues that changes in Russian ECH policy and the ultimate inability of the ECH regime to fulfill its original purpose can be understood through the lens of Russia's state identity, which was an apprentice under Yeltsin, became a mercantilist under Putin, and continues to be a mercantilist under Medvedev. Russian state identity changed due to shifts in elite ideas about the legitimacy of state power, which transformed the structures of domestic politics in important ways and ultimately changed the Russian state's relationship to domestic actors. In particular, these ideas motivated state-building strategies, affected societal identities and interests, underpinned coalitional choices, and influenced the dynamics of domestic politics. Overall, this affected the environment for the policy-making process, state capacity, and ultimately state behavior related to the ECH regime.

The following overview highlights the role of ideas about the legitimacy of state power with respect to the domestic economy in decisively shaping Russian domestic politics and ECH foreign policy outcomes. It shows how ideas about the legitimacy of state power with respect to other states affected foreign policy as well.

*Soviet state role identity: obviously a superpower and regime maker*

When negotiations on the ECH regime began in the summer of 1991, the Soviet delegation submitted a proposal that expressed its interests and vision for cooperating in the energy sphere. The substance of the proposal was informed by the new Soviet interest in markets and foreign investment but also reserved an important role for the state. This reflected the fact that the dominant set of economic ideas among state officials interpreted markets through the lens of reformist, post-Stalinist, Marxist-Leninist thought. From this perspective, the state was an important economic actor that played a causal role in protecting society in the energy sphere. I call this the Socialist Market approach (SCM), which reflected a particular, favorable understanding of the legitimacy of state power with respect to the economy.

Despite the fact that the USSR was greatly weakened and its policy had become very concessionary toward the West, the dominant idea within the state was that the USSR was still a superpower. From this perspective, there was nothing remarkable about the USSR submitting its own proposal. When the opportunity emerged to discuss building a regime for energy cooperation, not only did the Soviets have their own vision of how to do so, but the idea that the Soviet state could take action to build regimes that were an expression of its own vision – rather than fit its interests into a framework based on the vision of other states – was available to policy makers. This was based on a second key idea about the legitimacy of state power and its expression in the international sphere, the legitimate relationship between the USSR (as a superpower) and other states. This was an important background factor that turned the SCM vision into an actual proposal submitted for consideration by other states. This idea about the legitimate relationship between the Soviet state and other states reflected the USSR's role identity as very much that of a regime maker. The most obvious example of this outside the ECH sphere was Gorbachev's initiative for a common Europe based on the idea of merging the best elements of capitalism and socialism, a decidedly Soviet vision that went against the grain of the emerging neo-liberal consensus.

*Soviet state corporate identity: Gorbachev's reforms (low sovereignty)*

A major problem at the conference was that it was not clear to anyone what exactly Moscow represented: the entire USSR, Russia, Gorbachev? By that time, the Union republics had developed significant autonomy from the central state. In fact, the major political question was how to formally reconstitute the Union and whether the federal center would have any significant powers. Russia, by far the largest energy producer and exporter and a key transport state, had already declared sovereignty over its resources. The relationship between the center and the societal actors of greatest political import – the Union republics – was characterized by heterarchy. The state had very low sovereignty (corporate identity).

This too was a product of ideas about the legitimacy of state power relative to society in general. Initially, Gorbachev's project was to reform the Stalinist and Brezhnevite state, which

was over-centralized, ineffective, and, for Gorbachev, a travesty of socialism. Partial retrenchment of the central state was supposed to unleash the creative energy in society to make the Soviet system more effective and legitimate. In addition, liberalization had the tactical goal of creating support for reform along socialist lines. Liberalization included loosening of censorship, tolerance of free association, and the introduction of political competition, elections, and the transfer of certain decision-making roles (economic and political) to the local level. The project went terribly wrong, but the main result here is that it resulted in the hemorrhaging of central state authority and low state sovereignty. The key point is that Gorbachev decided to go down this path because of ideas about the legitimacy of state power: the critique of the illegitimate, over-centralized, Stalinist-Brezhnevite state.

If we combine the idea about the legitimacy of state domestic power (in the economic sphere and relative to society overall) with the idea that the USSR was a superpower, we can understand the origins of Soviet state identity (across both dimensions, corporate and role). Overall, the USSR had a pretender state identity. We can also see to a certain extent how these ideas shaped domestic politics and Soviet international behavior. However, because the USSR collapsed shortly after the ECH process began, it is not possible to test all the claims relating to ideas about legitimate state power, state identity, and foreign policy outcomes. It is clear that with its proposal, the USSR's agenda positioning was controversial and that it did not have the capacity to act as a unitary actor. However, not enough time elapsed to determine whether it had the capacity to follow through on its commitments or whether it would use sticks and carrots during bargaining with other states. Therefore, rather than being a full blown case study to test the state identity explanation, the Soviet case is most valuable as a shadow case for comparison with what came later in Yeltsin's Russia.

*The first image reversed and Yeltsin's neo-liberal choice: revolution from above*

Yeltsin was already moving in an increasingly radical liberal direction prior to the August coup. The significance of the coup was not so much that it changed his thinking, but that it transformed the balance of authority among top level officials in the USSR. After the August coup, Yeltsin quickly became the most powerful man in the Soviet Union and displaced Gorbachev as the key decision maker.

Once he became the key decision maker, Yeltsin had to make actual policy decisions, and this meant that he had to develop a vision of the state that he would build. Yeltsin's top priority was to reform the economy, and he needed a blueprint. Between late October and early November, he chose a group of young Soviet economists who presented him with a program that followed Western neo-liberal lines. These advisers were influenced professionally by the works of American academic economists, and when the opportunity to travel freely emerged under Gorbachev, they interacted with Western economists at international conferences that promoted the neo-liberal perspective. Moreover, they designed reforms explicitly based on these ideas and interactions. Thus, the international dimension of Russia's transformation was extremely important.

The neo-liberal program was accompanied by an explicit image of the state as oppressive to economic entrepreneurship, an image familiar to Western readers. Translated into the Russian context, the state was also oppressive to national groups (imperialist), including Russians themselves. Armed with this image, the first key moment in the new Russia's early



history was on October 28, 1991, when Yeltsin made his first programmatic speech to the Congress of People's Deputies and articulated this vision of the state. The second key moment was on December 8, 1991, when Yeltsin went behind Gorbachev's back and essentially disbanded the Soviet Union (the Belovezha Accord), destroying the Soviet state.

Why did Yeltsin choose the neo-liberal approach and this vision of the state? Having rejected the old system *in toto*, Yeltsin was looking to create a new Russia based on something radically different. He was looking for a new political economic model, and he was drawn to the image he had of Western states, and especially the United States, as successful states. This made the independent (a quality he associated with being American) advisers he chose seem particularly competent and well suited for the job of running his first government and implementing reforms.

In terms of economic reform, the free market blueprint was also attractive due to its close association with the West and the United States in particular. Moreover, its simplicity and stark contrast with Soviet economic thought also made it attractive. Having rejected all things Soviet, Russia was explicitly looking for a new foreign model upon which to build capitalism. The neo-liberal approach became the model Yeltsin chose, and the idea hardened within the government that this was the only way for Russia to emerge from its economic crisis (his advisers assured him that the results of reform would materialize in less than a year), build capitalism, and make Russia strong again. At the micro level, the decision was based on an implicit causal belief about the relationship between the state and the economy and its consequences for economic development and long term Russian power. Specifically, the idea was that maximum retrenchment of the state leads to the emergence of free markets, growth, prosperity, and state power. Finally, this argument was compelling because it could point to the economic and political successes of Western states, especially the United States, to support its causal claims. Behind the neo-liberal choice was an explicit view of the legitimacy of state power in the economy based on a particular theory of causation and a logic of consequences for Russia's capitalist development.

*State corporate identity under Yeltsin: state building and societal identities (low sovereignty)*

The neo-liberal approach was a central component of Yeltsin's state building. In the energy sphere it was characterized by the peculiar idea that the state should intervene in the economy as little as possible, and this motivated the creation of hitherto unheard of autonomy for the captains of Russia's energy sector. Once revolutionary leaders take control of the state, they usually engage in state building, not state destroying. However, viewed through the lens of the neo-liberal ideas that motivated his choices, Yeltsin's unexpected state-building project is not so puzzling.

The neo-liberal approach had important internal consequences. First, it shaped elite domestic identities with respect to the state. Historically, the Russian economic elite had been subordinated to the state. Although this varied, economic elites were essentially servants of the state. In the USSR, economic entrepreneurship was formally illegal, and when entrepreneurs did emerge openly under Gorbachev they were tainted with considerable stigma and still subordinate to and dependent on the state. By encouraging the transfer of control or ownership of valuable state resources to individuals and groups closely connected with the state (in the name of free markets, efficiency, and development), depreciating the state, and valorizing the unshackled

entrepreneur, the neo-liberal approach provided the background for Yeltsin's decision to both create the material base for an economic oligarchy and legitimate their political and economic autonomy from the state. As a result, this new economic super elite developed the identity of master with respect to the state, and state preferences and policy were no longer imperative or even a priority for them. This was especially true with respect to the oil and gas sectors.

Neo-liberal policy also laid the basis for master identities among regional elites. These identities were already being mobilized (not least by Yeltsin himself) during the political conflict under Gorbachev. In Yeltsin's Russia, they hardened particularly when the central state became incapable of meeting its financial commitments to local governments. Again, rather than rebuild state authority over the regions, neo-liberal reform compelled Yeltsin to abdicate responsibilities that were commonly accepted, indeed welcomed in these regions. Thus, regional leaders became masters because the former master (Moscow) was absent.

Neo-liberal policy also shaped the identities of political elites in the center. The decision to launch neo-liberal reforms set the tone for politics for the remainder of the decade. By 1991, a majority of Russians were in favor of private property. However, the idea of creating crash capitalism through neo-liberal policies was radical and illegitimate, particularly within the elite class, and became highly polarizing. Despite the president's very strong support from the Fifth Congress of People's Deputies of the RSFSR in late 1991, his relations with the legislature deteriorated very quickly. Not surprisingly, the course of reform was at the heart of the conflict. October 1993 saw a small civil war in which Yeltsin ordered the military to bombard the White House, which housed an intransigent Supreme Soviet (the precursor to the State Duma) that opposed Yeltsin's course. Later, a new constitution was crafted that gave the president (Yeltsin) much greater powers at the expense of the new parliament (the State Duma).

Different elites had different preferences and ideas, but in this highly charged environment two main political identities became salient: self-identified reformists (Yeltsin's executive branch and government) and self-identified defenders of Russia (the communist and nationalist majority in the State Duma). Obviously both groups identified as masters. Reformists (including Yeltsin) identified as masters with respect to the state because they controlled the executive and government and were formally in charge. The Duma opposition identified as masters not because they felt the state was illegitimate per se, but because Yeltsin's rule was illegitimate and they saw their cause as a crusade to save Russia from the West and the national comprador class. As already mentioned, the oligarchs were also masters as economic entrepreneurs (the privileged new social group).

With everyone a master, no one was a master (including the state); state-society relations were heterarchical. This resulted in a state corporate identity characterized by low domestic sovereignty.

### *Political dynamics: polarization and the difficulties of policy making*

It goes without saying that this type of domestic politics did not create an environment that was conducive to effective policy making. To begin with, when it came to policy, everyone was a master: the government, the State Duma, the regional elites, and the oligarchs. Policy making was also characterized by heterarchical relations (both between the state and society and between the branches or layers of government). However, though this may make consensus difficult, effective policy making under heterarchy ultimately depends on the configuration of

interests (whether there is convergence) and the political process (whether compromise or persuasion is possible).

The problem was not just heterarchy but also the political dynamics that emerged after Yeltsin went down the neo-liberal path. The neo-liberal choice created a deep schism that structured domestic politics. The oligarchs and reformers were loyal masters, but the opposition consisted of disloyal masters. Overall, with such antagonistic identities, intense polarization occurred, and this meant that the policy-making process was nearly toxic.

Moreover, even after the political economic situation in Russia got worse, Yeltsin stayed the course. He re-embraced his initial neo-liberal choice when he agreed to Loans for Shares, an inside deal with the emerging economic oligarchy to exchange valuable state assets (including important oil companies) at very low prices for loans to the state (to pay pensions and federal employees) in advance of his 1996 re-election. The election campaign was framed by the reformers, who dominated the mass media, as a choice between progress and a return to Stalinism and potential civil war. After his re-election, Yeltsin re-committed to neo-liberal reforms by appointing a new government of reformers. Therefore, the 1991 choice was reproduced at key moments during the remainder of the decade, and this supported the binary identities and polarization within Moscow's political class.

Due to the ongoing conflict with Yeltsin over his neo-liberal course, the Duma was predisposed to oppose government policy in general. Moreover, the defenders of Russia could be mobilized to oppose policy by invoking the government's neo-liberal credentials. For example, Vakhirev could mobilize Duma support against the liberal government, not because the Duma supported Vakhirev's policy, but because of the Duma's general rejection of Yeltsin and his liberal governments. With politics akin to warfare, political coalitions often reflected the logic that "the enemy of my enemy is my friend."

Finally, because of the highly charged ideological conflict and the general mistrust and antipathy between reformers and defenders, policy debates were unproductive. Rather than engaging in constructive debate based on some common conceptual ground, policy making degenerated into a tragicomic combination of trench warfare and political theater that led to obstruction, gridlock, and on several occasions political crisis. This was conducive to neither genuine policy deliberation within the state nor unitary actorhood. As a result, despite signing the Treaty, Russia could not ratify it on two occasions. It was unable to follow through on its commitments.

#### *Role identity under Yeltsin and ECH policy: the regime taker*

At the same time, Russia's role identity became that of a regime taker. Since the neo-liberal approach to domestic economic policy was chosen for its Western credentials (again the perceived success of these states made the neo-liberal causal logic compelling), the international economic regimes being offered by Western powers at the time, to the extent that they enshrined neo-liberal principles and were associated with the West and United States in particular, became very attractive. Thus, when the Russian delegation replaced the Soviet delegation in the ECH context, they quickly adopted the neo-liberal framework that was being proposed by the United States, the United Kingdom, and the European Commission. This also meant that an alternative coalition (including key Western European states such as Germany, France, Italy, Norway, and

the Netherlands that saw a greater role for the state in the energy economy) that might have developed around the more state-centered approach proposed by the USSR did not materialize.

Why did Russia do it? Russia did not embrace the regime offered by the West because of economic crisis. The economy had already gone off a cliff by 1990, so the economic crisis was constant before and after August 1991 (or only marginally different) and could not have produced differing Soviet and Russian policy. Perhaps Russia chose this course because it was politically weak. After all, it was experiencing a revolution at the time. The conventional wisdom concerning the relationship between revolution and the choice of a neo-liberal regime gets the causal relationships exactly wrong. The period after the coup was a revolutionary moment when structures, interests, and identities were fluid. At the same time, Yeltsin was much stronger politically than Gorbachev had been before the coup. Because of the fluid structures and his personal authority, many options were available to Yeltsin. In fact, the revolutionary moment only became an actual revolution when he made his choice to go down the neo-liberal path and disband the USSR. Therefore, revolution did not cause Russia to embrace a neo-liberal approach to the regime; it was endogenous to Yeltsin's choice of neo-liberalism. Ultimately, Russia embraced the American, British, and European Commission vision of the emerging regime because it enshrined attractive neo-liberal values and principles. Moreover, both domestic reforms and ECH policy were consistent with the model for building capitalism that Russia chose.

From 1992 through 1994, Russia was active in ECT negotiations, and in many respects it took the lead among post-Soviet states. Russia was clearly promoting its own interests and made bold proposals, some of which were accepted. For example, the EU agreed to a transition period for post-Soviet states before full implementation of the ECT rules would go into effect. However, Russian policy preferences fell consistently within an neo-liberal framework, which put them very much within the mainstream. While trying to set the agenda, Russia's agenda positioning was still conventional. This contrasted with the Norwegian delegation (an energy exporter), which challenged key principles and emerging rules but was isolated because the other main energy exporter (Russia) rejected this approach. I examine the Norwegian approach – which I call the state management approach (SM) – in a shadow case study to highlight its contrast with the Russian neo-liberal approach.

Interestingly, one of the reasons Russia was able to extract concessions from the EU is that both Russia and its European partners saw the ECH as a way of generating political support for Yeltsin at home. The idea was that a successful agreement would show Yeltsin's domestic audience the benefits of international cooperation. Therefore, political relations between Russia and its ECH partners were very cordial. Russia promoted its interests as it understood them, but at no time did it deploy sticks and carrots to shape incentives for other states.

An important question is why Russian ECH policy showed such continuity during the 1990s even though neo-liberal reformers did not fully control the government during that period. The evidence suggests that Russian policy makers could be divided into two groups. The first consisted of the true believers in the neo-liberal approach. The second group consisted of officials who did not necessarily hold the same ideological commitments but nevertheless followed what I am calling the ideological line, which institutionalized the neo-liberal approach into the role of being a state official in charge of state policy.

The basis for the ideological line was the idea that through its ECH policy, Russia was sending a signal to investors and other states. At one level, ECH policy signaled that Russia accepted the neo-liberal approach and especially legal restraints on the state associated with legal sovereignty; this was supposed to reassure international investors, and the idea was that this was the only way to attract investment into Russia. At the same time, Russia's ECH policy was signaling to other states that Russia could be accepted into international society as expressed through its accession into a plethora of international regimes. Russia was showing the community of states that it was just like every other state, that it accepted international law and norms and played by "the rules of the game", and as a "civilized" and "normal" state was worthy of inclusion into the international system. The implicit foil for the new Russia was the USSR.

In short, Yeltsin chose the neo-liberal model because of the causal belief that this was the only way to build capitalism and make Russia strong. Having accepted neo-liberal principles for domestic reform, embracing a regime proposal based on neo-liberal principles was the next logical step. Despite changes in the government, this policy course persisted because it became institutionalized into the Russian state through the role capacity of state officials. Officials developed policy along neo-liberal lines not so much because they believed in this, but because it was their job to do so. The premise for institutionalizing the ideological line was that Russia needed to send a signal through its ECH policy that it was safe for foreign investment and a worthy candidate for inclusion into the international system. From this perspective, the ECH was a litmus test to demonstrate that Russia had become a normal, civilized state that accepted international law and norms. All of this was consistent with a regime taker role identity.

Finally, when we combine the regime taker role identity with the low sovereignty of Russia's corporate identity, we see that overall Russia had an apprentice state identity. Both the role identity and corporate identity, as well as Yeltsin's state-building project, Russian domestic identities, and the character of domestic politics, were products of a particular understanding of the state that motivated Yeltsin's choice to go down a neo-liberal path.

### *Thermidor: Putin and the SS approach*

By the time Vladimir Putin became president in 2000, Russian society was exhausted from its prolonged embrace of the neo-liberal approach. The general population and the elite class were prepared for a new approach to the state. The approach that the new president articulated was in important ways a reflection of beliefs about the state in society. President Putin was clearly a central figure in the transformation of Russia's state identity. However, we cannot explain why he pursued the policies that he did without understanding the ideas about the state that prevailed in Russian society at that time.

Putin's vision of the state reflected both continuities and change with respect to his predecessor. Like Yeltsin, he was anti-communist, supported markets, and was skeptical of an expansive economic role for the state. However, he also thought that Russia had gone too far in its rejection of the state under Yeltsin. The state was an important source of social stability and security. Moreover, he was also influenced by the idea that state power had a legitimate role in certain key economic sectors, of which energy was at the top of the list. This is the SS approach that Putin laid out in his dissertation for the *kandidat* degree as well as in subsequent pronouncements.

If the SS approach implied a new state relationship with the energy sector, it also suggested a very different relationship between Russia and other states than what prevailed under Yeltsin. Whereas under Yeltsin, Russia was looking for a developmental model and embraced regimes proposed by other states, under Putin, Russia would develop its own approach and then promote it through tough bargaining with other states. This was a principled position since it was what great powers did and obviously reflected a very different view of the legitimacy of Russian state power relative to other states. In addition, Russia would address domestic issues first and then develop foreign policy. This contrasted with Yeltsin, for whom this sequencing did not exist. Having adopted a foreign model, he tried to impose it domestically even when it went against domestic interests.

This approach was different from the SCM approach under Gorbachev because it was not inspired by socialist principles. Although the state played an important role, protecting workers from exploitation was not part of it. In addition, the areas of the economy in which the state would intervene were smaller.

*State corporate identity under Putin: state building and societal identities (high sovereignty)*

Very quickly, Putin began a new state-building project that was motivated both by the general image of the state as a source of stability and security and the SS approach in particular. This meant changing relations between the Kremlin and the regions, the oligarchs, and the Duma. From a societal perspective, rebuilding state authority was a legitimate goal. However, to advance state building, Putin still had to offer incentives, use coercion, and on a few occasions deploy state violence. The latter was the exception rather than the rule. Of particular note were the campaign in Chechnya, the detention of the oligarch and media magnate Vladimir Gusinsky, and the extended imprisonment in Siberia of Russia's former richest oligarch and oil baron, Mikhail Khodorkovsky. The second Chechen campaign was not a departure from policy under Yeltsin; indeed, it began under Yeltsin's watch when Putin was the new prime minister. However, cracking down on the media and incarcerating oligarchs were lines that Yeltsin never crossed, even when they might have made sense from the perspective of the state interest. The state that Yeltsin was building did not behave in this way. Under Putin, if important state interests were at stake, this use of state power was legitimate.

The domestic consequences of this state-building project were significant. By late 2003, Putin had consolidated state authority over the entire political and economic elite. Previously masters, regional leaders and oligarchs were now servants of the state. The Duma also became compliant when Putin's party Unity (*Edinstvo*), which would later become United Russia (*Yedinaya Rossiya*), formed a majority through an alliance with the communists. The communists would later be marginalized, but both Putin and his party adopted important (though not all) parts of their platform. Again, because Putin's idea of the legitimacy of state power in certain social and economic spheres overlapped to a certain extent with the ideas of the communists and nationalists (rather than being diametrically opposed to them), this type of political coalition now became possible.

The SS ideological line motivated a particular type of more conventional state-building project, and its public articulation transformed societal identities. The broad legitimacy of the line portended the success of state building; however, Putin still had to use inducements and violence to project state authority and power. As a result, political relations between the state

and societal actors became hierarchical. The state's corporate identity was characterized by high sovereignty. Though debate and bargaining could take place, the state would set the terms of the debate and have the final say, and other actors would not be able to veto the final decision or re-open debate because they had lost.

*Political dynamics and policy making: deliberation and solving problems*

Under Putin, polarization disappeared. Previously, the Russian political field had been dominated by the battle between (loyal) reformers and the (disloyal) defenders of Russia. Now both groups were marginalized, giving way to a centrist coalition that formed around the vision of state power that Putin presented and dominated politics to the displeasure of extremists at both ends of the spectrum. Thus, hierarchy was accompanied by a political process that was characterized not by extreme conflict but by deliberation, bargaining, and compromise.

This had a salutary effect on foreign policy making. In particular, opponents of state policy could not take advantage of the pathologies of the political process to block state policy and promote their own agenda. Policy making was no longer akin to trench warfare or political theater. It had become a productive arena, the foundation of which was an elite consensus about the primacy of state interests. As a result, deliberation, compromise, and most importantly solving problems became possible. This can be seen in developments in the gas industry and how this shaped state ECH policy.

A key moment in ECH policy was when the state finally took control over the state-owned gas monopolist, Gazprom. Previously, Gazprom managers had near total control of the company and developed gas policy, both domestic and foreign, as they saw fit. With the great autonomy afforded them under Yeltsin, top managers could also engage in lucrative and informal rent extraction at the expense of the central state. Insofar as policy was based largely on the personal interests of management, the company's corporate identity (its operational logic) was a fiefdom. This was one of the reasons the company was against the ECH, and this contributed to Gazprom's opposition to ratification of the Treaty in 1997 and 2001. Moreover, when the government tried to curtail this autonomy and promote state interests, company management could mobilize the opposition in the Duma to create a political crisis and block these attempts.

The elimination of political polarization meant that under Putin, state building at Gazprom was successful. In particular, the state could finally replace the old managers with Putin loyalists who implemented the new ideological line (the SS approach), thereby successfully curtailing the autonomy of the company. As a result, the firm's corporate identity was transformed; it became the leading national champion.

The state also established its authority over the gas industry, which included Gazprom but also independent gas and oil companies that produced a relatively small but still significant amount of gas, in general. This meant the state could solve key issues that motivated Gazprom's opposition to the ECH. Most important was the question of how to structure the gas market, an issue that could not be solved previously since relevant actors were masters who could veto or derail government reforms, or put them back on the agenda again after losing in the previous round. This also meant that the state could change relations with competitors in Central Asia (gas foreign policy was largely determined by previous managers independent of and in contradiction to state interests) in a more cooperative direction.

The uncertainty over gas reform and relations with Central Asian states were sources of strategic insecurity for Gazprom, and this also dictated an anti-ECH policy. With these issues finally resolved and the conflict of interests between management and the state eliminated, the firm could finally see that the ECH was a potentially valuable instrument for promoting its goals on the quickly changing markets in the EU. As a result, Gazprom joined negotiations in 2004 on the draft Transit Protocol, an agreement that would elaborate the transit provisions of the Treaty. From that day forward, Gazprom would be the most important actor promoting ECH policy in Russia. This was probably the single most important development in the history of Russian ECH policy. Gazprom went from destructive opposition to constructive cooperation with the state in the ECH policy sphere.

*ECH policy under Putin: the regime maker*

As mentioned earlier, Putin articulated that Russia was a great power that developed foreign policy based on domestic interests that would no longer be subordinated to foreign policy goals. In negotiating with other states, Russia would henceforth drive a hard bargain to advance its interests and vision. This was a principled position for Putin since it constituted Russia as a great power. This did not mean that Russia sought out confrontation or would not go along with arrangements that suited it. However, it did mean that it was not looking for foreign models anymore. In this respect, the SS approach differed from the state management approach of Norway. Both saw an important and similar role for the state in the energy sector; but Norwegian thinking was not premised on the idea of being a great power.

The SS approach also differed from the dependency approach of the opposition under Yeltsin. From that perspective, the international economy was a source of exploitation. From an SS viewpoint, the international economy was an opportunity; whether Russia benefited or not depended on how the state played its hand. Obviously, this meant that integration under Putin meant something different than under Yeltsin. Russia would continue on its course of integration, but under terms that it set and negotiated with other great states. Implicitly, Russia would use its power to shape the outcomes. This was what great powers did. Russia's role identity had become that of a regime maker.

Changes in Russian ECH policy became manifest very quickly. In 2000, government officials and Putin himself expressed a favorable attitude to the ECH. The government re-submitted the Treaty for ratification. This was consistent with the ideological line that Putin inherited from Yeltsin; Russia was still signaling to foreign investors and states about the kind of state it had become. However, Putin also indicated that Russia would consider the question of ratification carefully. Previously, there had been no need within the government to consider ratification; the challenge was to convince the opposition.

Ratification hearings in 2001 saw vehement public opposition from Gazprom; its identity as a fiefdom had not changed yet, and its strategic insecurities would be addressed later. The most interesting aspect of the hearings was a genuine policy debate between different perspectives that were nevertheless grounded by a single concept: the state interest. Moreover, a broad consensus emerged: ratify, but not immediately. This was indicative of how Russian domestic politics had changed under the new president. As a result, Russia linked ratification to developments in negotiations on the draft transit protocol. This was a nod to the concerns raised



by Gazprom, which was significant because for the first time the state and Gazprom were beginning to see eye to eye relative to the ECH.

Previously, Russia had not made ratification contingent on other issues. Moreover, political conditions to ratification this late in the game (seven years after negotiations ended and Russia signed the agreement) were a new and controversial development in the ECH context. This was an early change in agenda positioning consistent with the new ideological line that construed Russia as a great power that could drive a hard bargain to promote its interests.

### *Russia resurgent*

By 2006, changes in Russian ECH policy were less subtle. In advance of the G8 summit in St. Petersburg, Russia linked its ratification of the Treaty to reciprocity in investment (for Gazprom) through asset swaps. This was a response to the scandal that erupted in the United Kingdom when Gazprom attempted to acquire shares in Centrica, a major UK energy company, and prompted UK officials to thwart the deal. The scandal came on the heels of the first Russo-Ukrainian gas war in January 2006, which made energy security and Gazprom's reliability as a supplier prominent concerns in the EU. Understandably, neither Russia nor Gazprom took this lightly. However, although the foiled investment deal was the proximate cause for the linkage, Gazprom had to be a productive part of the ECH process for Russia to propose a linkage to ratification.

Furthermore, in the run up to the summit, Russia began pressuring the EU to accept its deal. This required a complex maneuver that involved the president, government, and both houses of the Federal Assembly. United by a single understanding of what ECH policy represented at the moment – the interests of the state, which substantively reflected the interests of Gazprom – Russia was able to act effectively as a unitary actor and deploy sticks and carrots for the first time in the ECH setting, all within a short time frame. There was opposition from important actors, but even this was limited. Even opponents supported the policy in broad strokes. This was consistent with servant identities and hierarchical relations.

Russia was adapting a key regime principle (reciprocity) and doing so outside the regime (in the G8) through non-regime instruments. Its agenda positioning had become even more controversial. Moreover, it was putting pressure on the EU to accept its deal. Previously, the EU put pressure on Russia; now Russia had turned the tables. All this was consistent with the new self-image of the state as a great power and reflected Russia's new regime maker role identity.

### *The mercantilist: adapting the ECH regime*

Even these changes were minor compared to what came next. The G8 was a seminal moment when Russia began adapting the ECH in major ways that affected every aspect of the regime: principles, norms, rules, and decision-making procedures. In addition to the new understanding of reciprocity just mentioned, Russia proposed a new definition of energy security. Russia was also calling to legitimate a more active role for the state, which went beyond making laws; this violated regime norms concerning the division of labor between states and business posited by neo-liberalism. It proposed to overhaul the Treaty, which was a radical move given the near sacred status of the agreement within the regime. All this was done with

little regard for decision-making norms. Essentially, Russia was trying to rewrite the bargain struck a decade earlier, a controversial change in agenda positioning if there ever was one. Furthermore, the level of diplomatic coordination reflected that Russia could behave very effectively as a unitary actor.

Despite decisively shaping the debate within the ECH, changing thinking within the Secretariat, and producing some institutional changes within the regime, in terms of substantive outcomes, Russia's attempts were ultimately unsuccessful. Part of the reason had to do with the very conservative nature of the regime. To make significant changes required full consensus. The decision-making norms also favored incremental changes and a long process of consensus building and bargaining.

An additional factor had to do with the interests of EU states, the number of which had grown since the 1990s. EU states now made up a majority within the regime, and they were broadly satisfied with the regime, which after all had been designed largely according to their vision a decade earlier. However, the EU continued unofficial discussions with Russia over the draft transit protocol, and the two parties were able to come to agreement (or near agreement) on all of the most difficult issues. This suggests that the EU was trying to accommodate Russian demands when they fell within a pre-existing framework was consistent with the decision-making process that had been enshrined both formally and normatively into the regime.

A key lesson is that negotiating tactics matter. Russia's bold moves and disregard for procedures and norms – portrayed as “political” behavior – raised questions about the character of the Russian state. This suggests that the Europeans were reacting not so much to Russia's substantive demands, which went against their interests, but also to the tactics that it used. This had become a fundamental part of Russia's role identity as a great power that drove a hard bargain, but it was very much what gave the EU pause. Russia was not behaving like a law abiding state. Therefore, relations were deteriorating because the transformation of Russia's state identity led to demands and tactics in the context of bargaining that alienated its EU partners. Ironically, the ECH was originally supposed to promote cooperation and peace, but nearly two decades later it was becoming a source of conflict.

### *Medvedev: continuity in ECH policy*

Medvedev's administration presents an opportunity to test two competing explanations for Russia's changed behavior. On one hand, the new president clearly had a different background from his predecessor, and all indications were that he was more liberal. At the same time, the 2008 financial crisis hit Russia harder than other states and also led to a dramatic, immediate fall in energy prices. Both factors suggest that Russia would become more concessionary. Many expected it to revert to policies that resembled those under Yeltsin.

However, 2009 saw Russian behavior become even more assertive. Again, an external factor was the proximate cause: the second Russo-Ukrainian gas war. The second conflict was both longer and more severe, and as a result, it bankrupted the ECH in the eyes of the Russian leadership. In consequence, Russia proposed a brand new regime, the Draft Convention on International Energy Security, which it began promoting in a variety of different venues that included the ECH. The most likely explanation is that Russia was trying to advance its adaptation agenda within the ECH regime, and it was shopping venues both to generate support

for its proposal but also to put pressure on its fellow ECH states by showing that it had other options.

By the fall of 2009, Russia announced that it was abrogating its provisional application of the Treaty, which it undertook in 1994. The most proximate cause appears to be developments in the Yukos case (previously owned and managed by the imprisoned former oligarch Mikhail Khodorkovsky). The shareholders of the nationalized oil company had taken the Russian state to international arbitration under the auspices of the Treaty and demanded compensation between \$30 and \$100 billion, making this the largest damages claim in the history of international arbitration.<sup>24</sup> In late spring, it became clear that Russia, which had agreed to participate in the proceedings, would lose the first round. Russia had argued that non-ratification of the agreement meant that the tribunal did not have jurisdiction in the case. The panel disagreed, however, finding that provisional application was grounds for examining the case on its merits. As a result, Russia abrogated its provisional application. From a legal perspective this has no bearing since abrogation is not retroactive, and the Treaty also stipulates that its provisions are in effect for twenty years after withdrawal from the agreement. Therefore, abrogation needs to be understood not as a strictly legal move, but through a political lens: Russia was signaling its displeasure by taking a step backward with respect to the regime.

In short, despite the change in leadership and the negative changes in the international economy and energy markets, the tenor of Russian ECH policy has not changed. If anything, it has become more assertive in response to external events. Its agenda positioning continues to be controversial, and it continues to use sticks and carrots to shape other actors' incentives.

Finally, Russia's role identity has not changed. The idea of being a great power that drives a hard bargain to promote its interests and vision of the international economy has been institutionalized into the official roles of the Russian state and continues to animate it even under the new, more liberal president. There is no indication that its corporate identity has changed, either. For the time being, Russia still has a mercantilist state identity, and its behavior is consistent with this.

## **Organization of dissertation**

Chapter 2 examines the IR literature, rationalist and constructivist, on regimes and foreign policy. This is followed by a brief review of how mercantilism has been used in the literature. It also discusses questions related to measurement, case selection, theoretical scope, and data collection. (The reader can skip this chapter without sacrificing comprehension of the chapters that follow).

Chapter 3 examines the ideological line under Gorbachev and Yeltsin. The first goal is to show the contrast between the two given very similar structural conditions. The second goal is to relate the ideas in the ideological line to the changes in ECH policy that happened in late 1991. More generally, it establishes that under Gorbachev the USSR had a regime maker role identity, and under Yeltsin Russia had a regime taker identity.

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<sup>24</sup> Ibid., "Yukos Could Bankrupt."

Chapter 4 examines Russian policy during negotiations on the Treaty. It shows that it reflected the neo-liberal approach and that Russia's agenda positioning was conventional. To bring this into relief, I present a shadow case study of Norwegian ECH policy during the same time. Next I discuss the interaction between neo-liberal ideas and the idea of sovereignty. The chapter also examines the political strategy for ratification and its limits given Yeltsin's lack of authority over the Duma, which declined ratification. Finally, I explain how the ideological line became institutionalized into the Russian state as a signal that Russia was sending to other states and investors.

Chapter 5 examines Gazprom's role in ECH policy to help us understand why Russia was unable to commit to the agreement through ratification and could not behave as a unitary actor. It demonstrates Gazprom's opposition and presents evidence that Gazprom played an important role in blocking ratification. Next, it examines the sources of Gazprom's autonomy from the state. Finally, it demonstrates that the state's relations with its own firm were heterarchical. In so doing, it establishes the state's corporate identity (low sovereignty) in the gas sphere.

Chapter 6 establishes that under Putin, state corporate identity was characterized by high sovereignty. It looks at tax collection as a measure of state sovereignty over the course of the Yeltsin period and through the consolidation of authority by Putin during his first term. In addition, it investigates the new ideological line under Putin, the source of Russia's new state identity. Finally, it looks at Putin's state building and his policy toward Gazprom.

Chapter 7 looks at the effects of the old ideological line during Putin's early tenure as president. It also examines the second ratification debate to show how the new ideological line under Putin shaped the foreign policy-making process. In particular, the policy debate was deliberative and structured by a single concept (the state interest), and it reflected Russia's role identity as a regime maker. Finally, for the first time the state and Gazprom saw eye to eye on ECH policy.

Chapter 8 looks at how high sovereignty related to the transformation of Gazprom's corporate identity and how this affected Russian ECH policy. In particular, Russia's agenda positioning, ability to act as a unitary actor, and use of sticks and carrots shifted.

Chapter 9 explores Russia's attempts to modify the ECH regime, an expression of its regime maker role identity. It also examines the effects of Russia's attempts, why they were unsuccessful, and why the ECH is a source of conflict between Russia and the EU.

Chapter 10 looks at Russian ECH policy under Medvedev. Russian policy became more assertive, suggesting that its identity did not change as a product of the new leadership or the global economic crisis. In fact, Russia proposed a new regime in response to the second gas war with Ukraine. It also abrogated its provisional application as a response to developments in the Yukos arbitration case under the auspices of the Treaty.

The Conclusion returns to the question of regime creation, adaptation, and failure, showing what the state identity approach adds to our understanding of when regimes will succeed or fail and the politics of international regimes. This is important because given the significant changes in power forecast for the 21st century, we can expect rising powers to make new demands related to the governance of the international system. This may be an opportune time for IR scholars to revisit the debate on international regimes.

## CHAPTER TWO: IR LITERATURE, METHODS, AND DATA

### Overview

This chapter presents the relevant IR literature – rationalist and constructivist – on state foreign policy and international regimes. The goal is to show the shortcomings of current approaches with respect to explaining the development of the ECH and therefore position my state identity approach within the broader landscape of IR scholarship. I also review the usage of the term mercantilism in the IR literature to show that its meaning has proliferated thus undermining its analytical utility. From this perspective, mercantilism understood as a state identity brings clarity to what is otherwise an important realist insight about the role of power in international political economy. Finally, I discuss questions related to measurement, data collection, case selection, and theoretical scope.

### Rationalist accounts of state policy and regime outcomes in IR

#### *First generation of research: power, interests, and the functional value of regimes*

There is copious and varied literature explaining regime outcomes in IR.<sup>25</sup> The first major debate was between neo-realists, neo-liberal institutionalists, and neo-realist institutionalists. Neo-realists argued that international “regimes” reflected the interests of powerful states and change was driven by changes in the relative distribution of power in the international system.<sup>26</sup> One main variant of this approach, Hegemonic Stability Theory (HST), argued that international regimes would be stable to the extent that one dominant power in the international system was able and willing to protect the public goods that regimes provided.<sup>27</sup> Exogenous technological or economic shifts drove changes in power and how it was distributed

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25 For two important summaries, see David A. Lake, “International Political Economy: A Maturing Interdiscipline,” Draft 2.0, August 7, 2004, prepared for eds. Barry R. Weingast and Donald Wittman, *The Oxford Handbook of Political Economy* (New York: Oxford University Press); and Beth Simmons and Lisa Martin, “International Organisations and Institutions,” eds. Walter Carlsnaes, Thomas Risse, and Beth Simmons, *Handbook of International Relations* (London et al.: Sage, 2002).

26 For example, Stephen Krasner, *International Regimes* (Ithaca, NY: Cornell University Press, 1983). Also, Robert Gilpin, *War and Change in World Politics* (Cambridge and New York: Cambridge University Press, 1981); Stephen D. Krasner, “State Power and the Structure of International Trade,” *World Politics* 28 (April 1976): 317-347; Edward D. Mansfield, *Power, Trade, and War* (Princeton: Princeton University Press, 1994), 151-190; T. Evans and P. Wilson, “Regime Theory and the English School of International Relations: A Comparison,” *Millennium* 21 (3): 329-351; Simmons and Martin trace this perspective to classical realists as well: Hans J. Morgenthau, *Politics Among Nations: The Struggle for Power and Peace* (New York: Knopf, 1967); see Raymond Aron, *Peace and War: A Theory of International Relations* (Garden City, NY: Anchor Press, 1973); Stanley Hoffmann, ed., *Contemporary Theory in International Relations* (NJ: Prentice-Hall, 1960); Edward Hallett Carr, *The Twenty Years' Crisis, 1919-1939: An Introduction to the Study of International Relations* (New York: St. Martin's Press, 1966), 170-171, 189.

27 Charles P. Kindleberger, “An Explanation of the 1929 Depression,” Chapter 14 in *The World in Depression, 1929-39* (Berkeley: University of California Press, 1973); Krasner, *International Regimes*; Susan Strange, “Cave! Hic Dragones: A Critique of Regimes Analysis,” in Krasner, ed., *International Regimes*.

in the international system.<sup>28</sup> Moreover, such historical transitions were inherently destabilizing; a declining hegemon and a rising power created a situation that was rife with conflict and at the extreme would result in a hegemonic war.

This perspective was challenged by neo-liberal institutionalists, who claimed that regimes were more than just the expression of the interests of dominant states. In this view, regimes also fulfilled important functions such as lowering transaction costs and solving coordination problems. In contrast to HST, the neo-liberal institutional perspective suggested that a concert of states and not just a hegemon could support the persistence of a regime that provided valuable functions.<sup>29</sup> Therefore, it became necessary to understand not only the hegemon's interests, but also those of the other states and the functional value that regimes procured for them.

The two approaches came to a synthesis in the works of neo-realist institutionalists, who recognized that regimes did fulfill important functions but also claimed that they were not just the site of games of cooperation but also games of distribution.<sup>30</sup> As Krasner noted, "There are however many points along the Pareto frontier: the nature of institutional arrangements is better explained by the distribution of national power capabilities than by efforts to solve problems of market failure."<sup>31</sup> Thus, room emerged for explanations based on both power and regime value, although the former were considered more important.<sup>32</sup>

Overall, the first generation of scholarship pointed to the importance of state power, interests, and regime function to explain the fate of international regimes. This research strongly supports the finding that regimes are affected when the power and interests of key states change. However, all three approaches were systemic level explanations; they exogenized the sources of states' interests. Second, power was reduced to material factors (weapons, national wealth, technology) that were relatively easy to observe and measure. The question of the theoretical relationship between ideas and state power and interests was subordinated to the epistemological preference for construing power in material terms. Finally, the synthesis that emerged was inadequate for explaining change over time: why and how do situations of harmony become situations of conflict? Or, more specifically, why is the problem of distribution more salient in certain cases rather than others? Following Krasner, one would have to look at the power and

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28 Gilpin, *War and Change*.

29 Robert Keohane explained the persistence of international economic institutions even after the decline of the United States in the 1970s by pointing to the value that these institutions provided to other states. Robert Keohane, *After Hegemony: Cooperation and Discord in the World Political* (Princeton, NJ: Princeton University Press, 1984).

30 Stephen Krasner, "Global Communications and National Power—Life on the Pareto Frontier," *World Politics* 43, 3 (1991): 336-366. Also Duncan Snidal, "The Limits of Hegemonic Stability Theory," *International Organization* 39, 4 (Autumn 1985): 579-614; Arthur A. Stein, "Coordination and Collaboration: Regimes in an Anarchic World," in Stephen Krasner, ed., *International Regimes*; Lisa L. Martin, "Interests, Power, and Multilateralism," *International Organization* 46, 4 (Autumn 1992): 765-792; Geoffrey Garrett and Barry R. Weingast, "Ideas, Interests, and Institutions: Constructing the European Community's Internal Market," in *Ideas and Foreign Policy: Beliefs, Institutions, and Political Change*, ed. Judith Goldstein and Robert O. Keohane (Ithaca, NY: Cornell University Press, 1993).

31 *Ibid.*, 337.

32 For a more differentiated synthesis see Volker Rittberger and Michael Zürn, "Towards Regulated Anarchy in East-West Relations," in *International Regimes in East-West Politics*, ed. Volker Rittberger (London and New York: Pinter, 1990); Martin List and Volker Rittberger, "Regime Theory and International Environmental Management," in *The International Politics of the Environment: Actors, Interests, and Institutions*, ed. Andrew Hurrell and Benedict Kingsbury (Oxford: Calrendon Press, 1992), 85-109.

interests of states. But, as already mentioned, neither approach dealt with either of these issues in a satisfying manner.

Overall, no significant technological shifts in energy occurred during the period examined in this research. Similarly, the functions of the ECH did not really change, although Russia's perception of its value certainly did. Clearly, Russian power and interests did change, and the most relevant hypothesis that emerges from these perspectives relates to changes in the structure of energy markets, which have shifted from a buyer's market to a seller's market. The most obvious indication of this shift is the dramatic change in oil prices that we have experienced during the past two decades.

Although the structure of energy markets certainly changed the patterns of wealth transfer between energy exporters and importers, the case evidence suggests that it is at best an imperfect predictor of state interests and policies with respect to international regimes. In particular, chapter 3 finds that Soviet and Russian ECH policy in 1991 were very different despite the fact that the structure of energy markets remained constant during that time. In chapter 10 we see that, in the wake of the Great Recession of 2008, energy prices collapsed, and it looked as if the structure of energy markets might be shifting again. Many observers expected Russian behavior to change accordingly, but insofar as it changed, it moved in the opposite direction from what we would expect. Russia proposed a new regime to replace the ECH; it was even more dissatisfied than previously. Finally, changes in the structure of energy markets after 1999 do correlate in general terms with Russia's "resurgence" under Putin, and Russia's ECH policy did begin to change during that time. However, Russia aimed to adapt the regime instead of simply withdrawing from it altogether. As we will see in chapter 8, a key reason that Russia chose adaptation rather than withdrawal was that its largest firm – the gas monopoly Gazprom – developed a favorable view of the regime, and it is difficult to connect this important development to changes in the structure of energy markets.

Overall, we can say that the structure of energy markets is an important factor that certainly shapes the constraints and opportunities available to Russia as the world's largest energy exporter. However, the way that Russia relates to these constraints and opportunities is mediated by other factors, and as a result, Russia's international behavior in the ECH sphere is indeterminate relative to the structure of energy markets.

### *Second generation of research: domestic factors and state policy*

More recent scholarship has gone in two different directions: the sources of state interests and the additional effects of regimes, which have come to be referred to as institutions. As mentioned above, early research exogenized the question of state interests, preferring to focus on the systemic level and the distribution of power across states. This gap motivated later researchers, mostly of a liberal orientation, to open up the black box of the state and look at domestic politics as a source of state interests. This work can be divided into two major strands: economic and political factors that drive the constitution of state interests. Those interested in economic factors derived state interests by looking at the relationship between the international economy and domestic economic groups. The key cleavages were factoral (labor vs. capital) and

sectoral (asset mobility).<sup>33</sup> The concatenation of domestic alliances that emerged predicted the positions that states would take with respect to international institutions.

Other scholars focused on the political factors that mediated between the interests of economic actors and state policy. One set of approaches focused on the variation in (formal) institutions of representation.<sup>34</sup> Still another group of scholars focused on the variety of

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33 Jeffrey A. Frieden and Ronald Rogowski, "The Impact of the International Economy on National Policies: An Analytical Overview," in *Internationalization and Domestic Politics*, ed. Robert O. Keohane and Helen V. Milner (Cambridge: Cambridge University Press, 1996), 48-75; Ronald Rogowski, "Political Cleavages and Changing Exposure to Trade," *American Political Science Review* 81, 4 (December 1987): 1121-1137; Helen V. Milner, *Resisting Protectionism* (Princeton: Princeton University Press, 1988), 18-29; Michael J. Hiscox, "Class Versus Industry Cleavages: Inter-Industry Factor Mobility and the Politics of Trade," *International Organization* 55 (Winter 2001): 1-46; Kerry A. Chase, "Economic Interests and Regional Trading Arrangements: The Case of NAFTA," *International Organization* 57 (Winter 2003): 137-174; Jeffrey W. Ladewig, "Domestic Influences on International Trade Policy: Factor Mobility in the United States, 1963 to 1992," *International Organization* 60 (Winter 2006): 69-103; James E. Alt, Fredrik Carlsen, Per Heum, and Kåre Johansen, "Asset Specificity and the Political Behavior of Firms: Lobbying for Subsidies in Norway," *International Organization* 53, 1 (Winter 1999): 99-116. The debate can be traced to the differences implied by the Ricardo-Viner and Heckscher-Ohlin theories of international trade. For some syntheses, Stephen P. Magee, "Three Simple Tests of the Stolper-Samuelson Theorem," in *Issues in international economics*, ed. Peter Oppenheimer (Stocksfield: Oriol Press, 1980); and more recently Michael Hiscox, *International Trade and Political Conflict: Commerce, Coalitions, and Mobility* (Princeton, NJ: Princeton University Press, 2002). The debate continues today. For more recent examples, see Jeffrey A. Frieden, "Real Sources of European Currency Policy: Sectoral Interests and European Monetary Integration," *International Organization* 56, 4 (Autumn 2002): 831-860; Kerry A. Chase, "Moving Hollywood Abroad: Divided Labor Markets and the New Politics of Trade in Services," *International Organization* 62 (2008): 653-687. For research on international finance and exchange rate policies, Jeffrey A. Frieden, "Capital Politics: Creditors and the International Political Economy," *Journal of Public Policy* 8, 3/4 (2008); "Invested Interests: The Politics of National Economic Policies in a World of Global Finance," *International Organization* 45, 4 (1991):425-451; "Monetary Populism in Nineteenth-Century America: An Open Economy Interpretation," *Journal of Economic History* 57 (1997): 367-395; Angela O'Mahony, *Monetary Regimes: The Interrelated Choice of Monetary Policy and the Exchange Rate*, Ph.D. dissertation, Political Science, University of California, San Diego.

34 Ronald Rogowski, "Trade and the Variety of Democratic Institutions," *International Organization* 41, 2 (Spring 1987): 203-223; Daniel L. Nielson, "Supplying Trade Reform: Political Institutions and Liberalization in Middle-Income Presidential Democracies," *American Journal of Political Science* 47, 3 (July 2003): 470-491; Edward D. Mansfield, Helen V. Milner, and Jon C. Pevehouse, "Vetoing Cooperation: The Impact of Veto Players on International Trade Agreements," *British Journal of Political Science* 36, 4 (2006); Judith Goldstein, "Ideas, Institutions, and American Trade Policy," *International Organization* 42, 1 (Winter 1988): 179-217; Edward D. Mansfield, Helen V. Milner, and B. Peter Rosendorff, "Free to Trade: Democracies, Autocracies, and International Trade," *American Political Science Review* 94, 2 (June 2000): 305-321; Daniel Y. Kono, "Optimal Obfuscation: Democracy and Trade Policy Transparency," *American Political Science Review* 100, 3 (August 2006): 369-384; Timothy Frye and Edward D. Mansfield, "Timing Is Everything: Elections and Trade Liberalization in the Post Communist World," *Comparative Political Studies* 37, 4 (2004): 371-398; Michèle B. Bättig and Thomas Bernauer, "National Institutions and Global Public Goods: Are Democracies More Cooperative in Climate Change Policy?" *International Organization* 63 (Spring 2009): 281-308; Ben W. Ansell, "Traders, Teachers, and Tyrants: Democracy, Globalization, and Public Investment in Education," *International Organization* 62 (2008): 289-322; James Raymond Vreeland, "Political Institutions and Human Rights: Why Dictatorships Enter into the United Nations Convention Against Torture," *International Organization* 62 (Winter 2008): 65-101; Jonathan Slapin, "Bargaining Power at Europe's Intergovernmental Conferences: Testing Institutional and Intergovernmental Theories," *International Organization* 62 (Winter 2008): 131-62. Some of the mechanisms include the number of veto points (Peter F. Cowhey, "Domestic Institutions and the Credibility of International Commitments: Japan and the United States," *International Organization* 47, 2 (1993):299-326; Andrew MacIntyre, "Institutions and Investors: The Politics of Economic Crisis in Southeast Asia," *International Organization* 55, 1 (2001):81-122), number of parties, and type of electoral system (Ronald Rogowski, "Institutions as Constraints on Strategic Choice," in *Strategic Choice and International Relations*, ed. D. A. Lake and R. Powell (Princeton, NJ: Princeton University



capitalism of the state (the relationship between states and the economy).<sup>35</sup> Recently, David Lake has attempted to synthesize these insights to create the Open Economy Politics approach, arguing that “From a range of early perspectives, [this] dominant approach, now structures and guides research [in International Political Economy].”<sup>36</sup>

There are a number of problems with both perspectives. First, although the study of the sources of state interests and the resultant move to the domestic level rather than the systemic level of analysis were welcome advances for IR scholarship, these approaches simply passed the buck on the problem of interests by focusing on domestic actors, the interests of which were either assumed or based on general empirical findings from other broad bodies of literature. What interests emerged in particular empirical cases, the sources of actors’ interests, and how they change remained largely unexamined. As already mentioned, the change in Gazprom’s interest was a key factor in Russian ECH policy; however, this literature offers limited guidance for understanding this important development.

Second, although the inclusion of domestic political variables was a second important advance in IR analysis, this research boils down domestic politics to the question of either domestic regime type or variety of capitalism. The problem with the former is that many states in the world today are experiencing accelerated political development, which means that their regime type itself is changing. This raises the question of whether regime related political institutions that are in flux can operate in these settings as posited by regime theorists.<sup>37</sup> In the

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Press, 1999); J. Mark Ramseyer and Frances McCall Rosenbluth, *Japan's Political Marketplace* (Cambridge, MA: Harvard University Press, 1993).

35 For example, see Suzanne Berger, ed., *Organizing Interests in Western Europe: Pluralism, Corporatism, and the Transformation of Politics* (Cambridge: Cambridge University Press, 1981); Peter Swenson, “Bringing Capital Back In, or Social Democracy Reconsidered: Employer Power, Cross-Class Alliances, and Centralization of Industrial Relations in Denmark and Sweden,” *World Politics* 43, 4 (July 1991): 513-544; Jude C. Hays, Sean D. Ehrlich, and Clint Peinhardt, “Government Spending and Public Support for Trade in the OECD: An Empirical Test of the Embedded Liberalism Thesis,” *International Organization* 59 (2005): 473-494; Layna Mosley, “Room To Move: International Financial Markets and National Welfare States,” *International Organization* 54, 4 (Autumn 2000): 737-773; Mark Thatcher, “Varieties of Capitalism in an Internationalized World,” *Comparative Political Studies* 37, 7 (September 2004): 751-780; David Andrew Singer, “Capital Rules: The Domestic Politics of International Regulatory Harmonization,” *International Organization* 58 (Summer 2004): 531-565; Frances Rosenbluth and Ross Schaap, “The Domestic Politics of Banking Regulation,” *International Organization* 57 (Spring 2003): 307-336; also see Peter A. Hall and David Soskice, eds., *Varieties of Capitalism: The Institutional Foundations of Comparative Advantage* (New York: Oxford University Press, 2001), 1-68; Peter J. Katzenstein, *Small States in World Markets: Industrial Policy in Europe* (Ithaca, NY: Cornell University Press, 1985); Dani Rodrik, “How Robust Is the Theory of Optimum Subsidy?” Unpublished paper, John F. Kennedy School of Government, Harvard University; Dani Rodrik, *Has Globalization Gone Too Far?* (Washington, DC: Institute for International Economics, 1997); and Geoffrey Garrett, *Partisan Politics in the Global Economy* (New York: Cambridge University Press, 1998).

36 Lake, “International Political Economy,” 1. Lake reduces IPE to the study of two basic questions: 1) the political determinants of openness and 2) the effects of integration on domestic interests and ultimately government policy. Thus, although he contends that he is developing a comprehensive approach for the study of IPE, the focus on openness and societal interests relegates the analysis of state sovereignty to the outskirts of his research agenda. Lake also sees IPE as a blend of economics and political science. This essentially precludes the study in IPE of state identity, which has been informed by developments in sociology and other social sciences.

37 Research in comparative politics makes an important distinction between democratic states and democratizing states and suggests that the logic of politics varies in very significant ways depending on whether a country belongs to the former or the latter. In a democracy, number of parties, veto points, and electoral system may affect the aggregation of interests. However, democratizing states are characterized by a different kind of politics, and these

Russian case, changes in political institutions related to the regime were endogenous to the same factor that explains changes in Russian ECH policy: elite ideas about the state. In short, politics in most of the world cannot be understood through the lens of regime type since this variable itself is in flux.

The varieties of capital perspective point to a very important set of factors that *are* relevant to the cases examined in this dissertation: the relationship between the state and domestic economic actors. However, the variety of capitalism insight is treated in static terms in the IR literature: research examines what happens given a particular type of state and its relationship to firms. Scholars have not asked where that kind of state came from or how a particular variety of capitalism (that is, particular relationship to domestic economic actors) emerged or might change.<sup>38</sup>

This brings us to the major problem with all of the perspectives examined so far: they do not examine the development of the state and how this shapes international outcomes at specific historical moments. Moreover, different works are based on competing visions of the state. Scholarship in the liberal tradition sees the state as an aggregation of the preferences of domestic groups. For Marxist scholars, the state is an instrument of the dominant class.<sup>39</sup> Work inspired by realist principles portrays the state as autonomous from domestic society in areas that are important for international relations. In all three cases, the state is unchanging.

This research on Russian ECH policy points to an important transformation in the Russian state in terms of its relationship to domestic society and how this affected foreign policy. This work is an opportunity to understand theoretically the factors that generate different types of states – autonomous states and states that are subordinated to society – and the consequences of state development for foreign policy and international regime outcomes.

### *Second generation of research (part two): international institutions and effects on state policy*

A separate vector of recent research has concentrated on the effects of the institutions themselves on state policy. Institutions can affect domestic laws and regulatory processes,<sup>40</sup> set domestic precedents,<sup>41</sup> and even influence the quality of democracy.<sup>42</sup> This literature has also enquired into the micro-mechanisms through which international institutions affect state policy. In this way, institutions can be a location for the interaction of political leaders and networks of

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factors simply are not meaningful in the same way in these contexts. This is most definitely true in the Russian cases examined here.

38 Of course, comparativists who work in VOC literature are interested in these questions, but that interest has not affected research in IR.

39 Some strands of neo-Marxist scholarship provide for some state autonomy. As noted by Moravcsik, these approaches cannot be analytically distinguished from realist approaches. However, such neo-Marxist approaches differ from realists due to their very different normative commitments.

40 Tonya L. Putnam, "Courts Without Borders: Domestic Sources of U.S. Extraterritoriality in the Regulatory Sphere," *International Organization* 63 (Summer 2009): 459–90.

41 M. Patrick Cottrell, "Legitimacy and Institutional Replacement: The Convention on Certain Conventional Weapons and the Emergence of the Mine Ban Treaty," *International Organization* 63 (2009): 217–248.

42 Robert O. Keohane, Stephen Macedo, and Andrew Moravcsik, "Democracy-Enhancing Multilateralism," *International Organization* 63 (Winter 2009): 1–31.

elites.<sup>43</sup> Long term contact, exchange of information, and sustained problem solving have all been identified as mechanisms – whether rationalist or constructivist – that affect the interests and policies of states.<sup>44</sup>

This literature raises important theoretical questions. Explanations for changes in state behavior that focus on elite interactions do not examine the sources of beliefs and preferences of state officials. In particular, are beliefs and preferences a property of the private individual, or are they derived from the role of state official, or is it a combination of both? At the heart of this problem is the relationship between the state and the officials that compose its agencies. How we answer this question has important consequences for our understanding of how international institutions might affect state policy. In practical terms, this means that strategies based on intergovernmental interaction, learning, and cooperation may not always be successful.

Interestingly, as we shall see in chapter 4, the political strategy underpinning the early development of the ECH was very much premised on these types of academic theories. Russia's early leadership tried to import international law through the centerpiece agreement of the ECH: the ECT. Underlying this approach was the goal of legally locking in a particular type of relationship between the Russian state and international actors (other states and investors). More generally, the ECH was part of a strategy to use the window of opportunity that emerged in the aftermath of the Soviet collapse to make sure the Russian economy did not become closed again like its Soviet predecessor.

At the same time, elites in both the West and Russia used the ECH forum as a vehicle for promoting particular economic ideas and approaches. As we shall see, neither the lock-in nor the learning through interaction strategy was successful in any enduring way. In fact, this study of Russian ECH policy suggests that political factors are more significant than cognitive ones in getting states to see eye to eye. At the same time, unless a cognitive consensus already exists, one is not likely to emerge for cognitive reasons.

## **Constructivist approaches**

### *Background: ideas and state behavior*

IR research in the constructivist tradition has also contributed to our understanding of changes in state behavior. The analytical focus has been on ideas and the interests and policies that these produce.

Theorizing in IR to understand the effects of ideas on policy began as a response to the behavioral, neo-realist turn at the beginning of the 1980s. The first wave of scholarship focused on demonstrating the utility of a focus on meanings as an alternative to purely materialist

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43 Abraham Newman, "Building Transnational Civil Liberties: Transgovernmental Entrepreneurs and the European Data Privacy Directive," *International Organization* 62 (Winter 2008): 103-30; Emilie M. Hafner-Burton, "Network Analysis for International Relations," *International Organization* 63 (2009): 559-592. To the extent that cooperation is expected to emerge, this work appears to be inspired by the neo-functionalism of an earlier generation of scholars, most notably Karl Deutsch and Ernst Haas.

44 To the extent that the mechanisms are constructivist, this work connects with the norms literature I discuss below.

explanations.<sup>45</sup> According to Anne Clunan, this first generation of research “established convincingly that social and cultural context matters, making it no longer necessary to argue for the usefulness of a constructivist approach in opposition to rationalist alternatives. With this acceptance, it is now time to move ahead and work out some of the details and problems of constructivist theory.”<sup>46</sup> From this perspective, constructivism has established its credentials as a legitimate and useful approach for the study of social phenomena, creating a space to elaborate a research program that advances beyond merely showing that “ideas matter.”

There are three broad constructivist approaches related to understanding state international behavior as an outcome: the norms approach, the domestic society approach, and the state systemic approach.<sup>47</sup> To preview my main argument, all of these approaches have neglected the question of whether the state actually exists as a sovereign<sup>48</sup> actor that cannot be reduced to the officials that occupy positions in the state. My goal is to explore the origins of the sovereign state. I acknowledge that state sovereignty has varied historically; therefore, I am also interested in understanding why states have different levels of sovereignty, the processes through which the level of sovereignty change, and the consequences for state behavior.

### *Norms and state policy*

The norms approach is interesting because it examines the relationship between normative ideas and state policy outcomes at the micro-level, bringing process and agency to the forefront of our analysis.<sup>49</sup>

Work in this tradition has identified different actors associated with the production, transmission, and implementation of norms: political entrepreneurs,<sup>50</sup> international civil society,<sup>51</sup> scientific (epistemic) communities,<sup>52</sup> and governmental elites.<sup>53</sup> Scholars have also

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45 Peter J. Katzenstein, ed., *The Culture of National Security: Norms and Identity in World Politics* (New York: Columbia University Press, 1996); *Cultural Norms and National Security: Police and Military in Postwar Japan* (Ithaca, NY: Cornell University Press, 1996); John Gerard Ruggie, ed., *Multilateralism Matters: The Theory and Praxis of an Institutional Form* (New York: Columbia University Press, 1993); *Constructing the World Polity: Essays on International Institutionalization* (London and New York: Routledge, 1998); “International Regimes, Transactions, and Change: Embedded Liberalism in the Postwar Economic Order,” in *International Regimes*, ed. Krasner; Yosef Lapid and Friedrich Kratochwil, eds., *The Return of Culture and Identity in IR Theory* (Boulder, CO: Lynne Rienner Publishers, 1996).

46 Anne L. Clunan, *The Social Construction of Russia's Resurgence: Aspirations, Identity, and Security Interests* (Baltimore, MD: Johns Hopkins University Press, 2009), 8.

47 Ted Hopf, *Social Construction of International Politics: Identities & Foreign Policies, Moscow, 1955 and 1999* (Ithaca, NY: Cornell University Press, 2002).

48 To remind the reader, I am using Krasner's definition of sovereignty, meaning domestic sovereignty; that is, state authority and control over domestic actors.

49 Jeffrey T. Checkel, “Why Comply? Social Learning and European Identity Change,” *International Organization* 55, 3 (2001): 553-588; Amy Gurowitz, “Mobilizing International Norms: Domestic Actors, Immigrants, and the Japanese State,” *World Politics* 51, 3 (1999): 413-445; Jeffrey T. Checkel, “Norms, Institutions, and National Identity in Contemporary Europe,” *International Studies Quarterly* 43, 1 (March 1999): 83-114.

50 Martha Finnemore, “Norms and War: The International Red Cross and the Geneva Conventions,” in *National Interests in International Society* (Ithaca, NY: Cornell University Press, 1996).

51 Richard Price, “Transnational Civil Society Targets Land Mines,” *International Organization* (Summer 1998): 613-644.

pointed to the varying causal processes that are involved in norm change: the emergence of new elites during crisis,<sup>54</sup> external sanctioning,<sup>55</sup> mobilization and domestic political pressure,<sup>56</sup> professional training and iterated behavior,<sup>57</sup> appropriate, consequential, and habitual logics,<sup>58</sup> elite complex learning and domestic empowerment,<sup>59</sup> norm congruence,<sup>60</sup> and argumentative persuasion.<sup>61</sup>

Although this literature has developed many useful insights, the focus has been on the relationship between a single policy norm, the beliefs of the relevant policy elites, and the resulting incremental effects on state policy. At the same time, research on how different norms interact is lacking. Second, in the background is the implicit assumption that the state is a sovereign actor. However, much less attention has been given to the norms underpinning state sovereignty, and how various policy norms interact with the sovereignty norm. Since the norm of sovereignty is a fundamental pillar of contemporary political life, a policy norm that affects the sovereignty norm portends dramatic changes in domestic politics and state international behavior.<sup>62</sup>

In short, there are two broad gaps in the literature. First, it focuses on changes in one norm at a time, while holding other norms constant. However, a change in one norm may affect other norms, and we do not understand how this happens or what the consequences for state behavior are when a whole complex of norms changes at the same time. Second, by focusing only on policy norms, this research has not really allowed for the possibility that some norms are more basic than others. For example, whether the United States follows the nuclear weapons

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52 Peter M. Haas, "Banning Chlorofluorocarbons: Epistemic Community Efforts To Protect Stratospheric Ozone," in Peter M. Haas, ed., *Knowledge, Power, and International Policy Coordination* (Columbia, SC: University of South Carolina Press, 1992).

53 Martha Finnemore and Kathryn Sikkink, "International Norms and Political Change," *International Organization* (Autumn 1998): 887-917; J. Nicholas Ziegler, *Governing Ideas: Strategies for Innovation in France and Germany* (Ithaca, NY: Cornell University Press, 1997); Peter A. Hall, ed., *The Political Power of Economic Ideas: Keynesianism Across Nations* (Princeton, NJ: Princeton University Press, 1989).

54 Hall, *Political Power of Economic Ideas*.

55 Robert Keohane and Judith Goldstein, eds., *Ideas and Foreign Policy: Beliefs, Institutions, and Political Change* (Ithaca, NY: Cornell University Press, 1993); Wendt, *Social Theory of International Politics*.

56 Checkel, "Why Comply?"; Checkel, "Norms, Institutions, and National Identity in Contemporary Europe," *International Studies Quarterly* 43, 1 (March 1999): 84-114.

57 Finnemore and Sikkink, "International Norms and Political Change," 887-917.

58 T. Hopf, "Identity Relations and the Sino-Soviet Split," in *Measuring Identity: A Guide for Social Scientists*, ed. Rawi Abdelal et al. (Cambridge and New York: Cambridge University Press, 2009); Hopf, *Social Construction of International Politics*; Nina Tannenwald, *The Nuclear Taboo: The United States and the Non-use of Nuclear Weapons Since 1945* (Cambridge: Cambridge University Press, 2007).

59 Robert G. Herman, "Identity, Norms, and National Security: The Soviet Foreign Policy Revolution and the End of the Cold War," in *The Culture of National Security*, ed. Katzenstein et al.; Jeffrey T. Checkel, *Ideas and International Political Change: Soviet/Russian Behavior and the End of the Cold War* (New Haven: Yale University Press, 1997); for an earlier statement, see Ernst B. Haas, *When Knowledge Is Power: Three Models of Change in International Organizations* (Berkeley: University of California Press, 1990).

60 Checkel. "Norms, Institutions, and National Identity in Contemporary Europe"; Gurowitz, "Mobilizing International Norms."

61 Checkel, "Why Comply?" 553-588; Jennifer Mitzen, "Reading Habermas in Anarchy: Multilateral Diplomacy and Global Public Spheres," *American Political Science Review* 99, 3 (August 2005): 401-417; Thomas Risse, "'Let's Argue!' Communicative Action in World Politics," *International Organization* 54 (2000): 1-39.

62 Finnemore and Sikkink do mention dramatic changes (world time context) but do not pursue this question theoretically. Finnemore and Sikkink, "International Norms and Political Change."

taboo or the norms of the Geneva Convention is of course very important, but this is a different type of question than asking whether the United States actually has a sovereign state. If we allow that norms interact and that the sovereignty norm is more basic than other policy norms, it becomes clear that there is still a large gap in our knowledge concerning the relationship between norms and international behavior.

### *Societal theories and state policy*

The society-centered approach has paralleled many of the findings of the norms literature. The primary difference is that it has focused on the domestic rather than international sources of ideational change.<sup>63</sup> The conventional criticism that has been leveled against these works is that they ignore the effects originating at the systemic level. This literature also shares the problems identified previously during the discussion concerning the literature on norms (focus on only one norm at a time; no distinction between policy norms and more fundamental norms). Here, I will focus on the problematic treatment of the state (which also afflicts the literature on norms). Research in this tradition takes the state as a given: states adopt, states comply, states sanction, and states are pressured domestically. However, the view of the state is reductionist: the state boils down to the officials who inhabit the state and their beliefs. In other words, the state is not an independent actor. Relatedly, it is not clear whether the beliefs and behavior of policy elites within the state are a product of their private experiences in society or of their role capacity. Indeed, the distinction between the two is not addressed. In other words, for this literature, the state is really a placeholder for a succession of governments, a collection of bureaucracies, or a group of foreign policy elites.<sup>64</sup> Finally, in the literature all states are the same. There is no place for the notion that some states are sovereign in a way that others are not, and the implications of this for state policy are not considered theoretically.

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63 These theories are the IR successors to role-focused studies of foreign policy that were common before the behavioral revolution and Waltz's turn to systemic theory. The classic work is Holsti's study of national roles, in which he identified nine role types, including "revolutionary leader," "balancer," "non-aligned," "mediator," and others. According to Holsti, a role suggests that, "in a variety of international contexts and situations, [the states'] diplomatic-military decisions will be consistent with the 'rules' subsumed under the category or class of states." K. J. Holsti, "National Role Conceptions in the Study of Foreign Policy," *International Studies Quarterly* 14, 3 (September 1970): 255.

The main critique of the way that the literature on foreign policy uses roles is that it looks only at the beliefs of policy makers and not at all at the social structure within which their state exists. Put differently, the basic problem is the absence of Waltz's third image: what happens to roles when the state confronts the logic of the international system? In the words of Wendt, "role theorists have tended to assume that the social structure of international politics is too 'ill-defined, flexible, or weak' to generate significant role expectations, and so states' foreign policy roles are entirely a function of policy makers' beliefs and domestic politics, rather than their relations to Others. In effect, the agentic, role-taking side of the equation has been emphasized at the expense of the structural, role-constituting side which strips the concept of role of much of its interest." Wendt, *Social Theory of International Politics*, 227-8.

64 Hopf, *Social Construction of International Politics*; Hopf, "Identity Relations and the Sino-Soviet Split"; also Ian Alistair Johnson, "Cultural Realism and Strategy in Maoist China," in *The Culture of National Security*, ed. Katzenstein et al.; Elizabeth Kier, "Culture and French Military Doctrine Before World War II," in *ibid.*; Herman, "Identity, Norms, and National Security"; Rawi Abdelal, *National Purpose in the World Economy: Post-Soviet States in Comparative Perspective* (Ithaca, NY: Cornell University Press, 2001); Keith Darden, *Economic Liberalism and Its Rivals: The Formation of International Institutions Among the Post-Soviet States* (Cambridge and New York: Cambridge University Press, 2009).

A good example of this is Ted Hopf's brilliant study of the transformation of Soviet identity and behavior with respect to China. This work aimed to explain a change in state identity, not just the culture or identities of state elites. However, the analysis focused primarily on beliefs about the toleration of difference in society, their adoption by elites, and the consequences for foreign policy.<sup>65</sup> This neglects the dramatic transformation the Soviet state was undergoing at the time: from a totalitarian state to an authoritarian welfare state. As a result, Soviet sovereignty was changing so that the interest of the state was becoming subordinate to the interest of its ruling elite in personal security, with important consequences for subsequent state policy. Specifically, it is possible to imagine counterfactually that had Soviet sovereignty not changed, the policy debate over China would not have degenerated into a question of toleration of difference. Rather, the interest of the state might have trumped all other considerations, and decision makers might have decided that such a split could push China into the camp of its geopolitical and ideological adversary (the United States), leading to foreign policy that would have avoided a split.

An additional example of the society approach is Anne Clunan's project on Russian state identity. Similar to other works from the societal school, Clunan's discussion focused on the state not as a sovereign actor but as a collection of individuals and groups. Inspired by work in social psychology, she finds that identity is a source of self-esteem for the actors that carry it.<sup>66</sup> Therefore, Russian behavior is the product of a search for self-esteem on the part of individuals in a fallen superpower.

Although this is interesting and possible, there is an alternative and I think more compelling explanation: the state's responses concern the conflicts it perceives between the train of international events and its purpose and substantive goals. The focus on self-esteem diverts our attention from an important dynamic related to political and economic conflicts based on diverging international goals and purpose. To put it differently, international politics is not just about self-esteem. States are purposive actors, and they may become dissatisfied with the dynamics of the international system for substantive reasons that are independent of self-esteem.<sup>67</sup>

This becomes clear if we think about how self-esteem relates to the question of honor and glory. From the social-psychological perspective, self-esteem, honor, and glory can all be reduced to the psychological question of feeling good about the self. However, it is worthwhile to recall the insights of Thomas Hobbes, who made a distinction between honor, which "is an argument and signe of Power ...[and] consisteth onely in the opinion of Power," and vain-glory, which, "consisteth in the feigning or supposing of abilities in our selves, which we know are not, is most incident to young men, and nourished by the Histories, or Fictions of Gallant Persons;

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65 Hopf, , *Social Construction of International Politics*, 300.

66 It is unclear how this might work in the context of a state-centered explanation. The implication is that, as we add the state as an actor to the analysis, the individuals who make up the state come to feel low self-esteem that they would not have felt otherwise. Presumably, something about the state or its institutions works as follows: if international event A, civil servant X feels low self-esteem.

67 For example, we can say that Israel resists Iran's entry into the "nuclear club" because the self-esteem it draws from being the only member in the Middle East would suffer. Although this is probably true, the exclusive focus on self-esteem diverts our analysis away from a more important problem: Iran's becoming a nuclear power is first and foremost a problem for Israel because of the perceived threat to its existence and its strategic dominance in the region.

and is corrected oftentimes by Age, and Employment,” and is more closely related to self-esteem.<sup>68</sup> Thus, honor is not simply a question of feelings, but also one of recognition of power, agency, and substantive purpose by others. To the extent that states deploy power to realize their purpose, an exclusive focus on self-esteem risks missing conflicts in international politics that are significant and concern not just feelings, but real commitments to substantive goals.

Finally, the work that comes closest to the perspective adopted here is the study of post-war Japan and Germany by Thomas Berger, in which he acknowledged that during moments of great upheaval, societal beliefs become articulated into state structures, which later take on a logic of their own.<sup>69</sup> This suggests something akin to a state identity. However, unlike in this dissertation, Berger did not theorize the creation of a state identity, most likely because in the cases he examined the questions of state identity, genesis, and sovereignty were greatly affected by external factors (such as World War II and the subsequent US military occupations and political interventions in domestic politics).

*Current research on identity: where's the state?*

Within the constructivist tradition, scholarly interest in identity has grown considerably. In a Harvard Identity Project study of eight leading journals in IR from 1990 to 2002, Michael Horowitz found that 6.3 percent of the articles surveyed were on identity, but that the “number of articles skyrocketed throughout the study period, with the most enormous jump occurring around 1995.”<sup>70</sup>

Another important indicator of the vibrancy of this research program is that scholarship has turned to meta-theory to bring together the different strands of research on identity. In *Measuring Identity: A Guide for Social Scientists*, Abdelal et al. argue that,

The intense interest in scholarship on identity, as well as the many kinds of studies this fascination has spawned, has unfortunately undermined the conceptual clarity of identity as a variable....The progress of scholarly work on social identities depends on further developing an analytic framework that allows for comparison and differentiation among the many kinds of identities.....an analytic framework that is broad enough to serve the majority of scholars working on identity yet narrow enough not to include social phenomena that are distinct from, though related to, identity....that will enable scholars to compare types of identity...allow for nuanced operationalization of the theoretical sophistication of identity scholarship; and promote coordination across identity scholarship while providing a conceptualization that is flexible enough to allow researchers to tailor it to their own needs.<sup>71</sup>

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68 Thomas Hobbes, *Leviathan* (Oxford: Clarendon Press, 1909), Chapters X and VI.

69 Thomas Berger, “Norms, Identity, and National Security in Germany and Japan,” in *The Culture of National Security*, ed. Katzenstein et al.

70 Michael Horowitz, “Research Report on the Use of Identity Concepts in International Relations,” Harvard Identity Project, July 2002, 3. A similar, later study by Bruland and Horowitz found that identity research had become even more prominent in Comparative Politics, contributing 13.4% of the total articles surveyed. They also argued that the “study of identity in comparative politics is quite well developed... [and] there is evidence of an increasing trend in the number of articles explicitly dealing with identity concepts” in the subfield. Peter Bruland and Michael Horowitz, “Research Report on the Use of Identity Concepts in Comparative Politics,” Harvard Identity Project, April 2003, 4.

71 Abdelal et al., *Measuring Identity*, 17-18.



One thing that stands out about this volume (and about the identity research community in general) is its capacity to unite scholars from very different methodological orientations – most notably behaviorists and interpretivists – and varying substantive interests – International Relations, Comparative Politics, and American Politics. The ability to reach out to different fields and include a variety of different approaches is perhaps the most important marker of a successful research program.

At the same time, there are a number of areas in the identities literature that require more research. First, identity as an outcome has received much less attention than the question of how identity affects other phenomena.<sup>72</sup> Second, although there has been a growing interest in identity in political science in general and IR in particular, oddly, the question of state identity has received very little attention. Abdelal et al. listed the following identity types to demonstrate the vast range of identity research: “ethnic, national, linguistic, religious, gender, class, and other identities.”<sup>73</sup> When discussing the identities researchers will be able to compare with a single unified framework, they included: “ethnic, national, religious, gender, class, etc.” Although there are many references to state identities in the literature, there has been surprisingly little explicit theoretical treatment of state identity.

In his review of the IR identity literature, Horowitz presented a pie chart showing 15 types of identities. The categories include “civic,” “collective,” “social,” “group,” “immigration,” “miscellaneous,” “all,” and “others,” but not state identity. As we saw in our review of the constructivist literature on norms and domestic sources of state behavior, state identity is not always the subject of analysis. The absence of explicit research concerning the identity of the state is striking.

At the same time, references to state identities, both in and beyond academia, are common place. For example, the notion of a “status quo” or “revisionist” state is foundational to IR theory.<sup>74</sup> In 1862, Ferdinand Lassalle gave us the “night-watchman” state, and more recently, Peter Evans introduced the “midwife,” “demiurge,” and “custodian” states.<sup>75</sup> International law recognizes state “personality.”<sup>76</sup> In everyday language it is not unusual to discuss the “beliefs” or “reputations” of states. All of these anthropomorphic usages suggest a state that is an *actor* with an identity, and yet IR constructivist theory has not really engaged theoretically with this question. The question of how state identities emerge and change is a rich area for research to which this project aims to contribute.

My conception of state identity fits neatly with the two-dimensional framework of Abdelal et al. In particular, state identities have substantive contents (such as purpose and cognitive maps), and they are also contested via debates about the legitimacy of state power in a particular area. At the same time, my study of state identity advances this research program because it enhances our understanding of a key identity that has received relatively little attention: state identity. In particular, I look at the sources of state identity, how they change,

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72 Horowitz, “Research Report on the Use of Identity Concepts in International Relations,” 3.

73 Abdelal et al., *Measuring Identity*.

74 Gilpin, *War and Change*.

75 Peter B. Evans, *Embedded Autonomy, States and Industrial Transformation* (Princeton, NJ: Princeton University Press, 1995).

76 Wendt, *Social Theory of International Politics*, 195.

and the micro-level relationships between state identity, elite beliefs, domestic politics, foreign policy making, and international political outcomes.

### **Why identity? Why state identity?**

Strictly speaking, corporate identity and role identity (and thus state identity overall) are not causal variables. The actual causes of foreign policy are related to ideas about the state, their legitimacy or lack thereof, and the relationships, choices, and behaviors that these produced. To deepen this insight, we have to examine the relationship between the two ideas we are focusing on – state-society relations (corporate identity) and state relations with other states (role identity) – and foreign policy outcomes separately.

Ideas about state-society relations motivated particular state-building projects, constituted identities among societal actors, and shaped domestic political dynamics. These ideas enabled (and precluded) particular identities, choices, and behaviors, which generated the structures of domestic politics. Which corporate identity emerged (level of sovereignty) depended on these factors; corporate identity and state sovereignty were outcomes of these ideas. At the same time, domestic politics was the context within which foreign policy was made. Therefore, the effects of ideas about state-society relations on foreign policy were *indirect* in that the causal factors lay in how they affected domestic politics. But the relationship between corporate identity (level of sovereignty) and foreign policy outcomes is not causal. Both are effects of the legitimacy of ideas about state-society relations.

Ideas about the state's relationship to other states formed the basis of the state's role conception and thus constituted the role identity. These ideas (the role conception) were a background factor that either enabled or constrained certain policy choices, both substantive and tactical. They supported certain choices by providing background information about both a state's international power (the perception of what Russia could and could not get away with) and what substantive goals could and could not be raised during interaction with other states (to be consistent with the signal that Russia was sending). Thus, ideas about the state's relationship to other states had a more *direct* impact on foreign policy in that they did not operate through effects on the structures of domestic politics (as did ideas about state-society relations). However, state role identity did not cause foreign policy. Both foreign policy and state role identity were produced by ideas about the state's relationship to other states.

If it is not a causal variable, why use state identity? This is really two questions: Why identity? And why state identity and not just the identities of societal actors? The former question is raised by positivists. The latter is relevant for constructivists working in the identity research program.

Even though it is not causal, identity is useful as a method for investigating subjective beliefs that produce important relationships, choices, and outcomes. This is consistent with the Abdelal<sup>77</sup> framework, which posits identity as being composed of two dimensions: subjective beliefs and contestation over those beliefs. In short, identity allows us to focus on beliefs and the politics that different beliefs produce. Although most political scientists will agree that beliefs are important, we do not have a robust methodology for *empirically* investigating beliefs and the

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77 Abdelal et al., *Measuring Identity*.

politics that they produce. In this respect, identity as a methodology is an important empiricist (or scientific realist) response to the positivist position that we cannot know beliefs, that they should not be the subject of research, and that instead we should ground our study of politics in assumptions about interests/preferences, the validity of which lie in their ability to generate accurate predictions. Abdelal et al. justify their work in the sense that it brings together a broad variety of research on identity. This is valuable to constructivists already interested in identity. However, they do not speak to positivists, who are skeptical of the utility of research on identity and beliefs in general. Overall, identity is useful as a methodological platform for empirically studying beliefs and the politics they produce as an alternative to methods grounded in the positivist tradition.

But why *state* identity? This question is of interest to scholars who do not question the value of studying identity, but would point out that much of the analytical focus so far has been on societal actors (beliefs, identities, choices, behaviors). The reason this is a question of state identities is that the ideas in question are about the state and its sovereignty. The societal beliefs, identities, choices, and behaviors cannot be understood without reference to the state. Moreover, these ideas and their contestation have a fundamental significance for the structures of domestic politics that other ideas do not. In shaping the structures of domestic politics, these ideas and their contestation constitute different types of state actors that are associated with different behaviors. In short, without denying the importance of societal actors, state identity allows us to focus on a special type of politics associated with a particular substantive question and contest – what kind of state is legitimate – which structures domestic politics in fundamental ways and thus shapes what type of state emerges and the kinds of international behavior we can expect from it. This perspective is consistent with the general identity framework proposed by Abdelal et al.; however, it expands it to include a particular identity that they have missed – state identity – which is associated with an important kind of domestic politics and important international phenomena.

### **Contemporary literature on mercantilism in political science**

In this section, I provide an overview of how mercantilism is used in contemporary political science with the goal of demonstrating that it has come to mean very different things to different authors. This supports the claim that my conceptualization is an advancement that subsumes all of these disparate elements but in a clear and more parsimonious way. Specifically, while establishing the essential core of mercantilism — a state with high sovereignty that sees itself as a regime maker – the identity perspective allows us to assign an analytically proximate place to purpose and means that are historical expressions of the identity and should be considered, but need not be included in the core. Moreover, my conceptualization helps us understand how the structures of the international economy change.

There are four main strands of thought on mercantilism in contemporary political science: rational choice, institutionalist, world systems theory, and structural functionalism. The most significant example of the rational choice literature is *Mercantilism as a Rent-seeking Society: Economic Regulation in Historical Perspective* by Robert B. Ekelund, Jr., and Robert D. Tollison. This work appeared in 1981 and was self-consciously shaped by developments in public choice and economic regulation theory and also the emergence of the literature on the new

institutional economics.<sup>78</sup> It positioned itself as an “improvement or alteration”<sup>79</sup> of the classic work by Heckscher,<sup>80</sup> and the primary critique was that the latter did not pay sufficient attention to the domestic political process.<sup>81</sup> Ekelund, Jr., et al. noted that, “One of Smith’s principal themes... was that mercantilism was equivalent to the demand for regulation and rents by merchants and manufacturers... Smith attributes mercantile restrictions of all kinds – colonization, restrictions designed for specie accumulation, and so forth – to the self-seeking interests of merchants.”<sup>82</sup> Consequently, the “interpretation”<sup>83</sup> that they proposed reduced the essence of mercantilism to, “the supply of and demand for monopoly rights through the machinery of the state.”<sup>84</sup>

This perspective included social purpose and the process of domestic politics in the core of the definition. Most notably, the state is entirely captured by domestic actors. In addition, this approach is not very helpful for understanding the role of state power in the international economy or how the structures of the international economy change. Interestingly, because they promoted laissez faire policies, neither the United Kingdom in the 19<sup>th</sup> century, nor the United States after the end of the Cold War qualify as mercantilist even though very clearly they were exercising great state power to shape the structure of the international economy.

The institutional approach is represented best by the work of T. J. Pempel, *Regime Shift: Comparative Dynamics of the Japanese Political Economy*.<sup>85</sup> In this work, Pempel did not define mercantilism, but his usage suggests that it is a set of economic policies that ameliorated Japan’s position in the international economy. In describing Japan’s political economy and economic success, he wrote, “[a] high level of mercantilism limited foreign direct investment, as well as the import of most manufactured products and consumer goods. At the same time, Japan produced a great number of internationally competitive exports.”<sup>86</sup>

In the same work, he coined the term “embedded mercantilism” to denote a public policy paradigm he defined as a set of policy practices that composed one part of a regime type and consisted of policy outputs that are the product of politics but can also change politics.<sup>87</sup> Mercantilism was embedded because it was the product of “institutional arrangements and coalition alliances guaranteeing systemic and semipermanent rewards.”<sup>88</sup>

For Pempel, the state was a set of institutions and a vehicle for policy outputs that came from the preferences of social coalitions. It did not have its own identity or interests separate from society. Thus, the core of mercantilism included means and purpose but only a limited vision of the state. Second, the international system was discussed, but — probably because he

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78 Robert B. Ekelund, Jr., and Robert D. Tollison, *Mercantilism as a Rent-seeking Society: Economic Regulation in Historical Perspective* (Texas A&M University Press, 1981), 5.

79 Ibid.

80 Eli F. Heckscher, *Mercantilism* (London: Allen & Unwin, 1955).

81 Ekelund, 5.

82 Ibid., 9.

83 Ibid., 5.

84 Ibid.

85 T. J. Pempel, *Regime Shift: Comparative Dynamics of the Japanese Political Economy* (Ithaca, NY: Cornell University Press, 1998).

86 Ibid., 14.

87 Ibid., 26-27.

88 Ibid., 27.

is studying Japan — international politics, the sources of rules, and power were relegated to the background. The international system was basically a market that can be taken advantage of through well-designed policy interventions.

Mercantilism also appeared in the title of Immanuel Wallerstein's work, *The Modern World-system II: Mercantilism and the Consolidation of the European World-Economy*.<sup>89</sup> The father of world systems theory, Wallerstein did not precisely define mercantilism, nor was he interested in "definitions that constitute its 'essence.'"<sup>90</sup> He noted that it was a period in history, involved economic policy interventions of a nationalist cast by the state, and was concerned with the international movement of commodities. Later, he revealed that mercantilist policies were aimed in the *middle-run* (italics in original) to increase the efficiency of production. Interestingly, he claimed cryptically that, "to argue that economic nationalism is the state policy of the weaker against the stronger and of competitors against each other is merely to accept an orthodoxy."<sup>91</sup>

For Wallerstein, the international economy was characterized by competition for economic efficiency. He did not discuss rules or where they came from, although they were implicit in his focus on free trade, and they appeared to favor the states that produced them. Ideas were represented primarily as "ideological justifications."<sup>92</sup> The state was not examined as an autonomous actor; it expressed the logic of the world capitalist system. The core of mercantilism (insofar as one can be said to exist in his work) is a mechanical state that attempts to fulfill the objective imperatives of a competitive international economy, one of which is the pursuit of greater economic efficiency. Thus it includes purpose but not means. Mercantilism understood in this way is not very helpful for understanding how the international economy changes over time.

Finally, the structural functionalist approach, which generated some of my hypotheses earlier, is best embodied by the work of the prominent IR scholars Robert Gilpin<sup>93</sup> and Stephen Krasner.<sup>94</sup> From this point of view, mercantilism consisted of states' concern for power in a competitive world. Following Viner, Gilpin argued that wealth could be pursued to the extent that nationalists consider wealth and power as being complementary.<sup>95</sup> Although mercantilism in these works was treated as a general concept, there was ambiguity about what it meant specifically. For Gilpin, it is alternatively a changing label that was synonymous with economic nationalism or protectionism; a general commitment to state building; a set of themes or attitudes rather than a coherent and systematic body of economic or political theory; a commitment to the "primacy of the state, of national security, and military power in the organization and functioning of the international system"; the conduct of economic warfare; commitment to the primacy of domestic welfare, the welfare state, or "policy competitiveness"; and finally, attempts to "change

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89 Immanuel M. Wallerstein, *The Modern World-system II: Mercantilism and the Consolidation of the European World-economy* (Academic Press, 1980).

90 Ibid., 37.

91 Ibid.

92 Ibid.

93 Gilpin, *War and Change*.

94 Stephen Krasner, "State Power and the Structure of International Trade," *Defending the National Interest: Raw Materials Investments and U.S. Foreign Policy* (Princeton, NJ: Princeton University Press, 1978), 38.

95 Robert Gilpin, *The Political Economy of International Relations* (Princeton, NJ: Princeton University Press, 1987), 32.

the rules or regimes governing international economic relations in order to benefit themselves disproportionately with respect to other powers.”<sup>96</sup>

Thus, the core in this approach did include states making economic regimes in a competitive international system, but otherwise the definition was muddled. This was because it attempted to include both social purpose and means in the essence of the phenomenon, whereas my definition relegates them to particular historical expressions that are important but remain outside the core. Because of the focus on regime making, the structural functionalist definition is closest to the one I propose here. However, my innovation is two-fold: by introducing the identity perspective, I am able to separate the core (high sovereignty and a regime maker role conception) from the chaff (purpose and means) while keeping the latter both open-ended and analytically proximate.

Second, the identity perspective proposes an alternative mechanism for change. Like Wallerstein, structural functionalists focused on economic and technology related factors as the source of power behind mercantilism. The identity perspective leaves the question of the source of power outside the core, thereby suggesting that this too can vary historically. Moreover, although technology and economics can be a source of power, they are only two sources among many. Ultimately, the source of power also varies historically, and the constructivist intuition is that it is subjective rather than objective, something that I aim to demonstrate in this work.

## **Measurement**

### *Ideological line*

To measure the ideological line, I look at the public articulation of two ideas by leaders: the legitimate role of the state with respect to the economy (and society more generally) and the legitimate role of the state with respect to other states. I focus on early public statements by Yeltsin and Putin since their articulation of the ideological line, I argue, transformed Russian politics and state identity.

The key data are Yeltsin’s first speech to the Congress of People’s Deputies in late October 1991 and Putin’s address to the Federal Assembly in June 2000. I do not systematically present these data over time. Although their statements have obviously varied, the core ideas in which I am interested did not change over time for these two leaders. I make this assessment based on my examination of their subsequent public statements, as well as interviews with participants in and close observers of Russian politics. This claim is also consistent with the findings of the secondary academic literature on Russia.

### *State role identity*

State role identity is the institutionalization of the role conception (state’s relationship to other states) that is articulated in the ideological line. To measure the role identity, I look at elite discourses to see how elites saw the relationship of Russia to other states in terms of ECH regime development. I also look to see whether that discourse was institutionalized into the state.

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<sup>96</sup> Ibid., 31.

Evidence of institutionalization comes from statements that state officials behave a particular way due to the imperatives of their official role and not because of personal preferences. Additional evidence comes from repeated discourses articulating the same role conception from different individuals over time in different settings.

The data come from several sources. First, I look at key texts related to the ECH process: the works of former Deputy Minister of Energy Andrei Konoplyanik, who has been a central figure in Russian ECH policy since the beginning of the process; the transcripts related to the seminar held in 1997 in advance of the first ratification hearings (for which the transcript is not available publicly); the transcripts related to the ratification hearings in 2001; and archival records documenting the ECH process. Additionally, I present evidence from public statements by both participants and observers of the ECH process. Finally, I use data from interviews with participants in and observers of ECH policy making in Moscow.

*State corporate identity: state-society relations and sovereignty*

To measure state corporate identity, we need to ascertain the relationship between the state and elites in society. If relations are hierarchical, corporate identity is characterized by high sovereignty. If relations are heterarchical, corporate identity is characterized by low sovereignty.

To measure whether a hierarchical or heterarchical relationship exists between the state and societal elites, I used several strategies. One strategy is direct: to look at discourses and behavior to see how societal actors relate to the state (their identity with respect to the state). The sources of data are newspaper accounts, secondary literature, and interviews.

In particular, I am interested in what discourse and behavior reveal about the identities of societal elites. Do they identify as servants of the state or masters in their own right? The oligarch Mikhail Khodorkovsky yelled at Minister German Gref that he would have him sacked over a disagreement on tax policy (chapter 6); the oligarch Boris Berezovsky publicly announced after Yeltsin's 1996 victory that since the oligarchs paid for his re-election, they had "the right to occupy government posts"<sup>97</sup>; and the CEO of the gas monopoly Gazprom, Rem Vakhirev, mobilized the Duma to thwart government attempts to reduce his autonomy: these are strong indicators that elites have a master identity and heterarchical relations to the state. Likewise, when the scholar William Tompson wrote that private business in Putin's Russia was a servant of the state; or when Putin publicly scolded the business magnate Oleg Deripaska and threw a pen at him; or one interview subject remarked that under Putin a "hierarchy of interests" had been created between private business and the state — these are strong indications of servant identity in society and hierarchical relations between the state and societal actors.<sup>98</sup>

A second strategy is to look at public opinion surveys related to the state in areas that concern this study (economics and energy). In chapter 6 we look at survey results for the general population over time and for elites at a critical moment: right before Putin began consolidating state authority. Results showing that public opinion supports state ownership of enterprise or expresses a belief in the efficacy of the state in solving problems in the energy sector suggest that the state enjoys legitimate authority. Legitimate state authority is an important factor that

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97 Andrei Piontkovsky, "Reformer or Oligarch?" *The Moscow Times*, March 11, 1997.

98 Interview in Moscow, Spring 2009.

supports the emergence of hierarchical rather than heterarchical relations between state and society. On this basis, we might deduce that hierarchical relations might emerge in the relevant sphere.

A third strategy is to look at state-society relations behaviorally in an area that is similar to but also independent of what I am trying to explain (Russian ECH policy). I have chosen to look at relations in the area of tax collection. This is a good indicator of state-society relations because taxes are extremely important to the state and yet they are very difficult to collect, especially from elites. For this reason, if a hierarchy of relations exists in the area of tax collection, this is a good indication of hierarchical relations in other areas that are important to both the state and societal elites. From this perspective, tax collection is closely related to ECH policy since both energy policy and taxes are very important to the state. However, since large amounts of money are at stake, the state may encounter serious resistance in both areas from societal elites. Therefore, understanding state-society relations in taxes is a reasonable substitute for measuring state-society relations in energy policy in the sense that they present similar levels of importance to the state and resistance from societal elites. In other words, the strategic context is comparable in both policy areas. The advantage of these data is that they are independent of all the outcomes I am trying to explain.

Finally, I also look at the relationship between the state and Gazprom, which was a key actor in the ECH process. Understanding the identity of this corporate actor (whether as a fiefdom of its masters or a national champion) illuminates the type of relations that existed between the state and the firm and thus the level of state sovereignty at the heart of the ECH process. Specifically, I look at tax and structural reform policy. I also look at leaders' state building with respect to the firm that shaped the level of firm autonomy from the state and influenced state sovereignty with respect to the company. This is the most direct indicator of state sovereignty in the ECH sphere. The data sources are media accounts and interview statements concerning state-firm relations.

### **Data sources and collection**

I have collected data on Russian state domestic sovereignty, its conception of its role in international relations, and Energy Charter outcomes. The data come from public primary sources, secondary texts, and interviews.

I have collected primary texts from a broad variety of sources:

- Archival documents related to negotiations on the Energy Charter political declaration and ECT (*travaux préparatoires*) located at the Energy Charter Secretariat in Brussels
- Archival documents related to subsequent negotiations located in the private collections of various participants
- Word searches in the Factiva electronic database, which has all of the major newspapers, wire services, and some magazines (1991-2010)
- Texts (articles and books) written by decision makers and participants
- Texts (articles and books) received from or recommended by interviewees
- Energy strategy documents and commentaries



- Trade magazines (from the Russian state Lenin library and the Russian state public library for science and technology):
  - neftegazoviy vertikal (1992-2008)
  - neft i kapital (1996-2000, 2002-8)
  - neft gaz i biznes (2000-5)
  - neftyanoe khozaistvo (2003-4)
  - gazovaya promishlenost' (1987-2008)
  - gazovaya promishlenost'. Series: ekonomika, organizatsiya, I upravleniye proisvodstvom v gazovoi promishlenosti (as available).
  - ekonomika i upravlenie neftegazovoi otrasli (as available).
- Ministry of Foreign Affairs anthology of official documents (1994-8)

Secondary texts were chosen from the American and European academic literature on Russian politics and energy policy. Interviews were conducted with more than 60 Russian elite participants in and observers of the Energy Charter process. By elite I mean academics, business people from different energy companies (both Russian and foreign), foreign diplomats working on Russian energy, Russian public officials, and consultants or advisers to public officials. Public officials and especially contemporary public officials are underrepresented because of low response rates.

The interview subjects were identified using two strategies. First, I identified potential respondents by examining public statements on Energy Charter policy made between 1990 and 2010. These statements were gathered through electronic queries of the Factiva database, which includes the major Russian and English wire agencies, newspapers, and some magazines. Second, I used “snowball” sampling – personal references and introductions from respondents I met – to identify other potential respondents. These two sampling strategies ensured that my interview subjects constituted as broad and representative a sample as possible. Additionally, I have tried to meet with subjects from different organizations, demographic categories, and ideological groups. If subjects from a particular organization, demographic category, or ideological group could not be interviewed, I relied on public sources that reflected the views of the missing group.

Interviews included mostly face-to-face meetings but also some telephone conversations. They were open ended, semi-structured, and generally lasted between 60 and 90 minutes. Several respondents agreed to follow-up interviews. Most of my respondents asked to remain anonymous.

## Relevant empirical domain and case selection

The empirical domain of interest for this framework is international systems in which the norm of legal sovereignty — whereby states acknowledge other states' right to exist — prevails.<sup>99</sup> The most relevant sets of cases are non-colonial states after World War II, when we can tentatively speak of the legal sovereignty norm emerging in the state system.<sup>100</sup> The above typology should help us understand state identities in the international system after World War II.

This study focuses on the contemporary state of Russia. It explores Russian state identities and Energy Charter policies. I divide the history of the new Russia into three periods. The first was the period under former President Yeltsin (1991 to 1999). The second was the period when former President Putin was the head of state (2000 to 2008). The third period begins when the current leader, President Medvedev, came to power in 2008 and continues until 2010.

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99 Wendt calls this a Lockean world; the prevalence of the legal sovereignty norm means states do not fundamentally question the right of other states to exist. This means that although states will continue to compete and go to war, these are wars of distribution and not constitution. The sovereignty norm means that, even during a war, it is not the existence of states that is fundamentally in question. Wendt characterizes the relationship between states in this setting as one of competition rather than enmity. An example is the first Gulf War. The United States invaded Iraq, but then did not go to Baghdad to finish off Saddam Hussein or stay and occupy Iraq. It was concerned with the more limited distributional goal of who controlled how much oil in the Persian Gulf and the related question of what the balance of power would be in the Middle East.

This kind of relationship — where states acknowledge other states' right to exist — is not possible in a Hobbesian world, where the main concern is not distributional but existential. Because states are so concerned with their survival, every other state is viewed as a means toward one end: accumulating power to survive. In this world, we can expect all states to believe themselves to be regime makers; the dangers of Hobbesian anarchy simply do not create space for it to be otherwise. States that are regime takers become so not because they see themselves as such, but because the logic of survival compels them to accept the regimes of others (balance or bandwagon). Furthermore, we do not expect to see many states with low sovereignty. The perilous character of the international system implies that such states will not survive; they are simply not fit for this kind of environment, whereas they are sufficiently fit to survive in a Lockean system.

100 World War II is a turning point because in the West the United States did not punish the states it defeated, but rather rehabilitated them and gave them close to full sovereignty. As a result, states learned that they did not have to always have full sovereignty or aspire to regime making in the international system to survive. The East is more complicated: on one hand, the USSR annexed the three Baltic states and Western Ukraine; clearly this is the logic of a Hobbesian world. But although we cannot say that it respected the full sovereignty of the Eastern European states, it did respect their legal sovereignty; it did not deny their right to exist in a nominal sense (on a map, at the UN, etc.). This is why it makes sense to call them satellite states: they were their own actors, but they were not fully independent. Precisely because we are concerned with the question of legal sovereignty, the 20th-century communist bloc in Eastern Europe meets our test of a Lockean world.

An alternative interpretation is that the East European communist states were really colonies and that this zone ultimately had a Hobbesian logic, at least from the perspective of the people who lived there at the time. There is much truth to this claim. I believe the actual truth is somewhere in the space between colony and legal sovereignty. However, because my goal here is to delimit the empirical realm where my theory is applicable, and because I want to include more rather than fewer cases, I am prepared to grant that Eastern Europe was also part of the Lockean international system after World War II. However, I acknowledge that this choice is not uncontroversial from both an empirical and normative perspective.

The choice of Russian Energy Charter policies is motivated by methodological, theoretical, and practical reasons. Methodologically, they are interesting because they present us with policy behavior that has varied considerably over time. By tracking these changes and examining policy debates and decision making, I can use comparative analysis (over time) and process tracing to adjudicate between my explanation and other explanatory factors. In this sense, Russia is a critical case for adjudicating between rationalism and constructivism.<sup>101</sup>

Moreover, because I look at Russian foreign energy policy, these are “hard cases” for constructivism because we expect rationalist explanations to work best in the economic realm in general, and particularly in the energy sphere, given the strategic importance (both for security and financial reasons) of energy resources to states.

Theoretically, the Russian cases are interesting because Russia is a major player in this crucial part of the international political economy (energy). Russia’s changed understandings, interests, and policies point to an important potential transformation in the architecture of the international system. This is an opportunity to theorize not just how structure affects states but also how international structures are transformed. This is precisely what is missing from Wendt’s approach<sup>102</sup> and systemic theories in general.

Finally, the case of Russian ECH policy is practically important because they point to the relationship between Russia and the EU in a crucial area of the international system. As the Cold War came to an end, energy was envisioned as a vehicle for integrating Russia into the international economy and community. It was believed that the economic complementarities that energy presented would lead to economic and political cooperation and ultimately prevent the re-emergence of a hostile Russia and a divided Europe. The institutional form that this project took was the Energy Charter regime. Ironically, energy and the Energy Charter regime have become an important source of conflict between Europe and Russia. The two Ukrainian gas wars and Russia’s non-ratification of the ECH are only the tip of the iceberg. To promote the practical goal of international cooperation, it behooves us to understand how and why such optimism has given way to acrimony and skepticism. This project seeks to answer this question by looking at what happened on the Russian side and the interaction between Russia and the EU; the domestic politics of the EU are not considered. The argument is that Russia has experienced a shift in state identity due to changing elite beliefs about the legitimacy of state power.

In addition, I include two shadow case studies of Soviet and Norwegian ECH policy. The USSR collapsed very early in the ECH process; therefore, it is not possible to fully test my explanation on this case. Not enough time elapsed to produce all the outcomes of interest, but one important outcome – agenda positioning — is available from initial Soviet policy. Since the structural situations of the USSR and Russia in 1991 were very similar, the Soviet case is useful to control for explanations related to structural factors.

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101 Ian Alistair Johnston has argued that since structural realism and cultural realism make similar predictions in his case, a critical test would “look for periods...in which, controlling for structural change, one can identify fluctuations in the strategic culture.” Ian Alastair Johnston, “Cultural Realism and Strategy in Maoist China,” in *The Culture of National Security*, 257. However, adjudication is also possible even if one variable(s) is not always constant. It is still possible to compare the respective patterns of change across the dependent and independent variables. This is the strategy I pursue here.

102 Wendt allows for the possibility of structural transformation due to unit factors; however, this is not his primary interest.

I have only researched Norwegian policy during 1991 through 1994, when the regime was being created. Although both Russia and Norway are exporters, the structures of their energy industry are different. In this respect, Norway is not as good a control as the USSR; the structural situations of Russia and Norway are different in important ways. However, the Norwegian case is useful to bring into relief the neo-liberal character of Russian ECH policy during the formative period of the regime.

Finally, this study should be seen as a plausibility probe aiming to determine whether a new, untested theory merits further investigation in an expanded number of cases.

### CHAPTER THREE: NEO-LIBERAL STATE BUILDING – IMAGES OF THE STATE AND THE ORIGINS OF RUSSIAN ECH POLICY (1990 TO 1991)

Boris Yeltsin's impressions about his early 1992 trip to the United States

[T]ravel enables you to learn much about yourself and others.

At Camp David...Cheney called to Mr. Baker, "Jimmy, pour me a juice, will you please." "Jimmy" poured some for himself and Mr. Cheney, in an absolutely relaxed and natural way, without any affectation or airs....

I thought to myself at the time: why are Americans like this? I realized it was because they are absolutely independent people – even from the president himself – and *therefore they could work for the sake of ideas, for the sake of a cause.*

We are still too dependent on one another, on power...Ridding ourselves of this dependency is an uphill battle.<sup>103</sup> (emphasis added)

#### Overview

This chapter examines the process through which the ECH regime was created to understand why it developed along neo-liberal lines. Because of the contrasting preferences across various national states within the European Economic Community<sup>104</sup> and the European Commission (EC), the Europeans did not have a single approach to the design of the agreement. Moreover, when the opening round of negotiations brought in additional states, these included potential supporters for both visions, which amplified the uncertainty concerning what the agreement would look like.

The opening European Energy Charter Conference in July 1991 revealed that the constellation of bargaining positions was more or less balanced. The neo-liberal perspective brought together the United Kingdom, United States, and EC, while Norway, many European national states (especially the Netherlands, Germany, Italy, and France), and the USSR preferred a more prominent role for the state in economic activity. At the start of negotiations, the ultimate form that the regime would take had not yet been determined and still depended on how negotiations would proceed. In particular, whether the agreement would evolve in a neo-liberal or more state-oriented direction was contingent on a dominant coalition of states lining up in support of one vision.

When the conference opened, despite the universal interest in cooperation, the conflicts inherent in reconciling the two different visions came to the fore immediately. This was reflected in the debate concerning how to reconcile the need for binding legal guarantees to private market actors with the need for states to pursue policy objectives through protocol agreements. This tension was also revealed in the debate over how energy projects would be

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103 Boris Yeltsin, *The Struggle for Russia*, trans. Catherine A. Fitzpatrick (New York: Random House, 1994), 123-4.

104 Henceforth, I will refer to this group of states as the Europeans.

financed. At the heart of all these issues was the question of the state's legitimate economic role in the energy sphere.

Despite the fact that the Soviet economy was in the throes of a severe crisis, the USSR delegation submitted a counter-proposal that called for a significant state role. Believing that the state had an important role to play in the energy sector, the Soviets foresaw that state policy – to be implemented through sector-specific protocols – would be central to the design of the agreement, so negotiations would have to proceed along a “broad front.” This conflicted with the neo-liberal vision, which recommended creating a loose legal framework that protected the interests of firms and limited states' ability to intervene in the energy economy.

With respect to financing, the Soviets identified a number of concrete projects in which private firms and banks in coordination with states could invest. This particular vision of state, firm, and bank cooperation was given the term “financial mechanisms.” The underlying idea was that states would play an active role in mobilizing and allocating financing. This contrasted with the neo-liberal approach, which saw the states creating a favorable environment protected by law within which firms would make investment decisions autonomously.

The Soviet Union's role identity, influenced by the idea of being a superpower, was that of a regime maker. At the same time, the Soviet state's corporate identity was already characterized by low sovereignty (by 1991, relations of authority between the Kremlin and the Union republics were characterized by heterarchy). The USSR had the state identity of pretender.

Before the next set of meetings in September, dramatic political events transpired in the USSR: the August putsch. After the coup, Moscow adopted a radically different approach to the ECH. Whereas the pre-coup proposal envisioned a prominent role for the state in the energy business, Moscow now preferred the neo-liberal idea of a minimal state role and emphasized the primacy of private actors on energy markets. This had two immediate consequences. First, the idea of creating financial mechanisms was dropped as the new Russian government did not foresee a direct state role in mobilizing or allocating financing. Instead, government representatives communicated their interest in creating a “favorable investment climate” for private actors through legal guarantees. Moscow's new market orientation meant the momentum at the conference was channeled toward negotiating a legal treaty rather than separate protocols. Therefore, instead of proceeding along a broad front, the locus of activity moved to working group two (WG II),<sup>105</sup> and the main document over which this group was negotiating, formerly “Basic Protocol,” was renamed the “Basic Agreement.” This reflected the fact that private market actors, which demanded formal legal guarantees, now took on a more legitimate role than states, the policy goals of which were supposed to be achieved through protocols.

Why did Moscow's ECH policy change? The unsuccessful coup transformed the political landscape in the USSR, leaving Gorbachev badly weakened, conservative elements demoralized, and RSFSR President Yeltsin the most powerful figure in the country. After the

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105 The initial conference created five working groups for subsequent negotiations. Working group one (WG I) negotiated the initial political declaration signed in December 1991. Working group two (WG II) negotiated the text of the Basic Protocol, later renamed the Basic Agreement, which would become the Energy Charter Treaty signed in December 1994. Working group three (WG III) negotiated issues related to energy efficiency, leading to a protocol also signed in December 1994. The two remaining working groups – on hydrocarbons and nuclear materials and safety – were later abandoned.

coup, Yeltsin quickly moved to take control over the state and policy making. With a new government in power, some adjustment to foreign policy was to be expected. However, rather than make incremental changes to the Soviet position and continue bargaining, the new state embraced the radically different neo-liberal approach being promoted by the competing coalition of states (United Kingdom, United States, EC).

I argue that Moscow adopted the neo-liberal approach to the ECH regime due to ideas about the legitimacy of state power that prevailed in the new government. Specifically, after the coup, Yeltsin articulated a new ideological line that broke from the past by rejecting all things Soviet and embracing their Western, neo-liberal opposite. What I call the “rupture narrative” also entailed a particular image of the state. Since the state had been ubiquitous in the Soviet economy, the new ideological line consisted of liberating the economy from state influence as much as possible and essentially crafting the new Russian state in what was perceived as a Western, and particularly American, neo-liberal mold. This vision also informed the new government’s approach to energy policy. In particular, since state action was to be restricted in the energy sphere, the problem of investment risks had to be addressed by creating legal guarantees for firms. Given the new government’s assumptions about the state’s legitimate role in the energy economy, the neo-liberal approach was the only viable solution to the problem of attracting foreign investment. Finally, since the ECH was being negotiated at that time, these beliefs influenced Moscow’s bargaining position.

Under Yeltsin, Russia was explicitly looking for foreign models to build capitalism, so the new state’s role identity was that of a regime taker. At the same time, Yeltsin inherited the pattern of authority that existed under his predecessor – heterarchical relations between the central state and regional actors – and the authority of the state actually deteriorated during his tenure. Overall, Russia’s corporate identity was characterized by low sovereignty. Russia’s state identity was that of an apprentice.

The ECH policy shift in Moscow was significant. From the perspective of the international system and the ECH regime in particular, a new state with a changed agenda replaced a previously central state during a relatively short period of time. Whereas the Soviet Union might have led the coalition of states supportive of a more state-oriented design for the ECH, the policy emanating from Yeltsin’s Russia aligned better with the neo-liberal vision. As a result, the Russian posture no longer coincided with the Norwegians, Germans, Dutch, Italians, and French, but instead accorded with that of the United States, EC, and United Kingdom. The Russian defection disrupted what was previously an evenly distributed balance of power. Overall, the new Russia had a decidedly free market posture, and this essentially precluded any chance of a coalition of states that supported a state-oriented approach to the regime. With only one politically viable approach on the table, the ECH regime took off on a neo-liberal path. Moscow’s defection had pushed the development of the regime in a particular direction.

## **Organization of chapter**

The remainder of this chapter presents empirical evidence to establish and explain the change in ECH policy that occurred after the August coup and demonstrate how this affected the regime. First, I examine the USSR’s approach to international cooperation during the late Soviet period. In contrast to their Russian successors, the Soviets had a distinct vision for the post-Cold War system that included promoting the equal status of socialism and capitalism. This was

captured by Gorbachev's project for a Common European Home. Moreover, despite their difficult economic and political situation, the Soviets defied the emerging Washington consensus and demanded accommodation. This can also be seen in their bargaining position, which reserved an important role for the state in energy cooperation. Despite the terrible weakness of the USSR, the idea that it was a superpower that could shape international regime outcomes was still institutionalized into the Soviet state. The USSR's role identity was a regime maker.

The second section explores the logic of the Soviet socialist market (SCM) approach that underpinned its proposal, focusing particularly on the Soviet view of the state. As demonstrated by the thinking of Leonid Abalkin, a top economist in Gorbachev's last government, the state was meant to protect society from the potentially catastrophic consequences of a free market in energy; in the words of Karl Polanyi, energy was a "fictitious commodity." The state also served the function of protecting workers from exploitation by financial capital.

Third, I examine relations between the Kremlin and the Union republics to establish that the USSR's corporate identity was characterized by low sovereignty. When combined with a role identity of regime maker, this meant the USSR had a pretender state identity.

Fourth, I explore Moscow's changed position in the aftermath of the August coup. The new, post-coup delegation headed by a Russian official embraced a neo-liberal orientation, inspired by the approach of the United States, United Kingdom, and EC, which precluded the kind of state action implied by the SCM approach. The new Russia was a regime taker. This accelerated negotiations by resolving previously controversial questions. Ultimately, it meant that the architecture of the new regime would evolve along a neo-liberal track rather than provide for a significant state role in energy.

Fifth, I examine the new ideological line that emerged in Yeltsin's first government after the coup. This vision included a narrative that rejected the Soviet state, which it portrayed as imperial and oppressive, and embraced what was perceived as its American, neo-liberal opposite. I call this the "rupture" narrative because it called for a dramatic break from the Soviet past.

This image influenced the new government's state-building strategy in general and informed critical early decisions concerning territory and the economy. The new Russia would not reproduce the imperialism of the Soviet state, and the USSR would be disbanded, leaving Russia with a significantly reduced territory. The Russian state, in contrast to the Soviet state, would not be directly involved in the economy. To the contrary, policy was motivated by the aim of radically destatizing the economy and allowing free markets to emerge. Crucially for energy policy, this included placing investment decisions not with central state authorities but with firms. As demonstrated by the thinking of Andrei Konoplyanik, a deputy energy minister in Yeltsin's first government and the Russian father of the ECH, the government believed that the state was not equipped to manage large investments into energy, and so a legal system based on Western norms had to be developed to protect the interests of private investors.<sup>106</sup> As a result, the Russian government preferred a neo-liberal, rather than SCM, approach to the charter.

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106 This thinking appears to have been inspired by Konoplyanik's studies of energy investments in the West while he was at Gosplan and the new institutional economics in Western thought as expressed in the doctoral dissertation of Yegor Gaidar, the architect of Russian shock therapy. E.T. Gaidar, *Ékonomicheskie reformy i ierarkhicheskie struktury (Economic reforms and Hierarchical Structures)*, in *How Russia Became a Market Economy*, Anders Åslund (Washington, DC: Brookings Institution, 1995), 8.



This investigation yields an important theoretical insight concerning the mechanics of state behavior. The conventional wisdom in IR and political science is that incumbents of the state look out objectively at the world – at both international and domestic politics – as they make decisions. This research shows that when confronted with important decisions, leaders can also gaze within and call up beliefs about their own state. This image of their own state then mediates their subjective assessment of domestic and international politics and informs their policy choices.

The final section examines the consequences for the ECH regime by exploring how the Russian shift affected early developments in its evolution. Briefly, the new Russian approach, inspired by the neo-liberal approach, meant that the interests of market actors in receiving legal commitments prevailed over the interests of states in developing energy policy. As a result, the Basic Protocol was renamed the Basic Agreement (eventually the Treaty), which became the focal point of negotiations.

### **The late Soviet approach: regime making under difficult circumstances**

#### *Soviet economic interests in energy cooperation: a win-win economic proposition*

Energy cooperation with the West advanced a number of Soviet economic interests. On the one hand, the USSR wanted to increase its energy trade to boost its foreign currency revenues,<sup>107</sup> which were badly needed for budgetary reasons and particularly to fund critical imports. At the same time, the Soviet energy industry was in chronic need of investment for further development<sup>108</sup> and technology for modernization.<sup>109</sup> Energy cooperation – including trade and investment – with Western Europe was already ongoing. Consequently, Soviet overtures at the time can be understood as a means to deepen cooperation which was considered to be in the interest of the Soviet state.

At a meeting of the Common Market in Dublin on June 25, 1990, former Dutch Prime Minister Ruud Lubbers proposed the creation of a “European Energy Community.”<sup>110</sup> According to Konoplyanik, this proposal, dubbed the Lubbers Plan, touched on a wide variety of “problems that were (and still are) critical to the USSR and Russia.”<sup>111</sup> It aimed to expand trade and put European energy use on a more rational, secure, and ecologically sound footing and also foresaw increased export of capital and transfer of technology from West to East. The proposal also suggested that the integration process would “without doubt, spread to adjacent sectors of the economy and to other branches (the Lubbers Plan names ecology and transport).”<sup>112</sup> Finally,

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107 Vitali V. Bushuev et al., eds., *Energy of Russia 1920-2020, Volume 2: Energy Policy at the Turn of the Century* (Moscow: Energiya Press, 2008), 10.

108 Ibid., 32.

109 Ibid.

110 Andrei Konoplyanik, “The Energy Charter Treaty: A Russian Perspective,” in *The Energy Charter Treaty: An East-West Gateway for Investment and Trade* (Russian edition), Thomas W. Walde (Moscow: Mezhdunarodnie Otnosheniya, 2002), 138.

111 Ibid., 139.

112 Andrei Konoplyanik with the collaboration of Friedrich von Halem, “The Energy Charter Treaty: A Russian Perspective,” in *The Energy Charter Treaty: An East-West Gateway for Investment and Trade* (English edition), Thomas W. Walde (London: Kluwer Law International Ltd., 1996), 157.

the initial proposal suggested that the energy sphere was a propitious area in which to begin economic integration with Europe “on account of the strong participation of the State.”<sup>113</sup>

The idea of an energy regime solicited a positive reaction from the USSR.<sup>114</sup> Under Mikhail Gorbachev, it was discussed at the highest levels of government.<sup>115</sup> A few weeks after the Dublin meeting, the plan was endorsed jointly by EC and Soviet diplomats in Brussels. At the time, Soviet diplomats commented that the plan accorded with “[their] vision of the solution to Europe’s energy problems” and that “Pan-European co-operation would help their country improve the efficiency of extraction and consumption.”<sup>116</sup>

The proposal was appealing because of the obvious economic benefits that energy cooperation portended. Soviet oil production was falling, and energy cooperation was supposed to infuse the industry with capital, new technology, and managerial “know-how.” These, it was believed, would transform the energy industry at every stage of the production cycle. In terms of exploration, production, processing, and transport, it would promote the development of new projects and also improve the efficiency of old ones, thereby reversing the decline in output.

As far as consumption was concerned, the USSR economy was infamous for its wasteful use of energy, and Soviet scholars had long been arguing that additional volume could be captured through more efficient energy use, both in energy production and consumption.<sup>117</sup> It was believed that Western capital and technology would lower Soviet energy intensity. This amounted to a significant gain in efficiency; holding everything else equal, the Soviet economy would be able to produce the same quantity of economic output with less energy. Therefore, through efficiency gains in both production and consumption, Western cooperation would generate additional volume for export and increase the earnings of the state. This concerned not only oil, but all fuel and energy including gas, electricity, and coal. Overall, the project presented a win-win proposition; through diversification away from the Middle East, it enhanced security of supply for Europe, and for the USSR it promised greater export revenues and more efficient production.

### *The political dimension: energy cooperation and Gorbachev’s Common European Home*

The Soviets were also enthusiastic about creating a new energy regime with the West because it accorded with their vision of cooperative political relations. Cooperation with the West was a major part of Gorbachev’s foreign policy based on the New Thinking.<sup>118</sup> The latter portrayed the Western bloc not as a threat, but as a partner. According to Konoplyanik, the USSR initially understood Lubbers’s proposal as a political initiative, a “protocol of intentions.”<sup>119</sup> The Soviet leadership was evaluating the proposal from the perspective of

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113 Ibid., 156.

114 Konoplyanik, “The Energy Charter Treaty: A Russian Perspective,” (Russian edition) 138. A Soviet delegation was already present at the June 1990 Dublin meeting where Lubbers unveiled his proposal; however, there was no public reaction at the time.

115 Telephone interview with Konoplyanik, August 2009.

116 David Buchan, “Brussels and Moscow agree energy plan,” *Financial Times International*, July 6, 1990, 3.

117 Thane Gustafson, *Crisis amid Plenty: The Politics of Soviet Energy Under Brezhnev and Gorbachev* (Princeton, NJ: Princeton University Press, 1989).

118 Herman, *The Culture of National Security*.

119 Konoplyanik, “The Energy Charter Treaty: A Russian Perspective,” 138.

building a new architecture for post–Cold War Europe and preventing the emergence of a new Iron Curtain. Konoplyanik noted that Lubber’s overall political premises, derived from the historical experience of economically integrating Germany and France into the European Steel and Coal Community after World War II, resonated with Soviet decision makers.<sup>120</sup>

This conception was also consistent with the Soviet vision for a Common European Home, a project to reshape the overall political and economic structure of post–Cold War Europe that Gorbachev had been developing since as early as 1984, when he spoke before the House of Commons in the United Kingdom.<sup>121</sup> The project is noteworthy because it called for the blending of the best elements of capitalism and socialism and was a distinctly Soviet contribution to the debate about what post–Cold War Europe and the international system should look like.

The Soviet belief that the post–Cold War European political economy should incorporate elements from socialism went against the grain of what was becoming the dominant political economic ideology in several of the great powers, particularly the United States and United Kingdom. However, this was a genuine proposal at the time that was taken seriously and not easily dismissed. Moreover, the idea found a sympathetic audience in other important states, particularly France, where a socialist (François Mitterrand) was president. Despite the difficult political and economic situation at home, the Soviets believed that, as a superpower, it was their responsibility to promote the well-being of the international community and so reserved the right to contribute to the design of post–Cold War Europe and the international system in general.

The idea that the ECH was embedded in the plan of a common European home emerged again in May 1991, two months before the opening conference. At that time, a delegation from the USSR led by V.V Taskaev, the head of the Department of Energy Development of the Commission of the Council of Ministers of the USSR, attended a conference on energy cooperation in Brussels.<sup>122</sup> The delegation also included V.V. Bushuev, the chair of the energy committee of the Supreme Soviet of the USSR.<sup>123</sup> In a speech that he would make repeatedly in many capitals around the world, Bushuev told Western audiences that “we are interested in cooperation as our common home should be not only warm, but also ecologically clean and rationally constructed. Energy should become that bridge which connects our economy to the world system.”<sup>124</sup> Ultimately, this stance was part of the Soviet delegation’s proposal, prepared by Taskaev’s group, for negotiating the 1991 Charter political declaration.<sup>125</sup>

### *Gorbachev at the July 1991 G7: in search of accommodation*

Only a month before the coup, Gorbachev traveled to meet with the heads of state of the leading industrial economies to plead for urgent financial assistance to support his reform program. The Soviet economy was in deep crisis and had been since 1990. Perhaps even more critically, its external debt situation was becoming desperate. The enormous difficulty of Gorbachev’s situation was clear to everyone at the time.

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120 Ibid.

121 Iver B. Neumann, *Russia and the Idea of Europe: A Study in Identity and International Relations* (London and New York: Routledge, 1996), 161.

122 Vitali V. Bushuev, ‘Ya’ I ‘Mi,’ (Moscow: Energiya, 2008).

123 Ibid., 116.

124 Ibid. Since he was a representative of the parliament, his statement was taken as the official Soviet position.

125 Ibid.

Since the G7 summit in Houston a year earlier, the United States and United Kingdom had been signaling that any aid should be multilateral and linked to the right kind of structural reform. In advance of the summit, Soviet reform economist Gregory Yavlinsky and a group of academics from Harvard prepared a proposal called the Grand Bargain, which tied liberal economic reforms to a very large influx of capital into the USSR from the West. Given the Soviets' desperate situation, it seems reasonable to think that the G7 would have been a good occasion for them to offer the Yavlinsky plan as a blueprint for domestic reform to negotiate financial aid. However, the Soviets signaled that they would stick to their most recent emergency program and not make a new proposal. In early July, Prime Minister Pavlov commented that "It is high time we stopped producing programmes... Gorbachev is not working on any programme, especially a new programme for his trip to London, at least not that I know of."<sup>126</sup>

The clearest evidence of the USSR's approach to international economic cooperation was the proposal, dated July 12, that they did send to the G7 in advance of Gorbachev's meeting.<sup>127</sup> It consisted of a 12-page letter that communicated the distinct vision of international economic cooperation that was characteristic of the late Soviet Union. Most conspicuously, it proclaimed repeatedly the USSR's commitment to socialism and the value of the state as an economic actor and insisted on "accommodation."

In Annex 1 to the main document, titled "Proposals for Drafting Economic, Scientific, and Cooperation Programs," the Soviets laid out more detailed proposals for cooperation by sector. In the passages related to energy (secondary, after conversion of the military industrial complex), they proposed "a set of coordinated large-scale projects in the framework of a common strategy for energy development that could be implemented with broad foreign capital participation."<sup>128</sup> When thinking of concrete projects, the Soviets clearly conceived of public authorities as one of several kinds of partners that would participate in cooperative endeavors:

Taking into account the size and nature of the prospective cooperation in these problem areas and their individual components it may involve partners ranging from governmental agencies of the USSR, its republics and regions, to various kinds of concerns and associations to individual enterprises, and is to comply with the Soviet legislation in force. Inputs in foreign currency may be repaid by energy exports from the USSR.<sup>129</sup>

Finally, the very fact that they were making a proposal in the form of a quasi-plan also suggests that the state would have a strong, albeit changed, role in future energy cooperation.

Rather than accepting the latest, Western-inspired reform plan, Gorbachev was continuing a discussion about the legitimacy of socialism and state intervention in the economy. From the perspective of the emerging Washington consensus, the Soviet stance was stubbornly defiant. Ultimately, the USSR was sending a signal that it was still a socialist state intent on contributing to the world order in a way that clashed with the neo-liberal, capitalist vision of political economy. The message was that the USSR, in spite of all the changes it had

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126 Brian Killen, "Gorbachev Has No New Economic Programme for G7, Pavlov Says," *Reuters News*, July 3, 1991.

127 Mikhail S. Gorbachev, "Personal Message from President Mikhail S. Gorbachev to Heads of State or Government Attending the G7 meeting in London and Annexes," July 12, 1991, accessed December 13, 2011, <http://www.g7.utoronto.ca/summit/1991london/personal.html>

128 Ibid.

129 Ibid.

experienced and the enormity of its current difficulties, was still the USSR. It was a superpower that had its own vision and intended to shape international politics by establishing certain rules and promoting principles it believed to be legitimate.

*The Soviet posture and early ECH negotiations: revising the market perspective*

The Soviets communicated a similar message at the opening of the Conference, which took place at the same time as the G7 summit in London. As the Conference opened, it was clear that the Soviets were enthusiastic about international cooperation in energy and had come a long way in their commitment to some sort of market reforms. However, the extent to which the USSR would embrace markets in energy was still an open question. Clive Jones, the EC's deputy director-general for energy commented a week prior to the conference, "The fundamental issue is the degree to which the Soviet Union will be willing to accept an attempt to reform its energy policy along market lines to give confidence to Western companies and bankers to invest in the industry."<sup>130</sup>

Once the conference opened, it was clear that the Soviets were prepared to promote their own vision. The Soviet delegation declared that it "agreed with the idea that its economy had to be transformed into a market economy," but for this to happen, "balanced solutions will have to be found."<sup>131</sup> A former deputy prime minister and Soviet ambassador to the EC, Lev Voronin,<sup>132</sup> warned that "[t]he charter must not set one group of nations against another, or one group of policies against another."<sup>133</sup>

The controversy created by the USSR's position was echoed by the EC's Director General for Energy, Constantinos Maniopoulos, who stated that although he was satisfied with the USSR's demonstration of readiness to introduce market-oriented measures into the energy sector, the work leading up to a final ECH agreement would be "complicated."<sup>134</sup> The following December, less than a week before the ECH was signed, Chairman Rutten claimed that the differences had been so great, "[i]t is a small miracle that the Preparatory Conference was able to agree on the text of the Charter within a period of three months."<sup>135</sup>

In between the July conference and the next meeting of WG I (September 23-24), the USSR took the lead in "modifying the market perspective."<sup>136</sup> The logic for this initiative was multiple. On one hand, the Soviets wanted a greater role for the state and the formulation of a common energy policy. In particular, they argued that initiative in energy was not the exclusive realm of private business, but that the state could take the initiative and promote cooperation as

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130 Andrew Hill and Deborah Hargreaves, "Moscow's stance key to European energy charter," *Financial Times*, July 15, 1991, 4.

131 "Conference on European Energy Charter Continues Its Work," *Agence Europe*, July 17, 1991.

132 Lev Alekseyevich Voronin was demoted from deputy prime minister in March of that year. From 1980-85, he was the first deputy chairman at Gosplan. Prior to that, he worked in the military industrial complex.

133 "Soviet Union Accepts Need for Energy Sector Market Reforms," *Financial Times*, July 16, 1991.

134 "Energy Charter Must Provide Aid to Soviets, East Europe, EC Official Says," *Platt's Oilgram News* 69, 136, July 17, 1991, 1.

135 Michel Chatelin and Marc van Beuge, "The European Energy Charter," *Resources Law: The Newsletter of the Canadian Institute of Resource Law* 37 (Winter 1992): 9.

136 Svein S. Andersen, "East of Market—West of State: The Energy Charter Negotiations," Working paper, Norwegian School of Management, 1997.

well. Second, the Soviets, supported by Norway, claimed that state sovereignty over resources should constitute the basis for regulation of natural resource management.<sup>137</sup>

According to Andersen, “the majority of participants were skeptical” of the idea of diluting the importance of markets in favor of the state.<sup>138</sup> State sovereignty was also controversial, as some participants construed it as being inconsistent with non-discrimination. The Soviet initiative to modify market principles was also understood by many participants to be an attempt to preserve elements of the old system; many countries argued that the proposal was “an attempt to preserve elements of the traditional state role, and thereby undermine the market perspective which was central to the Charter.”<sup>139</sup>

*The controversy over financing: concrete mechanisms or investment climate?*

One of the key differences between the Soviet proposal and the EC initial draft at the July Conference concerned the question of finance. Although everyone agreed that the USSR required significant investment to revitalize its energy sector, it was not yet clear what form this financing would take. EC officials reported that,

The Soviet Union has called on Western countries to provide money to help it and other eastern European countries adapt to a planned European Energy Charter....

The demand was made in a provisional draft of the charter submitted by Moscow for negotiations which resume in Brussels on Monday.

The Soviet paper, which EC officials stressed was provisional and drawn up before last month's failed Moscow coup, *calls for the creation of a financial mechanism* to help the eastern European countries fulfill the charter's goals.

It does not specify a figure.

An original July draft of the charter by the EC includes no reference to a financial mechanism, but EC officials said they expected the call to be accepted by Western countries next week.<sup>140</sup> (emphasis added)

It was clear that the Soviet vision of financial mechanisms was different from what the EC meant by legal framework and that reconciling these differences was necessary for negotiations to be successful:

The Soviet Union's position will be crucial to negotiations. In particular, delegates will want to know whether Moscow is happy to accept only a legal framework for energy reforms, or whether it wants specific funding, a request likely to be turned down by EC members.<sup>141</sup>

These passages also indicate that opinions in the West were mixed concerning whether this kind of arrangement would be accepted by the Europeans.

Overall, the conference saw two very different approaches to the question of finance. The solution favored by the EC, United Kingdom, and United States hinged on the creation of a

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137 Ibid., 20.

138 Ibid.

139 Ibid.

140 “Soviet Union Wants Western Funds for Energy Charter,” *Reuters News*, September 20, 1991.

141 Peter Torday, “US seeks G7 meeting on Soviet plight,” *Independent on Sunday* INDOS 1, September 22, 1991.

legal framework that would sustain a climate favorable to autonomous investment by firms. According to this abstract vision, finance was decided exclusively by private actors. As we saw in the G7 proposal, the Soviets were thinking of financing more concretely, at the project level. Their approach went beyond just creating a favorable investment climate for firms. The Soviets did not reduce the problem of finance to its legal and commercial elements, although they acknowledged that these were important. Ultimately, finance had an important political element because it touched on two questions of top concern to the Soviet state: energy security and exploitation of society by financial capital. As a result, they believed that the state would play a significant role in organizing the financing of energy sector transformation. The next section examines this thinking in greater detail.

### **The Soviet logic: causal and normative justifications for state action in energy**

During the July negotiations, the USSR argued that the ECH needed financial mechanisms, and this implied a role for the state. This position was motivated by two factors. First, Soviet policy was informed by causal beliefs connecting finance to energy security through state action. Second, state involvement was necessary to protect workers from exploitation by financial capital, a problem that emerged from Marxist-Leninist thinking. In both cases, the vision of the state had a positive valence; it protected the interests of society.

What was the causal link that connected finance to energy security through state action? When considering investment into their energy sector, the Soviets thought in terms of specific projects that needed financing to either move forward (for new projects) or achieve a higher level of efficiency (for existing projects) and ultimately produce a greater output. This output would be available for both domestic consumption and export.

To accommodate the participation of foreign actors in the energy sector, the Soviet solution beginning in the 1960s had been to craft intergovernmental agreements that opened up a space for cooperation between international firms, banks, and the relevant domestic agencies. Naturally, the state played a pivotal role. It eliminated risk by providing political guarantees to its Western partners. Domestically, it was also responsible for everything going smoothly.

Energy projects were also embedded in a larger conception concerning energy security in the USSR that entailed a significant role for the state.<sup>142</sup> Specifically, in the tradition of Soviet planning, the state made forecasts concerning future energy demand in the USSR. Through the optimization of complex economic models, state planners (*Gosplan*) made allocation decisions to the energy sector that were supposed to support a level of supply to meet expected demand.<sup>143</sup> This exercise was all the more urgent because of the significant lead time for these capital-intensive and technologically challenging projects. Since financing is an integral component of energy projects, this thinking translated into a concern for timely, properly allocated investment. If a project started late, even if all went smoothly thereafter, there would still be shortages relative to forecast demand due to the initial delay.

An energy shortage could pose a grave security risk to society and the economy, and the Soviet leadership was eager to avoid this at all costs. Thus, when oil production was falling

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142 Elena A. Telegina, *Energy Strategy of Russia*, self-published, Moscow, 2004.

143 Interview in Moscow, fall 2008.

under Gorbachev, the Soviets curtailed exports (forgoing valuable export revenues) and even had to import certain fuel products from international markets (expending scarce foreign currency reserves) to meet internal demand. Assuring an adequate supply of energy for the population and the economy was the responsibility of the state and a top political concern for the Soviet regime; Soviet life depended on it.

*Perestroika* ushered in important changes in economic thinking, in particular the possibility of introducing markets into the USSR. Although these ideas were deeply contested, within Gorbachev's government there was still a broad consensus concerning the importance of the state as an economic actor, and this certainly concerned the energy sector. Again, the causal reasoning described previously — connecting finance to energy security through state action — was one important consideration.

The leadership during the late Soviet period believed that state involvement in the mobilization of capital from abroad was an effective way to deal with financing the energy sector. This was consistent with a strand of economic thought that derived inspiration from the East Asian developmental states and was dominant within the Soviet government in 1991, when the ECH regime was being negotiated. Moreover, it was supported by several decades of successful cooperation in energy with Western European states according to a state-led model.

This causal logic can be seen in the writing of Leonid Abalkin, an academic economist who was the deputy chairman of the USSR Council of Ministers and chairman of its State Commission on Economic Reform from 1989 to 1991. According to Aslund, Abalkin was “from July 1990 on...the second man in government,” after the more conservative Prime Minister Nikolai Ryzhkov. Abalkin was not a radical reformer. In the summer of 1990, he declined to join the then most visible group of liberal economists, the Shatalin Group, which was charged with preparing the “500 day plan” for transition to a market economy. Instead, he joined Prime Minister Ryzhkov's group within the government that produced a plan calling for a “regulated market.”<sup>144</sup> According to Aslund, “at this point, Abalkin made a clear break with the radical reformers and sided decisively with the government.”<sup>145</sup>

Abalkin was an observer of the Japanese economic model. In a 1987 interview, he stated that, “Among the capitalist countries, I would assess the Japanese highest of all.”<sup>146</sup> It is not surprising then that he rejected the idea of a totally free market in contemporary society:

When we view the market as economic relations of a certain type, we should emphasize that at the present time it is by no means identical to the free market, the conception of which formed at the dawn of the capitalist system. The free market practically does not exist in any country today in its classical, 19<sup>th</sup> century form. Economic life is regulated by “the invisible hand” of the market but also by very visible methods of state control, financial policy, intra-firm planning, and intergovernmental agreements...Many modern processes in Western countries by no means diminish the economic role of the state even though they substantially alter the forms and methods of state economic regulation. The mechanical contrasting of the market “in general” and the planned system of national economic management is of a very conditional, purely academic

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144 Anders Aslund, “Differences Over Economics in the Soviet Leadership,” *A RAND NOTE* (Santa Monica: RAND, 1991), 29-30. For another view of the debates from this period, see Joachim Zweynert, “Economic Ideas and Institutional Change: Evidence from Soviet Economic Debates 1987–1991,” *Europe-Asia Studies* 58, 2 (March 2006): 169-192.

145 Aslund, “Differences Over Economics in the Soviet Leadership.”

146 Abalkin interview, *Der Spiegel*, July 6, 1987, 98, in “Divergent Learning and the Failed Politics of Soviet Economic Reform,” James Clay Moltz, *World Politics* 45, 2 (January 1993): 312.



character that is convenient for pedagogical purposes, but does not reveal the total complexity and contradictoriness of the modern world.<sup>147</sup>

According to Moltz, the fact that Abalkin's economic reasoning reserved an important role for the state was one of the reasons that Gorbachev brought him into his government.<sup>148</sup> The Soviet proposal to the Conference was consistent with this line of thought.

In his article "The Market in a Socialist Economy," which appeared in *Problems of Economics* in 1989, Abalkin cited John Kenneth Galbraith to make the causal claim that state-led financing for "especially daring technical projects" or state guarantees for "a market for the output of technically progressive branches" would reduce the risks and costs of production.<sup>149</sup> For Abalkin, the unique technical nature of the energy sector necessitated the involvement of the state; state intervention produced efficiency (lower costs) and reduced risk.

The most obvious interpretation of risk is the market risk investors and producers face when they consider investing in capital-intensive and challenging projects given unpredictable demand. This risk can be remedied by state financial support or demand management. There is also a second, more subtle way in which to interpret risk that was consistent with Soviet ideas about energy security, state-led financing, and the imperative of protecting society. Abalkin alluded to this later in his article:

The market is not and cannot be the only all-embracing system for regulating the proportions of reproduction in modern, highly socialized production. At the macroeconomic level, the implementation of large scientific-technical, social, and economic programs and the creation and functioning of the production and *social infrastructure are the object of planned state regulation....*

Planned regulation influences various aspects of the market: demand, supply, and prices. The state exerts a real influence on the volume and structure through the systematic structural and proportional development of social production and by distributing orders for strategically important products and for products with *high social priority*. It simultaneously influences the volume and structure of demand since the state order [*goszakaz*] is one of its most important forms. Supply is also influenced by indirect regulatory methods associated with the use of prices, taxes, interest rates, etc.<sup>150</sup> (emphasis added)

In this context, energy needs to be understood as more than just a simple commodity. This was due to its "high social priority" to society understood as consumers and workers.

The two ideas about risk were related: if a project is too risky for investors or producers, it does not go forward. Because of the time lag in energy projects, future supply shrinks, resulting in higher prices, shortages, or both. Because energy is a socially critical good, this was unacceptable for society and therefore for the Soviet leadership.

From this perspective, energy is the fourth "fictitious commodity" in the sense that Karl Polanyi understood land, labor, and money. Its availability in society cannot be governed exclusively by the market; the state has to intervene to make sure that the needs of society are protected. This conception of energy as a socially critical good created a space for the state to

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147 L.I. Abalkin "Rynok v ekonomicheskoi sisteme sotsializma ["The Market in a Socialist Economy]," *Voprosy ekonomiki* [*Problems of Economics*] 7 (1990): 3-12.

148 Moltz, "Divergent Learning and the Failed Politics of Soviet Economic Reform," 312.

149 Abalkin, "The Market in a Socialist Economy," 10.

150 Ibid.

deploy energy policy that also included financial policy. Financial policy was necessary because from a social perspective, when energy is concerned, uneven investment results in unacceptable cycles of boom and bust. Furthermore, the USSR presented the additional challenge of balancing investment geographically across very large expanses of territory.

Nearly twenty years after Abalkin's article, these concerns were expressed widely among my Russian interview participants.<sup>151</sup> During one of my most memorable interviews, in response to a question concerning whether Gazprom's natural gas monopoly might be broken up, a sectoral economist and director of a research institute at the Russian Academy of Sciences, told me (their voice raised in exasperation) that, "We have had enough with theories and experiments....People are not cats...around 60 percent of Russian energy depends on natural gas....Russia could freeze."<sup>152</sup>

However, Abalkin was not arguing in defense of the old Soviet plan administrative system. To the contrary, the purpose of his article was to theorize "socialist markets" to justify the introduction of markets and reconcile their existence in the Soviet economy without undermining the core principles of socialism. He argued that markets created a feedback mechanism that was necessary for any organic system, and its replacement by "administrative discretion inevitably result[s] in the deformation of socialism's economic system, in disproportions, in shortages, and in the loss of interest in one's role as a driving force behind economic development."<sup>153</sup> He also claimed that market competition produced innovation, reduced costs, and improved the quality of goods.<sup>154</sup> A socialist market constituted "the economic base for the subsequent democratization of economic life and the realization of self-management"<sup>155</sup> and led to "freedom of choice," without which it was "impossible to realize the qualitatively new status of a worker in ...socialist production."<sup>156</sup> Finally, markets created "the economic basis for the real freedom of the individual,"<sup>157</sup> and were an "indispensable condition for the successful functioning of socialist ownership and the realization of its potential and advantages."<sup>158</sup>

At the same time, he argued that the state had a critical role to play and a multiplicity of instruments with which to manage markets to ensure that, among other things, socially critical goods were provided. While these instruments had to be "scientifically substantiated, predominantly economic methods," they nevertheless were "qualitatively, fundamentally different from the methods of market-based regulation."<sup>159</sup>

Abalkin's approach implied a transition away from Soviet state economic planning, where Gosplan planned every widge of production, to indicative planning in which the central state set macro-level goals, coordinated with other actors, and shaped enterprise incentives, but did not necessarily intervene in every micro-level decision. This vision provided for a decrease in state economic functions while still retaining an important role for the state in general and

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151 Interviews in Moscow, fall 2007, 2008-9.

152 Interview in Moscow, fall 2008.

153 Abalkin, "The Market in a Socialist Economy," 12.

154 Ibid.

155 Ibid.

156 Ibid.

157 Ibid.

158 Ibid., 13.

159 Ibid., 15.

particularly in socially critical sectors of the economy, including energy. In this way, state-organized financing for energy projects operated by autonomous firms was an innovation that allowed for the introduction of markets but also had important continuities with Soviet values, including social security, and experiences related to state economic management.

The second reason for a state role concerned the normative status of markets in Marxism-Leninism. During the late Soviet period, although there was a tentative consensus related to the necessity of introducing some form of markets to revitalize the economic system, the question of private enterprise was still controversial in the USSR. Furthermore, the idea of a “free market,” without a prominent role for the state, was not legitimate for significant segments of the Soviet elite or indeed the Soviet population in general. In a paper published in the *Cato Journal* during the fall of 1991, Larisa Piyasheva, an adviser to then Mayor of Moscow Gavril Popov and self-identified disciple of the Chicago school of economics claimed that,

In the monolithic ranks of our economists, three directions of economic thinking—though not yet schools of economics—have taken shape. The first is the currently unpopular conservative bloc of traditional Marxists who defend our socialist achievements and want stabilization within the framework of state ownership and a planned economy. The second is that of market socialists, of social democratic orientation, who are seeking all sorts of compromise combinations of free markets with our currently existing structures of property and power (they are the absolute majority today and form part of the Gorbachev team). Finally, there are market radicals who are calling for straightforward privatization of property and free markets. They are a tiny minority....I consider myself to be a part of the last group.<sup>160</sup>

From a Marxist-Leninist perspective, one of the specific problems that markets presented was the exploitation of man by fellow man. In his article, Abalkin – who was part of the “market socialist” majority within the elite – went to great pains to address the question of hired labor or, “the use of hired manpower...as a means of enriching private owners.”<sup>161</sup> First, he argued that the “concrete coupling” of workers to the means of production would be flexible, based on free choice and adequate remuneration.<sup>162</sup> Second, he claimed that a distinguishing feature of socialist markets was:

enterprises and other economic links in the market, none of which uses hired labor, and in which the worker or collective is the full-fledged master of the means of production. The reference in the given case is not to the external, occasionally deceptive form of hire, but to the absence of hired labor as the antipode and reverse side of capital.<sup>163</sup>

Ultimately, the exploitation of labor was precluded in a socialist society due to the “socialist type of ownership of the means of production.”<sup>164</sup> Third, society would provide social guarantees to protect the worker and collective from the “stern laws” of capitalism; society would not be “removed from the creation of conditions that guarantee everyone the possibility of discharging his most important life functions if only at the minimal level.”<sup>165</sup> Finally, a “socialist manpower market” required a system “for the redistribution and retraining of workers and their placement

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160 Larisa Piyasheva, “Economic Reform: A Great Bubble or a Faint Chance To Survive?” *Cato Journal*, 11, 2 (Fall 1991).

161 Abalkin, “The Market in a Socialist Economy,” 15.

162 Ibid.

163 Ibid., 11.

164 Ibid., 13.

165 Ibid., 11.

in new jobs.”<sup>166</sup> Overall, a socialist labor market “presuppose[d] the existence of a powerful nationwide information, regulation, and oversight system.”<sup>167</sup>

A second and related problem that emerged from the introduction of markets was exploitation by financial capital:

The unevenness of the origination of financial resources and the requirement for them, the dynamism of modern production, and the structural *perestroika* associated with the curtailment of the conventional and the emergence of fundamentally new production require considerable mobility of financial resources. Their mobilization and redistribution with the aid of securities becomes a necessary condition for the successful and effective functioning of the economy. There is no basis whatsoever for denying the feasibility of using market methods to regulate the movement of these resources.

It is essential to basically rethink the question of sources of incomes derived from the movement of securities (interest, dividends, etc.). All these forms must not be equated with the exploitation of the labor of others. The realization of income from funds invested in securities acts as a form of realization of shared participation in the increment of economic effect that results from the use of additional financial resources in production. The initial labor basis for forming these resources from the population’s personal savings and the incomes of socialist enterprises determines the socially just and ultimately, labor basis for realizing incomes from securities.<sup>168</sup>

Abalkin did not specifically deal with the problem of foreign capital that might not have a “labor basis.” However, it is clear that in the Soviet context, financial markets would have a special status that merited an important role for the state:

We can also speak of forming the securities and investment resources market...Naturally this will be a very specific market that is largely controlled by state regulation with the aid of financial, interest, and tax policy.<sup>169</sup>

In summary, Abalkin’s thinking represented the dominant strand of economic thought within the Soviet government prior to the collapse. These ideas welcomed markets but only in a way that was consistent with socialism. According to Abalkin, these views were based on a “critical appraisal of historical experience, on the study of the positive results of the initial stage of NEP [New Economic Policy], and the experience of other socialist countries.”<sup>170</sup> In particular, Abalkin was inspired by “Lenin’s theoretical legacy, particularly his last works in which he concluded that we ‘have to admit that there has been a radical modification in our whole outlook on socialism.’”<sup>171</sup> These ideas originated in a positive (albeit critical) view of the Soviet experience.

To address the practical (smooth allocation of investment) and normative (exploitation and social security) challenges that socialist markets posed, it was clear that the state would have to play a central role. This role was reduced when compared to the Soviet plan-administrative system, but in no way was the idea to create “free markets.” The image of the state was based on parallels with the Soviet state under NEP, successful socialist states, and more recently, the Japanese developmental state, which, for Abalkin, was the most successful in modern capitalism.

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166 Ibid., 15.

167 Ibid.

168 Ibid., 14.

169 Ibid.

170 Ibid., 7.

171 Ibid.

Overall, the SCM approach was based on a positive image of the state, in which it served important economic functions for the benefit of society.

Finally, the ultimate purpose was to build on the achievements of socialism by rejuvenating the Soviet system. In contrast to the thinking that would become dominant after the August coup, socialism and the USSR were valorized, and the Soviet state served a productive function. Moreover, as part of Gorbachev's Common European Home vision, these values and achievements could be shared with Western Europe, thereby making capitalism more humane. It is in this context that the Soviet call for financial mechanisms and attempts to revise the market perspective within the ECH regime need to be understood.

### **Central state authority under Gorbachev: heterarchical relations with the Union republics**

Despite the fact that being a regime maker was institutionalized in the Soviet state, by 1991 the central state had increasingly dwindling authority domestically. This concerned foremost the Union republics, which were the most influential actors below the central state. Moreover, Yeltsin's RSFSR was very much at the vanguard of undermining Gorbachev's and therefore the Soviet state's authority.

For example, in April 1990, the Supreme Soviet of the RSFSR declared sovereignty over its natural resources, beginning a struggle over the control of mineral wealth that would last until the collapse of the Soviet state.<sup>172</sup> Later that year, the RSFSR also invalidated agreements with foreign companies related to the export of crucial commodities including oil, gas, uranium, and diamonds.<sup>173</sup> Regardless of what kind of energy regime the USSR proposed internationally, there were serious doubts about who was in charge inside the Soviet Union.

The devolution of authority concerned other key areas as well. After the crackdown in the Baltics in January 1991, Yeltsin began hinting that he would form a national reserve, encroaching even on the central state's monopoly on the legitimate use of violence. Many Union republics, including Estonia, Latvia, Lithuania, Byelorussia, and Ukraine (all with land borders to Europe) were organizing their own custom services.<sup>174</sup> During the period leading up to the collapse of the USSR, the central state fought the republics concerning the supremacy of federal laws, the so-called "parade of sovereignty,"<sup>175</sup> and which level of government was entitled to collect and spend tax revenues.

The devolution of authority away from the center was not entirely at the initiative of the republics. Under Gorbachev, the central state encouraged the republics to take control over certain issues. This was consistent with Gorbachev's plan to reform the overly centralized Stalinist-Brezhnevite state. For example, in July 1991 the USSR cabinet of ministers decided to

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172 Glenn E. Curtis, ed., *Russia: A Country Study* (Washington: GPO for the Library of Congress, 1996).

173 Kevin McCann, "Soviet energy - crisis or collapse?" *Energy Policy*, May 1991, 369 (from *Financial Times*, August 10, 1990, 3).

174 Alexander G. Granberg, "The National and Regional Commodity Markets in the USSR: Trends and Contradictions of the Transition Period," *Papers in Regional Science Journal of the Regional Science Association International* 72, 1 (1993): 15.

175 Edward W. Walker, *Dissolution: Sovereignty and the Breakup of the Soviet Union* (Boulder, CO: Rowman & Littlefield, 2003), 63.

devolve control over issuing export licenses to the authorities in Tyumen, an energy-rich republic inside the RSFSR.<sup>176</sup>

By almost any measure, the authority of the central Soviet state was very weak and decreasing. Relations of authority between the center and the Union republics were characterized by increasing heterarchy. The Kremlin had become only one of several actors competing for authority over key issues, including energy. As a sign of how desperate the situation was by 1991, the optimistic scenario from the perspective of the USSR would have been a successfully concluded new treaty that formally changed the locus of authority within the union. Therefore, Gorbachev began a project (the *Novo-Ogarevo* process) to recraft the Union to create a decentralized federation. Transferring previously unimaginable authority to the Union republics, this would have completely transformed the Soviet state; had it succeeded, it would only have formalized in law what was quickly becoming a reality on the ground. Of course, it did not succeed but actually became the pretext for an important turning point: the August coup.

Despite its regime maker role identity, by 1991 the USSR corporate identity was characterized by low sovereignty. Its state identity was that of a pretender. As we would expect, its agenda positioning was controversial; other states believed the Soviet proposal was trying to “preserve elements of the traditional state role, and thereby undermine the market perspective which was central to the Charter.”<sup>177</sup> However, because the USSR collapsed shortly after the ECH process began, there are no observations in ECH policy related to the other outcomes I identified in chapter 1.

### **The new Russia as regime taker: the legal climate, foreign investment, and the ECH**

After the August coup, a new delegation from the USSR took over negotiations on the ECH regime. With the exception of the three Baltic republics, representatives from the Union republics, many of whom had declared their independence, still came as one “Soviet” delegation. The delegation was organized around the interstate economic committee put together after the coup as an attempt to salvage the union through some sort of framework for economic cooperation. According to Konoplyanik, “at the time, the Europeans were integrating and we were disintegrating.”<sup>178</sup> The delegation was “led by a Russian official” and “spoke with a united voice at the meeting.”<sup>179</sup>

The first round of negotiations, held on September 23 and 24 in Brussels, concerned the ECH political declaration (WG I) that was supposed to precede a more elaborate agreement to be negotiated later. According to Andersen, who has reviewed the ECH archives, an important transformation occurred at the WG I meetings in September:

In the second meeting of Working Group I (Charter text) the discussions continued along the same lines as before, but it was clear that negotiators already had come a long way towards finding a compromise text. The number of footnotes which indicated reservations or proposals for change

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176 “Possible Impact of Soviet Oil on World Prices,” *Kommersant Daily*, July 22, 1991, 5.

177 Andersen, “East of Market—West of State,” 20.

178 Telephone interview, August 2009.

179 “East Europe, West Haggles over Key Points of Energy Charter,” *Reuters News*, September 24, 1991.

were only 16 (compared to more than 150 in the first round). *The impression was that the link to international market principles was strengthened and accepted by all.*<sup>180</sup> (emphasis added)

With a new delegation from the USSR headed by a Russian official, issues that had been controversial before the coup were now quickly resolved. Moreover, the negotiations were proceeding in an increasingly market-oriented direction.

The changed approach of the new “USSR” again revealed itself at the first full meeting at which the transformed, post-coup delegation participated. Reflecting the changes that were transpiring in the USSR, the vice minister of the interstate economic committee proclaimed that “the new Union Agreement...would have a positive effect on the Charter Conference through its emphasis on the market.”<sup>181</sup>

As work on the ECH declaration was wrapping up, the focus of attention moved to the subsequent agreements being developed in WG II. One of the early substantive questions in WG II was the relationship between the new agreement and the General Agreement on Tariffs and Trade (GATT), of which the Eastern bloc states were not yet members. This discussion consumed a great deal of time in the effort to design the subsequent treaty. Interestingly, a US State Department official reported that negotiations in WG II were bogged down in West-West debates while the Eastern bloc states, newly favorable to Western approaches, were caught in the middle:

[The Basic Agreement] was drafted by the UK, but was "too ambitious in some of the wrong ways" because it was "trying to re-address trade issues" that had "already been done at great length and with great difficulty, and should not be reinvented," he said.

"I think what we found towards the end of November...is that we were engaged in the business of using Basic Agreement deliberations to pull the Soviets and Eastern Europeans into a Western mode as a mechanism for doing West-West negotiations," he added.<sup>182</sup>

Whereas before the coup, the primary cleavage was between the USSR, which was trying to modify “the market perspective” and states that were skeptical of attempts to preserve elements of the “traditional state role,” after the coup, the “Soviets” were being pulled into various “Western modes” that were the subject of a primarily West-West debate.

At a London seminar on energy in December, Russian participants announced that “Russia's takeover of Soviet oil and gas industry operations located on Russian territory is now virtually complete.”<sup>183</sup> Again the participants highlighted Moscow’s new preference for a neo-liberal approach to energy cooperation and a focus on creating a legal environment for investment:

Shortly after the attempted Soviet coup in August, Russian Federation president Boris Yeltsin issued a decree announcing Russia's takeover of the Soviet-run oil and gas industry on Russian territory.

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180 Andersen, “East of Market—West of State,” 21.

181 Andersen, “East of Market—West of State,” 22. The vice minister was referring to efforts to salvage some sort of Union after the coup by drafting an economic agreement, which was initialed by the heads of the republics in October.

182 Nancy Moore, “U.S. To Make Sure Energy Charter Won’t Disadvantage Private Sector,” *Platt's Oilgram News* 69, 240, December 16, 1991, 1.

183 Douglas Busvine, “Russia Now Fully Controls Its Oil, Seminar Told,” *Reuters News*, December 11, 1991.

*New legislation was being drafted to encourage Western participation in the oil and gas sector and should be passed by the end of the first quarter of 1992, said A.S. Tishchenko, VNIOENG's director.*

"The main aim of those working on petroleum legislation was to establish a *legal basis* for the stable functioning of the oil and gas industry in the conditions of a market economy," Tishchenko said.

As well as existing joint venture arrangements, current legislation allows for awarding concessions, production sharing contracts, risk contracts and service contracts, he added.

New licensing rounds should also open up new exploration territory to interested Western companies, said Ivan Desyatnikov, head of foreign relations at VNIOENG.<sup>184</sup> (emphasis added)

The Russian government's special focus on legislation is also confirmed by Aslund, who recalled that "[t]he Gaidar team's first priority was to outline a large number of legal changes and have them implemented."<sup>185</sup>

Finally, as the signing conference approached, Moscow began elaborating its new neo-liberal orientation to energy cooperation and its aspiration to emulate the West:

Konopljanik [sic] said the signing of the charter would be a first step in helping to create a "common European economic, legal and energy environment." But, the Moscow-led Union would clearly have to *push up its economic and legal "levels" to meet Western standards*, he added. "We could use the charter to boost our own development," he said, adding that it would also speed up the Soviet Union's transition *towards an open market economy*.

But Konopljanik underlined that securing a political declaration on East-West energy cooperation in The Hague wouldn't be enough.

"We need to *create the legal and economic climate to attract private Western capital*," he insisted, adding that this would only be possible once the Basic Agreement on implementing the charter was also signed.<sup>186</sup> (emphasis added)

Before the signing conference, the new Russian Minister of Energy Vladimir Lopukhin unveiled proposed structural changes within the Russian oil sector – the creation of eight to twelve vertically integrated companies similar to the newly created Lukoil, which would compete with one another – and also revealed his general vision for the oil market. In addition to declaring an intent to liberalize the sector, Lopukhin's comments reveal his rejection of the Soviet model for a "proper," Western-inspired one:

According to Lopukhin, "At the moment we have an *irrational oil industry*. If output falls at a plant, it is compensated for its loss of earnings. So it gets more money for producing less."

Lopukhin said the Russian government planned to introduce a "*proper economic system*" very soon to boost output and make refineries and other plants self-financing.

"In the New Year companies will face price liberalisation. We must also introduce a credit system for oil production."<sup>187</sup> (emphasis added)

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184 Ibid.

185 Åslund, *How Russia Became a Market Economy*, 88.

186 "All Soviet Republics Said Agreed To Sign Pan-European Energy Charter," *Platt's Oilgram News* 69, 234, December 6, 1991, 1.

187 Ashley Seager, "Russia Hopes To Maintain Current Oil Export Levels," *Reuters News*, December 17, 1991.



Lopukhin also noted that the Charter would help regulate economic relations among the soon to be independent republics in a “normal” way: "It is also good for relations between the former republics. We plan to establish normal economic relations with each other....We need coordination."<sup>188</sup> (emphasis added)

This section has examined the policy posture of the new USSR delegation after the coup. The main goal was to highlight the new delegation's and especially Russia's preference for market solutions to the regime, in particular its interest in a neo-liberal design. This contrasted with the previous Soviet SCM approach. The following section examines why this approach replaced the original Soviet one after the coup.

### **Neo-liberalism in the new Russia: rejecting the past and emulating the West**

In this section, I sketch the ideational structure that informed the thinking of Yeltsin and the liberally oriented elites close to him as he took over state power after the August coup and developed his state-building strategy. This allows us to examine the neo-liberal ideological line as it emerged. I am particularly interested in the narrative of the state, or state image, that prevailed in Yeltsin's first government. The ultimate purpose is to show how these images of the state influenced Russian ECH policy choices.

To understand the ideational structure, I looked at how decision makers (primarily Yeltsin, but also key members of his team) and observers described the logic of their policy choices. This allows us to establish how the neo-liberal elite who came to power after the August coup understood statehood at a critical moment in Russian history: the moment of state genesis. Because this state vision also informed their ECH policy choices at the moment the regime was being created, it helps us understand why the regime developed as it did.

From a theoretical perspective, this exercise is important because it reveals that the mechanics behind state behavior can differ significantly from the dominant understanding in the IR field. From both a neo-realist and liberal perspective, as leaders make decisions, they look outward – both at the international system and at their domestic politics – to make an assessment of their state's objective situation. In particular, they make objective evaluations of actors' power and preferences, and this guides their policy choices. This is a basic assumption of mainstream IR theory and rationalist approaches in political science.

However, the case examined here suggests that the mechanics behind state behavior can follow an alternative pattern, and this merits attention. As they look outward into the international system and domestic politics, leaders also gaze inward, calling up beliefs that allow them to generate subjective narratives that mediate their interpretation of the outside world – both domestic and international – and inform their policy choices. For the purpose of this analysis, the key point is that these narratives entail images of one's own state.

Although the narrative is subjective, it is not idiosyncratic or unique to the individual. The narrative comes from the social structure, and we know this because it is shared by different individuals. It can be understood inductively through individuals' descriptions of their own thinking and decision making logic.

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188 Ibid.

In this section, I first examine the narrative in general – what I call the rupture narrative because it called for a dramatic break from the Soviet past – and the image of the state that it entailed. Next, I examine how this narrative and the state image it entailed informed two decisions that are central to state building: the territorial boundaries of the state and its relationship to the economy. Finally, I examine the writings of Andrei Konoplyanik, a deputy minister of energy in the first Yeltsin government and the Russian “father” of the ECH, to see how these ideas translated into ECH policy.

### *Images of the state and state-building after the August 1991 coup*

Yeltsin was already moving in an increasingly radical, liberal direction well prior to the August coup. The significance of the coup was not so much that it changed his thinking, but rather that it transformed the balance of authority among top level officials in the USSR.<sup>189</sup> After the coup, the authority and prestige that Gorbachev had enjoyed as head of state had moved to the heads of the Union republics, and Yeltsin, as the president of the RSFSR and most visible opponent of the coup, became the most authoritative actor in the USSR. According to Neumann,

The greatest “liberal moment”...since the spring of 1917 came in autumn of 1991, when an attempted *coup d'état* became the prelude to downfall for Gorbachev's Soviet state. As the Soviet Union disintegrated and the Russian federation took its place as the Russian state, the liberals, having abandoned Gorbachev and regrouped around Russia's president, Boris Yel'tsin, sailed into power and were to decisively influence the new state position.<sup>190</sup>

Under these circumstances, Yeltsin was in the novel situation of being the key decision maker in the USSR. When a new government comes to power, some policy adjustments are to be expected, but this does not explain why Moscow's new approach to the ECH regime was radically different than its pre-coup orientation.

The evidence indicates that as the incoming leadership confronted the unprecedented situation of being at the pinnacle of power, it harbored a particular narrative that evaluated the Soviet system in negative terms. Furthermore, while negating the Soviet past, they valorized its opposite: the West. This embrace of the West was not a new development. After an in-depth study of Yeltsin during this period, Breslauer concluded that:

Throughout 1991 and especially during his presidential election campaign of Spring 1991, Yeltsin promised that he would build a market economy on the Western model, integrate the country into the global capitalist economy, and see Russia take its place among the “normal” and “civilized” liberal democracies.<sup>191</sup>

Shortly after the coup, Yeltsin “proposed to emulate Western ‘civilization’ in many of its specifics.”<sup>192</sup> In an early post-coup speech, Yeltsin characterized Russia as “a country in a transitional period, which wants to proceed along a civilized path, the path along which France, Britain, the United States, Japan, Germany, Spain and other countries have been and still are

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189 Yeltsin, *Struggle for Russia*, 109-110.

190 Neumann, *Russia and the Idea of Europe*, 179.

191 George W. Breslauer, *Gorbachev and Yeltsin as Leaders* (Cambridge and New York: Cambridge University Press, 2002), 141.

192 *Ibid.*, 145.

proceeding.”<sup>193</sup> Having negated the Soviet self, members of the new government began to identify with its other: the West.

This narrative was dichotomous; a negative appraisal of the Soviet system was juxtaposed with a positive one of the West. This set up an ideational framework characterized by a series of dichotomies. On the one hand there was the Soviet system, which evoked largely negative connotations – unsuccessful, coercive, illegal, aggressively imperial, feared, stifling, abnormal, irrational, and barbaric. On the other hand was the West, which was seen in a primarily positive light – successful, voluntary, legal, benignly post-imperial, respected, empowering, normal, rational, and civilized. Through the prism of this narrative, the international environment was neither threatening nor constraining, but rather a beacon of progress and ultimately the source of a model for building a completely new type of Russian state.

The idea of a sharp break or rupture with the past was made explicit. For example, in justifying the necessity of shock therapy, Yeltsin wrote, “I would use shock therapy on myself, and not just one time. Sometimes it takes a sharp break or rupture to make a person move forward or even survive at all.”<sup>194</sup> This was the dominant narrative for many liberals during the brief “euphoric” moment after the August coup. This is confirmed by comments from a broad range of participants and observers.<sup>195</sup>

Immediately after the coup, Yeltsin’s thinking was shaped by this narrative, which rejected the Soviet system while embracing the West. Central to the rupture narrative was a specific state image that portrayed the authority of the Soviet state as illegitimate, being essentially imperialistic and oppressive. The narrative also included the positive image of a Western state with legal practices and democratic and market institutions that all limited state authority, which was the desired antithesis of the Soviet state to be rejected.

This ideational framework informed Yeltsin’s state-building strategy as he addressed questions related to the character of the future state and the scope of its authority. Most fatefully, since he understood the Soviet state as having too much authority, resulting in imperialism and oppression, his initial decisions were oriented toward limiting state authority, rather than rebuilding it, by adopting Western institutions and practices. Finally, this ideational framework also shaped his government’s approach to the ECH regime at the moment of its genesis. Specifically, given their views about the legitimate role of the state in the economy, a neo-liberal design was the only viable approach for dealing with their top concern: attracting foreign investment.

The following two sections examine the image of the state that emerged from the rupture narrative and how it influenced Yeltsin’s state-building strategy. I focus on two key decisions in particular: the geographic (external) and socio-economic (internal) boundaries of the state. The section that follows examines how this thinking translated into ECH policy.

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193 Ibid., 144.

194 Yeltsin, *Struggle for Russia*, 149.

195 See for example: “We Broke Through...,” *The Moscow News*, October 22, 2003; Padma Desai, *Conversations on Russia : Reform from Yeltsin to Putin*, (Oxford ; New York : Oxford University Press, 2006): 141-2, 171; Åslund, *How Russia Became a Market Economy*, 39, 62, 73, 90;

*The “imperial” Soviet state and the territorial question*

One of the first key questions Yeltsin faced after the coup concerned whether the new state would continue to have authority over the entire USSR or only Russia. Yeltsin was ambivalent concerning the territorial boundaries of the state.<sup>196</sup> After repeatedly sending mixed signals, he finally resolved the territorial question on December 8, 1991, by signing the Belovezhskaya Pushcha agreement, which abrogated the 1922 treaty that created the Soviet Union. His signature also nipped in the bud Gorbachev’s attempts to preserve the USSR as a geographic entity with a modicum of authority in Moscow. This effectively terminated the existence of the Soviet state in its territorial form.

In his memoirs, Yeltsin discussed this extraordinary decision in detail, giving us a window into his thinking. To begin with, he established a parallel between the post-coup situation and the one in which the Bolsheviks found themselves in 1917:

We were meeting to decide the fate of the Soviet Union.... If we recall the years 1917-1918, immediately after the democratic February revolution, the republics immediately began the process of succession [sic], eventually moving toward independence. Several new national governments were declared in the territory of the Russian empire, including in the Caucasus and Central Asia. Ukraine led the process. The Bolsheviks managed to suppress all the nationalist uprisings, forcing peasants and soldiers into a civil war, although the revolution was supposedly spontaneously proletarian. With an iron fist, the Soviets strangled the liberation struggles, executed the national intelligentsia, and dispersed the national parties.<sup>197</sup>

The specter of the Soviet past figured prominently in his thinking. Yeltsin considered the Soviet state to be inherently imperial and violent:

Gorbachev represented the Union, the empire, the old power, and I represented Russia, an independent republic, a new and as yet non-existent country. Everyone was waiting impatiently for this country to appear....The Soviet Union could not exist without the image of empire. The image of empire could not exist without the image of force.<sup>198</sup>

This state image was also shared by Yegor Gaidar, the architect of economic reforms.<sup>199</sup>

This negative appraisal of the Soviet state was juxtaposed with the experience of its Western opposite. This is clear in Yeltsin’s ruminations on the value of empire:

By that time all the other empires of the world had collapsed – British, French, and Portuguese – and it was not so long ago that the United States as well had tried to take almost direct control over a whole range of countries and neighboring continents on its own, but had failed.

We departed from the old formula of Union government and control of everyone by Moscow...I was convinced that Russia needed to rid itself of its imperial mission....

In signing this agreement, Russia was choosing a different path, a path of internal development rather than an imperial one....

That was how the decision came to me to make the multilateral agreement. That was why I was in Belovezhsky Nature Reserve.<sup>200</sup>

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196 Yeltsin, *Struggle for Russia*, 138-139.

197 Yeltsin, *Struggle for Russia*.

198 Ibid., 58.

199 Yegor T. Gaidar, *Days of Defeat and Victory*, trans. Jane Ann Miller, (Seattle, WA: University of Washington Press, 1999).

Overall, Yeltsin understood his decision as a choice between two strategies. One was to maintain the Union by recreating the “imperial” Soviet state, thereby repeating the history of the Bolshevik Revolution and civil war. In his estimation, this option entailed preserving central authority in Moscow, but at the expense of violence, oppression, and a drain on Russia. The other option was to follow the lead of Western states and forge international ties with the newly independent, post-Soviet states through legal agreements. Yeltsin chose the latter.

Discussing the dissolution in his memoirs, *The Struggle for Russia*, Yeltsin expressed directly his wish to reject the Soviet past: “I came to the presidency with the idea of making a clean break with our Soviet heritage.”<sup>201</sup> By signing the agreement at the Belovezhskaya Pushcha, he rejected the past. Under no circumstances would the new Russia follow in the footsteps of its Bolshevik and Soviet predecessors. Instead, from Yeltsin’s point of view, Russia had a fresh opportunity to follow a better, Western path. This was true even with respect to the question of territory, which from the perspective of state interests is a vital concern.

### *The “oppressive” Soviet state and the economy*

The significance of the rupture narrative and the image of the state that it constituted can also be seen in Yeltsin’s decision concerning a second, internal boundary between the state and other actors in the economic sphere. Again, the structure of this thinking is captured by the narrative presented earlier. Even before the coup, Yeltsin was moving in an increasingly radical direction on economic questions.<sup>202</sup> In 1989, he was already advocating a rapid transition to the market. At the same time, while claiming that, “Those who still believe in communism are moving in the sphere of fantasy,” he nevertheless identified as a “social democrat.”<sup>203</sup> Prior to the coup, pushing the boundary on market reforms was part of Yeltsin’s strategy to enhance his importance as the leader of the opposition by outbidding Gorbachev.<sup>204</sup>

However, after the coup, Yeltsin was committed to dismantling the Soviet state economy, and this had to be done rapidly and irreversibly. This was what made his program radical, and what he referred to as the “attack on the economic front” was his top priority once he came to power.<sup>205</sup> In his early memoirs he openly declared the goal of destroying the Soviet economy:

Gaidar’s reform had led ...to the destruction of the old economy. It was achieved with terrible pain....but achieved nonetheless. There was probably no other way to do it....Just as it had been created, so it must be destroyed.<sup>206</sup>

Later, in an October 2003 interview, Yeltsin again recalled that the statist economy had to be finished off and replaced by a Western model based on markets:

I had a perfectly clear idea of the task to be solved....The administrative command economy had to be replaced by a market one.... I realized that the transition could not be painless. That meant that unpopular measures were inevitable. What was needed was a *kamikaze* crew that would step

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200 Yeltsin, *Struggle for Russia*, 111-5.

201 Åslund, *How Russia Became a Market Economy*, 58.

202 Breslauer, *Gorbachev and Yeltsin as Leaders*, 135.

203 Ibid., 136.

204 Ibid.

205 Yeltsin, *Struggle for Russia*, 127.

206 Åslund, *How Russia Became a Market Economy*, 64.

into the line of fire and forge ahead, however strong the general discontent might be.<sup>207</sup> (emphasis added)

Overall, Yeltsin's description of his decision-making logic did not change over time.

Even though the “Young Turks” would only be appointed to Yeltsin's new government in early November, indications that Yeltsin would embrace the team of neo-liberal economists emerged as early as September 27, when Ivan Silayev resigned as prime minister of the RSFSR.<sup>208</sup> In general, the neo-liberals in Yeltsin's first government estimated that the Soviet economy should not be salvaged because it was inherently dysfunctional.<sup>209</sup> However, there was also a more specific reason. They believed that the Soviet state stifled the individual and was an obstacle to entrepreneurial activity. This is clear in Yeltsin's memoirs when he evaluated the very first results of Gaidar's reforms:

Gaidar's role consisted of raising our paralyzed economy to its feet and forcing its vital centers, its resources, its organisms to work....It was a quite brutal but necessary policy. While the other “doctors” were arguing over treatment plans, Gaidar dragged the patient out of bed and I think the sick patient took a few steps. I am making this analysis based on the fact that people with an entirely new psychology have emerged in our country. They have the psychology of the muzhik, the sturdy Russian peasant, who does not expect anyone to help him and does not rely on anyone — not the government, not parliament, or Yeltsin....If you look around, you will see that there are such people now, mainly young people, ....everywhere....*To put it bluntly, normal people – the kind of people who used to be crushed by the state – have begun to appear in our country.*<sup>210</sup> (emphasis added)

According to Aslund, “for Yeltsin, the central economic tasks were stabilization and economic freedom.” In his famous October 28 speech (written by Gaidar) announcing radical reform, Yeltsin declared:

[W]e have defended political freedom. Now we have to give economic [freedom], to remove all barriers to the freedom of enterprises and entrepreneurship, to give the people possibilities to work and receive as much as they earn after having *thrown off bureaucratic pressures.*<sup>211</sup> (emphasis added)

Thus the rupture narrative entailed an image of the Soviet state as oppressive in the economic sphere, stifling creativity and entrepreneurship. More generally, for the new elite in power, the Soviet state produced specific causal effects on entrepreneurship. The flip side is that the absence of the state in economic activity caused markets to emerge, and this caused economic development and wealth.

Because I am interested in connecting the first government's state image to its rejection of the Soviet state-oriented approach to the ECH regime, Yeltsin's attitude toward state authority in economic decision making is especially illuminating. To bring these ideas into relief, we can compare his approach to state planning to that of Gorbachev. According to Desai,

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207 “We Broke Through...,” *The Moscow News*, October 22, 2003.

208 Walker, *Dissolution*, 147.

209 Gaidar, *Days of Defeat and Victory*, 23.

210 Yeltsin, *Struggle for Russia*, 146.

211 Aslund, *How Russia Became a Market Economy*, 64-5.

Mikhail Gorbachev attempted to resuscitate the Soviet economy.... But perestroika also kept the economic planners fundamentally in charge. ... One of Yeltsin's primary goals was to end the planned Communist economy--not to reform it, but to finish it.<sup>212</sup>

Therefore, the rupture narrative also deprecated Soviet state economic planning, which represented state authority in general economic decision making.

As I have already suggested, Yeltsin's ideal for state-society relations in the economy was inspired by the "free market" model emanating from certain quarters of the West. This aversion to the Soviet economic model and embrace of a Western free market can be seen in Yeltsin's logic for choosing his early economic advisers: Yegor Gaidar, his team of young economists, and the network of Western economic experts to which they had access.<sup>213</sup> Yeltsin saw in Gaidar several outstanding qualities. Based on his recollections, he was particularly impressed by the originality of Gaidar's approach to economics. He wrote:

I felt that a new era had really begun in our history....

In the difficult months of the Gorbachev transition, I was already giving serious thought to how the Russian government should be reorganized, bringing in some fresh faces...I realized that a person ... [like Silayev] could no longer remain prime minister. *It was high time to bring in an economist with his own original concept*, possibly with his own team of people. Determined action was long overdue in the economy.<sup>214</sup> (emphasis added)

Yeltsin associated "original" with the neo-liberal economic approach that Gaidar brought to the table. Its originality was that it rejected Soviet Marxist economic thinking, which reserved a significant role for the state. Gaidar's model corresponded to how Yeltsin understood the organization of the US economy, which he admired. Again, the positive Western, particularly American, example loomed large.

Yeltsin also admired Gaidar and his team for what he saw as their "independence:"

Why did I choose Yegor Gaidar? I wanted to choose the chief economic helmsman intelligently.

Gaidar impressed me most with his confidence...*He was simply an independent man...who, unlike the dull bureaucrats in the government administration, would not hide his opinions....*

[H]e had a team of very young and diversified specialists. They weren't just a group of experts, but individuals, *younger people without any hang-ups, independent thinkers raring to go...* In short, I very much wanted to choose a different kind of person for this top economic post.<sup>215</sup>

Independence referred to the fact that they would not compromise their convictions in the correctness of their economic project. Yeltsin was looking for ideologically committed advisers

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212 Padma Desai, "Russian Retrospectives on Reforms from Yeltsin to Putin," *The Journal of Economic Perspectives* 19, 1 (Winter 2005): 87.

213 Gaidar, *Days of Defeat and Victory*, 59, 72-73; Padma Desai, "Russian Retrospectives," 87; Åslund, *How Russia Became a Market Economy*, 17-18, 20; Sachs, "The end of poverty," in *The Political Economy Reader: Markets as Institutions*, eds. Vogel and Barma, (New York : Routledge, 2008: 372; Merton J. Peck and Thomas J. Richardson, eds., *What is to be done? Proposals for the Soviet Transition to the Market*, (New Haven; London: Yale University Press, 1991), especially Appendix B, accessed December 12, 2011, <http://www.iiasa.ac.at/Admin/PUB/Documents/XB-91-016.pdf>

214 Yeltsin, *Struggle for Russia*, 123-4.

215 Ibid.

that would provide the technical expertise for his political project of breaking with the Soviet economic past by destroying the state economy and creating a Western, free market one.

Moreover, Yeltsin associated “independence,” and by corollary the qualities of his new team, with being American. Thus, recalling an episode from his 1992 trip to the United States, Yeltsin wrote:

[T]ravel enables you to learn much about yourself and others.

...At Camp David...Cheney called to Mr. Baker, “Jimmy, pour me a juice, will you please.” “Jimmy” poured some for himself and Mr. Cheney, in an absolutely relaxed and natural way, without any affectation or airs....

I thought to myself at the time: why are Americans like this? I realized it was because they are absolutely *independent* people – even from the president himself – and therefore they could work for the sake of ideas, for the sake of a cause.

We are still too dependent on one another, on power....Ridding ourselves of this dependency is an uphill battle.<sup>216</sup> (emphasis added)

Yeltsin revealed his impressions about an idealized form of interpersonal relations inspired by the United States; again, this was the opposite of his perception of the sycophantic Soviet self. This narrative of Americans as independent connected with the rationale he described for choosing Gaidar. Moreover, he underscored his belief that policy should be the expression of a vision, regardless of politics (being independent, even from the president himself).

Overall, Yeltsin’s choice of Gaidar and his team should be understood as 1) a rejection of the Soviet statist economy and an embrace of a Western, particularly American, free market model as described by neo-liberalism; and 2) the embrace of a new kind of official who (in Yeltsin’s estimation) was committed to the new ideological line and would promote it with determination in spite of political resistance. Both of these considerations were associated with Western, particularly American, practices, compared to which Soviet practices did not fare well.

The narrative described here, and especially the image of the state as imperial and economically oppressive, guided two early decisions concerning Russian statehood: the territory of the new Russia and state authority over economic decision making. The following section examines how this vision translated to the ECH by studying the policy thinking of Andrei Konoplyanik, the Russian father of the regime.

#### *Policy ideas and the ECH: the neo-liberal model as “normal” and legal guarantees for firms*

This section examines how the early Russian government thought of the new ECH regime. It is based on the interview responses and writings of Dr. Andrei Konoplyanik, an academic economist, deputy minister of energy in Yeltsin’s first government, former deputy secretary general of the Energy Charter Secretariat, and a key figure in Russian ECH policy making.

When the Soviets were first approached by the Europeans about the Lubbers Plan, Konoplyanik was working in the energy investment department within the state planning agency,

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216 Ibid.



Gosplan. The proposal was forwarded to him by the leadership of Gosplan, which received it from the Ministry of Foreign Affairs. At the time, he was “outside the process,” working as an “expert analyst,” and his assignment was to study its consequences.<sup>217</sup> Konoplyanik had already been studying energy investment in the West for several years as part of his work at Gosplan; however, his writings from the period reveal that he was careful not to transgress the policy line established by the leadership.

After the coup, as deputy minister of energy charged with foreign investment, he was the number two government policy maker for the ECH, second to Minister of Energy Vladimir Lopukhin. However, his role should be understood as technical rather than political. Konoplyanik was the expert who, among others, provided the intellectual basis for Russian policy and was a key negotiator. During an interview in 2009, Konoplyanik described the new government’s thinking about the ECH process in late 1991 as follows:

[A]fter all, don’t forget that when the first Russian government came in, it was November 1991, it was a situation in which the country was basically on the brink of collapse...that is why many of the processes that started then had a unique, one time character...[it was a] period of starting from zero....

Some people saw extra significance in the Charter, for example Lopukhin, Gaidar, and your humble servant who had been working on it for a long time....We were actively involved because first and foremost, we were interested in its contents; I saw its significance....

Gaidar and Lopukhin understood the significance of integrating Russia into the new...world order....

We believed that the rules of the game [spoken in Russian], the rule of law [spoken in English] ....were important.<sup>218</sup>

These comments, particularly the idea of “starting from zero” in the context of a “unique moment” are consistent with the rejection of the Soviet past as suggested by the rupture narrative that prevailed within Yeltsin’s government after the 1991 coup. The idea of integrating into a “new world order” by adopting “the rules of the game” based on “the rule of law” refers to the embrace of the neo-liberal approach preferred by the United States, United Kingdom, and EC.

However, these comments are still at the level of political ideology. In his writings about the ECH, Konoplyanik has given a detailed account concerning the economic logic behind the design. The Russian neo-liberal approach was primarily concerned with attracting foreign investment into the energy sector. According to Konoplyanik, the Soviet approach to foreign investment based on intergovernmental agreements and state planning and oversight had a certain logic that was effective. Ultimately, this model worked because of the state:

At the same time, hardly anybody – in the East or the West – doubted that direct economic relations between very powerful foreign monopolists on the one side, and the highest level of economic administration of the USSR on the other, was the most suitable way. In fact there was no alternative to this modus operandi, because the USSR economy was State owned and State managed....

[This] mechanism of interrelations with foreign investors...was intrinsically conclusive and effective. Moreover, this efficacy was reached by using purely administrative means.<sup>219</sup>

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217 Telephone interview, August 2009.

218 Telephone interview, fall 2009.

In this context, legal institutions were unnecessary since the interests of Western partners, including private firms, were addressed through interstate bargaining and Soviet state political guarantees at the level of specific energy projects:

This method of financing from abroad eliminated, for the creditors, certain business risks generally linked with business in countries lacking developed systems of economic/commercial law. In consequence, the development of such a legal system was not regarded as an urgent necessity for the USSR. There were no incentives for its development.<sup>220</sup>

As a result, there was no need for a system of commercial law; instead, there was a “system of decision making that was reinforced at the government level and was operative for each individual deal” that had “its own internal logic and was balanced.”<sup>221</sup>

However, this changed with economic reforms in Russia. In the context of the new economic model, the goal of creating “comfortable” conditions for private firms became an overriding priority. More broadly, the new state’s authority was being curtailed in the economic realm as represented by the drawing of a boundary between state administration and the economy:

When Russia began to reform its economy, the elaborate administrative procedures of relations with foreign investors were destroyed (exactly the same happened with regard to the relations with our own economic entities). The “system of ad hoc legal regulation”...*does not work anymore as the intensity of administrative centralization, especially in the economic sector, faded. This becomes particularly clear when regarding the process of ongoing delimitation between the functions of economic and State administration, the gradual transfer of cooperation with Western firms to the level of individual economic entities and concerns, and the broadening of cooperation with Western investors by means of growing participation by middle and small enterprises on both sides. The number of participants in such forms of cooperation becomes just too big. In such cases the only effective means of regulating the interrelations between the participants of such business transactions is to develop a system of economic law in the recipient country.*<sup>222</sup> (emphasis added)

Thus, Russian reforms consisted of creating an economic sphere largely distinct from the state, and authority for building the energy sector (and international energy cooperation) was vested with businesses rather than political actors. This created a need for a legal system to safeguard the interests of firms as a substitute for what were political guarantees under the old model. Moreover, this was considered to be a “normal” state of affairs:

So with the beginning of structural reforms in our economy objective requirements to develop a Russian system of economic/commercial law emerged, which would secure transformations in the field of social economy, *as well as normal activities of the participants in economic life and in their relations with the State.* Such a legal environment is only just beginning to emerge.<sup>223</sup> (emphasis added)

Whereas the state management approach had been perfectly fine previously, the need for legal rather than political guarantees now became necessary. This was a consequence of structural reforms in which the state’s role in the economy was being redefined and the state’s authority in

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219 Konoplyanik, “The Energy Charter Treaty: A Russian Perspective,” (English edition), 158-9.

220 Ibid., 159.

221 Ibid., 143.

222 Ibid.

223 Ibid., 159-60.

economic matters was being curtailed. As a corollary, the authority of non-state actors over economic matters increased. Moreover, the number of non-state actors grew as the role of medium and small business was expanding.

For Konoplyanik, the need for law was an objective necessity. However, an alternative possibility was to deploy financial and energy policy through transformed instruments of state economic management, as proposed by Abalkin. Theoretically, both were viable options. It is only when one imagines a radical change in the “delimitation between the functions of economic and State administration” whereby the authority concerning “cooperation with Western firms” is transferred primarily to “the level of individual economic entities and concerns” to secure “normal activities of the participants in economic life and in their relations with the State” that a legal rather than state/political framework becomes “objectively” necessary. **Whether a neo-liberal approach is imperative depends on the observer’s subjective vision of the state and its relations to economic actors.** If normal relations are based on a neo-liberal view of the state, then a neo-liberal approach is the only option. However, if normal relations are based on a Marxist-Leninist conception of the state, then SCM is adequate.

Because this is a key part of my argument, it is worth examining more closely what the neo-liberal approach implies in terms of state-firm relations and how it differed from the Soviet SCM approach. Dr. Thomas Walde, a British legal scholar and also a close observer of the ECH process, has written about this in discussing the history and logic of the ECH regime:

Russian negotiators, and Western supporters, may have partly viewed the Treaty as a way to *commit Russia’s volatile foreign investment policy to a market economy model*, and thus counterbalance the Russian pendulum swinging between nationalist xenophobia and Westernizing “open door” policies. *CIS countries and their negotiators do not (yet) have the same notion of law, contract, and property; their notion of law is still closer to the idea of a GOSPLAN Directive to entities subject to the State, than to a law distinguishing between the powers of the State and the protected sphere of individual and commercial freedom and proprietary rights... Signing on to such concepts may often seem, to the CIS policymaker, as the thing to do to become a market economy and part of the club of “civilized nations”*; they may have only hazy notions of what the obligations will actually mean for them.<sup>224</sup> (emphasis added)

This passage is interesting for a number of reasons. First, it draws a clear contrast between a neo-liberal approach, which creates a distinct, legal sphere of freedom that protects firms and individuals from the state, and a Marxist-Leninist, Soviet SCM conception, which sees only one social sphere in which private actors are ultimately subject to the state.<sup>225</sup> Second, it again supports the claim that Russian ECH policy was very much about committing Russia to a particular type of political economic system (a “market economy”). Moreover, this was seen as the “civilized” thing to do at the time. The following section continues the investigation of Konoplyanik’s thinking to deepen this final insight.

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224 Thomas W. Walde, “International Investment Under the 1994 Energy Charter Treaty” in *The Energy Charter: An East-West Gateway for Investment and Trade*, 255-6.

225 While I agree with Walde’s claim that the Western liberal vision was not dominant in the CIS, I would also contend that figures like Gaidar and Konoplyanik, academic followers of Western economic and political legal thought (Konoplyanik and Walde were co-authors) most certainly did understand law in the Western sense.

*Accelerated development: Russia's international integration through importing Western law and the ECH*

Konoplyanik's claim that a system of legal, commercial guarantees was imperative for foreign investment into the Russian energy sector did not necessarily entail directly importing the norms of international law into the new Russia. An alternative would have been to develop laws indigenously. By contrast, the strategy that Konoplyanik proposed was to develop a legally binding international agreement that would "fasten" the "rules of the game" to Russian law.<sup>226</sup>

[T]he formation of an effective legal environment within Russia could be obtained through Russia's participation in corresponding international treaties....

[This] will give Russia the opportunity to...use the accumulated historical experience of *western* nations to form effective legal mechanisms regulating the entrepreneurial activities in the energy sector.<sup>227</sup> (emphasis added)

That the ECH regime, as a complex of laws, was heavily influenced by Western legal practice is indisputable. According to Walde, "Many of the concepts of the Treaty come straight out of Western bilateral investment treaty and OECD practice."<sup>228</sup> Moreover, Konoplyanik argued that without "universally accepted 'rules of the game' ...taking root in Russia, it makes no sense to speak about the integration of Russia into the world economy."<sup>229</sup> From this perspective, the integration of Russia into the international economy after the Cold War could only take place according to Western rules.

This approach is extremely puzzling. Even small states rarely implement foreign legislation wholesale the way that Konoplyanik was suggesting. Furthermore, if we take a step back and look at Russian policy from the perspective of *la longue durée*, it is clear that a great power is even less likely to abdicate its sovereignty in a strategically vital area such as energy.<sup>230</sup> Moreover, most elites in Russia found this approach to foreign policy – what many saw as pandering and some as treacherous – highly objectionable even though they were experiencing the same objective economic and political situation as under the first Yeltsin government.

Russia adopted this approach due to a particular image of the state as being backward relative to the West. This can be seen in Konoplyanik's work:

Legislative activity aimed at creating a legal environment in the economic field and especially the energy sector...started when Russian statehood came into being. But there exists a lag, originated by the objective law of historical evolution concerning the time needed in different countries to work out such a legal environment....

Most of the countries negotiating with Russia...began to work out their own internal legislation much earlier than Russia...Russia is confronted with countries who whilst encouraging Russia to introduce corresponding legal rules ...are starting from a *more elevated position* in terms of their understanding of such a system. Legally binding clauses of concluded treaties ...have a *higher*

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226 Konoplyanik, "The Energy Charter Treaty: A Russian Perspective," 163 (Russian edition).

227 Ibid.

228 Walde, "International Investment Under the 1994 Energy Charter Treaty," 255-6 (English edition).

229 Konoplyanik, "The Energy Charter Treaty: A Russian Perspective," 163 (Russian edition).

230 Manchu China is an obvious example; however, Russia was not under foreign occupation, nor was it threatened by foreign military intervention, in contrast to the Bolsheviks. To the contrary, the other Great Powers, led by the Bush Sr. administration in the United States, were careful to respect Soviet sovereignty until the last minute.

*level of legal perfection than if they had been elaborated in the traditional way.*<sup>231</sup> (emphasis added)

At first Konoplyanik suggested that this backwardness had to do with legal knowledge. Thus he explained that importing legislation by ratifying the Energy Charter Treaty,

will give Russia the opportunity to avoid working out its own internal legislation through “trial and error” ...[than if] hatched by the not yet professional (as far as legal know-how is concerned) parliament.<sup>232</sup>

However, it is also clear that an important obstacle was political:

[The Russian parliament] wastes considerable time on political quarrels between different parties and factions, rather than on professional discussion of the essence of the laws to be adopted.<sup>233</sup>

Finally, Konoplyanik stated very clearly that at least part of the political dilemma had to do with competing visions of how to deal with the problem of attracting investment, over which there was no consensus in society:

Reality demonstrates the impossibility of creating an effective system of economic law overnight. Inevitably contradictions arise between time and quality which can only be smoothed away by sacrificing one or the other. The natural tendency to speed up these processes...led only to difficulties (especially in areas concerning subsoil or investment legislation). *Particularly, it appeared that there is no single concept\_agreed upon by all participants*, but rather several administrative or legislative bodies producing parallel...laws...*guided by different theoretical conceptions* and the different interests of their institutions. So eventually, there springs up a “war of legislative versions”...[the] executive’s efforts to play a more important part in the legislative process does not lead to joining the endeavours of both branches...but... to a “war of projects.”<sup>234</sup> (emphasis added)

Overall, this quotation demonstrates that the question of investment into energy was a vital concern for the Russian elite, and yet domestic politics could not function at least partly because there was no single policy vision on which various parties could agree. Moreover, the primary cleavage was between the executive branch and Yeltsin’s government and the parliament.

Finally, when we take into account that the majority of the parliament was populated by people with a vision similar to (or more conservative than) Abalkin’s, it is clear that at least part of the “war” that Konoplyanik described was about different images of the state among the elite, not the least with respect to the question of investment. This can be seen in Italian journalist Giulietto Chiesa’s description of a fall 1992 meeting in the city of Togliatti, attended by the directors of most of the largest factories and plants in Russia and the first government:

All the “Red directors” were there, at least of the biggest factories that were still state-owned....

They took the microphone one after the other while on the presiding committee there sat young people, almost juveniles, who had just left the walls of American universities, fully steeped in the Reagan-Thatcher credo, convinced believers in deregulation.

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231 Konoplyanik, “The Energy Charter Treaty: A Russian Perspective,” 162-3 (Russian edition).

232 Ibid., 163.

233 Ibid.

234 Ibid.

All the “Red directors” said approximately the same thing: we understand that socialism is dead; we know that a good part of our productive capacity must be sacrificed on the altar of competition, efficiency, and the market. But we beg you...to consider two key aspects of the situation. First, behind us stand millions of families, who we cannot just abandon to the whims of fate. *Second, many of the factories and plants represented here could become competitive on the world market in fairly short order if only the government worked out an investment policy aimed at revitalizing them.* We are ready to shut down what must be shut down, but *please tell us what we can save, what you want to set your sights on that would contribute to the growth of production in the future.*

I remember what boredom was etched on the faces of the young men of the presiding committee. *They had not contemplated any government investment program.* Still less were they concerned about the families of those who would lose their jobs. *Not because of hardness of heart. It simply never entered their minds...*<sup>235</sup> (emphasis added)

The same conflict over the image of the state was captured by the philosopher Vadim Mezhuyev, a professor at the Russian Academy of Art. His analysis is different from Chiesa’s because it looks at Yeltsin’s first government’s image of the state from a historical perspective:

The Westernizers of today are different...They have declared the state to be the main enemy of private property. *Nihilism toward the Russian state is perhaps their most characteristic feature.* I don’t know of any Westernizing democrat in the past who would have wanted to achieve political and economic freedom at the expense of territorial loss and geopolitical defeat, the weakening and disintegration of his own state.<sup>236</sup> (emphasis added)

In conclusion, this section has argued that Russia’s neo-liberal approach to the ECH regime emerged after the Soviet SCM approach due to contrasting images of the state. The rupture narrative rejected the Soviet state and embraced its Western opposite. This approach characterized the early government’s political ideology, which foresaw the destruction of the Soviet system and the introduction of “free markets.” It also translated into policy level, technical ideas about attracting foreign investment. In particular, it meant reducing state authority over decisions related to investment while increasing the authority of non-state actors over this issue. Moreover, it meant drawing a boundary between the state and the economy to create a sphere of freedom for economic actors that could only be protected from the state through law.

However, because this image of the Russian state was highly polarizing, national legislation that would implement this vision could not be created through regular political processes. To the contrary, legislative activity resulted in “war” within the Russian state. Thus, these laws (based on Western norms) had to be imported through the Treaty, thereby committing Russia to a “normal” investment regime.

The image of the state informed the new government’s neo-liberal approach to the ECH regime in two ways. First, it informed the strategic choice of opting for a neo-liberal design to the regime. Second, it made inevitable the tactical choice for bringing this model of relations between the state and economic actors in Russia to life; because of broad social resistance to this vision of the state, ordinary legislative processes could not function. As a result, legislation had to be imported into Russia through the new regime.

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235 Giulietto Chiesa, “Farewell, Russia,” *Novaya Gazeta*, March 17–23, 1997, in *Post-Soviet Russia: A Journey Through the Yeltsin Era*, R. Medvedev (New York: Columbia University Press, 2000): 60-1.

236 Vadim Mezhuyev, *Nezavisimaya Gazeta*, February 13, 1997, in *Post-Soviet Russia*, 69.

### Consequences for the ECH regime

Overall, the shift of the new delegation headed by Russia toward a market orientation facilitated a decisive transformation in the ECH process. The regime would overwhelmingly follow the neo-liberal vision incorporated in the British draft and promoted by the United States and EC. According to Andersen, an important transformation had already occurred at the WG I meetings in September, immediately after the coup:

In the second meeting of Working Group I (Charter text) the discussions continued along the same lines as before, but it was clear that negotiators already had come a long way towards finding a compromise text. The number of footnotes which indicated reservations or proposals for change were only 16 (compared to more than 150 in the first round). *The impression was that the link to international market principles was strengthened and accepted by all... Formulations about energy policy...were watered down.* Policy co-ordination was now to be sought when necessary to achieve the Charter objectives.<sup>237</sup> (emphasis added)

Therefore, with a new delegation from the USSR headed by a Russian official, issues that had been controversial before the coup were now quickly resolved. Moreover, the negotiations were proceeding in an increasingly market-oriented direction, and the idea of providing for policy in the regime – a key Soviet concern – gave way to the weaker call for policy coordination.

On October 1, the Secretariat announced that negotiations “defining the essential content of the charter [political declaration]”<sup>238</sup> had made so much progress that only a day, rather than two, would be needed to prepare for the upcoming plenary. The press reported that the agreed-upon draft would be very similar to the initial EC draft and noted the new posture of the “Soviet” delegation:

[T]he text...in short will not vary much from the EEC's [European Economic Community] initial proposal. All the delegations accept both the objectives formulated by the EC and the areas of action identified in the initial draft. *The USSR delegation submitted a counter-proposal dating from July, i.e. prior to the events of last summer in the Soviet Union. This delegation (which included representatives of the Republics, but expressed a single view) now appears willing to debate on the basis of the Secretariat's revised text, which takes into account comments by the Soviets and other delegations.*<sup>239</sup> (emphasis added)

The contents of the draft were described more precisely immediately before the meetings began on October 2:

The first category (the essential protocols) will define its practical operating rules (ratification of the charter, role of the secretariat, conditions for membership and subsequent amendments to the charter, financing) as well as the conditions of market operation (transparency, non-discrimination, free movement, etc.) and investments, including the arbitration body.<sup>240</sup>

Furthermore, it was explained that the Basic Protocols would be obligatory:

All charter participants should make a commitment to ratify the essential protocols which would represent a "balanced package" to be accepted by all. It would not be acceptable for participants to accept protocols "a la carte," agreeing to those of interest to them while rejecting those - possibly

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237 Andersen, “East of Market—West of State,” 22.

238 “The Main Points of the European Energy Charter Have Been Defined,” *Agence Europe*, October 2, 1991.

239 Ibid.

240 Ibid.

costly - in the area of nuclear safety, for example, with which they may feel less directly concerned.<sup>241</sup>

However, states would be able to opt out of the additional protocols if these did not meet their interests:

The more specific additional protocols, on the contrary, will cover areas (for example, technologies for "clean" coal, technology transfer, etc.) which are not necessarily of interest to all participants and the regulation of which could take on a less stringent uniform nature, without compromising the overall operation.<sup>242</sup>

At the meetings in November, it was announced that all issues related to the political declaration had been settled. With respect to finance, the charter was being described exclusively in neo-liberal terms:

Rutten stressed that it did not involve infusions of government money, but aimed at creating the right conditions for private investment in the Soviet Union and also secure energy supplies for other countries of Eastern Europe.

The charter provides an overall framework for energy cooperation, and deals with such issues as the removal of technological, legal and other barriers to the Soviet energy market.<sup>243</sup>

The importance of creating an “attractive” environment for investment by private business was also captured in another article:

Rutten noted that the Charter did not aim to create new public funds but to create conditions that made it attractive for private capital to invest in the development of energy resources in Eastern Europe.<sup>244</sup>

The idea of creating conditions for investors rather than financial mechanisms had prevailed:

Rutten said the charter was a "political declaration" which, while not legally binding, would have a decisive impact on the Soviet energy sector. He argued that although the treaty doesn't specifically provide for new financial instruments or funds for the Soviet energy industry, it would "create the conditions for private capital to invest in the Soviet Union" and facilitate its access to capital resources.<sup>245</sup>

With the political declaration essentially wrapped up, the center of gravity moved to negotiations on subsequent agreements, which continued for the next three years and culminated in the signing of the Treaty in December 1994. I examine these negotiations in the next chapter. However, events transpiring in these early negotiations merit attention as they were indicative of how the new posture in Moscow shaped developments within the regime.

The starting point for negotiations on the subsequent agreements was a UK draft circulated in September.<sup>246</sup> Prior to its circulation, the *Economist* reported on its largely neo-liberal orientation:

[I]t establishes legally binding terms for inward investment and trade, for a charter secretariat and a way of settling disagreements - both between its members and, even more vital, between

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241 Ibid.

242 Ibid.

243 “European charter for Soviet energy finalised in Brussels,” *Agence France-Presse*, November 21, 1991.

244 “Officials Agree Draft Text of Energy Charter,” *Reuters News*, November 21, 1991.

245 Ibid.

246 “A General Agreement on Tariffs and Trade for Energy,” *The Economist*, August 31, 1991.



companies and its members. Unless the economic liberalism of the British draft is abandoned, the protocol could become a model for the way that all business is done between East and West.<sup>247</sup>

Negotiations in WG II (on the subsequent agreement) very quickly revealed that the neo-liberal approach would dominate. As a reflection of this change, it was announced at the second plenary meeting of the Conference on October 22 and 23 that the Basic Protocol(s) were renamed the Basic Agreement, which would become the Treaty and the main staple of the regime.

The protocols had been a key component of the state-oriented approach; they were envisioned as the main vehicles for states to develop energy policies. This is why the protocols were sector specific rather than general because the different characteristics of various forms of energy required specific policy solutions. However, according to the new consensus, the Basic Agreement would only address issues of either a logistical nature or those related to either market-related or legal concerns. Moreover, while the Basic Agreement would be mandatory, subsequent protocols that could address policy questions would be optional.

With the exception of sector-specific issues that the Europeans prioritized – nuclear safety, energy efficiency, and environmental protection – the new regime would focus primarily on creating a legal framework. In contrast to the Basic Agreement (to become the Treaty in 1994), the additional sector-specific protocols, which were optional anyway, would fall to the margins of the ECH process for most of the remainder of the decade.

Previously, the idea of a legal framework, originating in the neo-liberal approach, had coexisted with the idea of protocols derived from the state-oriented approach. The former addressed the interests of private actors by creating legal guarantees; the latter promoted the interests of states by creating a framework for operational principles based on sector-specific policy concerns. However, with the exception of the specific issue areas that were a priority for the West, the neo-liberal approach had largely prevailed over the state-oriented one.

Concerning the role of the state specifically, the idea of management or special states' rights went too far.<sup>248</sup> Only "State sovereignty and sovereign rights over energy resources" was recognized. Moreover, identifying the content of sovereignty was postponed; it would have to be fleshed out in the subsequent legal agreement. Both the norms of free market and "state sovereignty" were integrated into the regime and remain formally in tension with each other to this day. However, the evolution of the regime during the 1990s was guided by the assumption that the interests of market actors came before those of states. Describing the regime in 1996, Konoplyanik wrote:

In general, the Charter is regarded as relying, by virtue of its interior structure, on two "pillars": the creation of a convenient business environment for private investors and the securing of conditions of cooperation on an international level between the contracting parties. In this context, it is correctly presumed that the first "pillar" is more important than the second.<sup>249</sup>

Moreover, no financial mechanisms were foreseen. Investment was to take place strictly within a neo-liberal framework. According to the press,

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247 Ibid.

248 Chatelin, "The European Energy Charter," 10.

249 Konoplyanik, "The Energy Charter Treaty: A Russian Perspective" (Russian edition).

Governments have encouraged their companies to plough money and know-how into the world's largest but sickest oil industry.

But the Charter does not underwrite investments, aiming simply to ease the flow of capital. That leaves the risk-taking to the companies when it comes to turning the Soviet oil industry around.<sup>250</sup>

Evaluating the regime that prevailed, Ruud Lubbers, the initiator of the process, later wrote:

[O]ne major problem remains, and that is the financing of projects. Commercial financing for projects particularly in Russia is very difficult to obtain. The reason is that in many countries the risks cannot be reinsured with the state. Finance Ministers are unable to bear the risk out of the public purse...One of the next steps to be considered in the EU...is a *mechanism* for covering the risks of investment projects.<sup>251</sup> (emphasis added)

In conclusion, the final version was written largely following the conception that had emerged within the EC. First, it embodied the European vision of a loose framework. Second, it emphasized the importance of market forces, although this was tempered by the inclusion of the vaguely defined concept of “sovereignty over resources” and the acknowledgement of exceptions (in terms of time for implementation) for states transitioning to the market. No financial mechanisms originating in state action were developed. Third, in no way did the Soviet vision of a legitimate role for the state, a partner in energy cooperation, make it into the final document. Finally, energy policy clearly took a secondary role to creating free markets protected by law. This format became the starting point for negotiations on the Treaty, which were to begin immediately. The neo-liberal vision had prevailed and would be elaborated at the next, crucial step, when a legal treaty was developed.

On December 17, 1991, the states came together in The Hague to sign the “Concluding Document of the Hague Conference on the European Energy Charter.”<sup>252</sup> The conference went off without a hitch. Twelve Soviet republics attended the signing ceremony, but only eight republics – Russia, Ukraine, Belorussia, Azerbaijan, Georgia, Kazakhstan, Tajikistan, and Uzbekistan – signed the agreement in The Hague. The agreement was also signed by the interstate economic committee, one of the last marks of Soviet statehood, which would expire at the end of the year. The charter was also signed by the three Baltic republics. Eventually, all of the former Soviet republics signed the agreement.

## Summary

When negotiations on the ECH began in 1991, the architecture of the regime was still contingent. There were two roughly balanced coalitions of states, one that favored the neo-liberal approach and another that was more inclined toward a greater state role. Negotiations could have collapsed and no regime emerged. However, the most likely outcome was that the United States would leave the regime (which it did in 1994 when it thought it could get a better deal with Russia on a bilateral basis) and the other states would find a compromise that reflected a mix of neo-liberal and more state-oriented perspectives.

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250 Simon Cameron-Moore, “Energy Charter Opens Western Route to Moscow’s Oil,” *Reuters News*, December 14, 1991.

251 Ruud Lubbers, “Foreword,” in *The Energy Charter*, xvii.

252 Secretariat, “Energy Charter Treaty and Related Documents,” accessed December 15, 2011, <http://www.encharter.org/index.php?id=29>

At the head of a potential state-oriented coalition was the USSR, which submitted a controversial proposal that included an important state role. This proposal was based on the Soviet belief that the state had an important causal role to play in promoting the energy security of society and protecting workers from exploitation (SCM approach). Despite the fact that the USSR was experiencing a deep economic crisis and the authority of the Kremlin was severely diminished – by 1991 relations of authority between the Union republics and the federal state were characterized by heterarchy and the USSR’s corporate identity reflected low sovereignty – the USSR still had the role conception of a regime maker, consistent with the idea of being a superpower that was institutionalized into the Soviet state. Overall, the USSR’s state identity was that of a pretender.

After the August coup, Yeltsin came to power with a very different understanding of the state. This thinking was based on a binary opposition between the Soviet and Western states (particularly the United States). This informed his choice of new governments. Significantly, his new advisers proposed to him the causal idea that maximally withdrawing the state from the economy would allow “free markets” to emerge, leading to economic development and wealth, like in the West. This shaped his subsequent project to destroy the Soviet state, an unexpected choice for a revolutionary leader in control of the state. This points to an important theoretical insight: leaders do not always look out objectively at international and domestic politics to make policy decisions. In some cases, their policy choices are shaped by subjective, internal views of their own state, what I am calling the first image reversed.

Having embraced a neo-liberal approach to domestic reform, it was not a huge leap for Russia to embrace the same perspective in the ECH context. As a result, when negotiations resumed after the August coup, Moscow’s new negotiating position was not just marginally different from its predecessors, it embraced the neo-liberal approach offered by the competing coalition of states. The new Russia had a regime taker role identity. Finally, with only one politically viable approach on the table, the regime began developing according to a particular neo-liberal logic even though other paths were possible.

The next chapter examines Russian policy during negotiations on the ECT, which lasted from 1992 to 1994. It shows how the new ideological line was institutionalized into the Russian state to constitute its regime taker role identity even after the true believers were no longer fully in power. At the same time, since Yeltsin’s authority did not extend to the opposition-controlled legislature, the role identity did not include the whole state but was restricted to the government. This undermined the political strategy for promoting ratification of the ECT.

It also shows that although Russia took the lead in negotiations, its agenda positioning was within the mainstream and conventional. To bring this point into relief, the chapter also examines the ECH policy of Norway (also an energy exporter to Europe), which in promoting a state perspective went against the neo-liberal consensus and was completely isolated.

## **CHAPTER FOUR: RUSSIA AS REGIME TAKER UNDER YELTSIN – STATE ROLE IDENTITY AND ECH POLICY (1992 TO 1997)**

### **Overview**

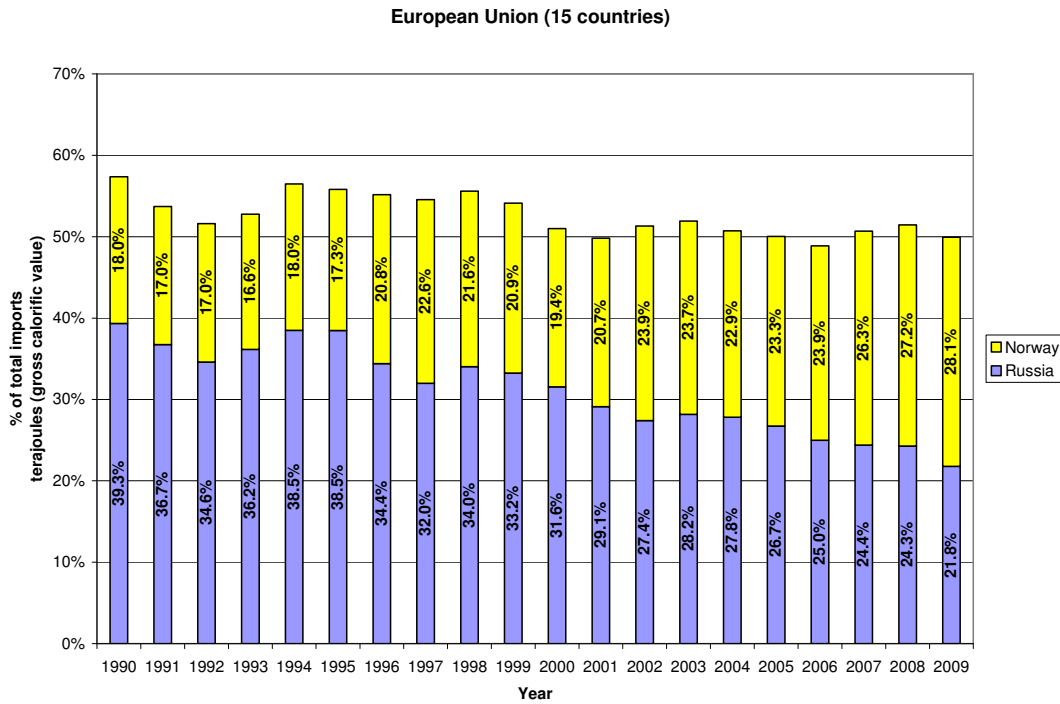
This chapter examines Russian policy toward the ECH regime from 1992 to 1997. I begin by examining negotiations on the Basic Agreement that lasted from January 1992 to December 1994, when it was signed as the Energy Charter Treaty. I focus first on the rules for investment that the Treaty created. I also look at the fate of the protocols that were initiated in late 1991. To bring Russia's policy into relief, I compare it to that of Norway. As we can see in Figure 4-1 and Figure 4-2,<sup>253</sup> Russia and Norway combined make up a very large share of EU gas imports. A priori, we might expect these two states to join forces and leverage their market power to design a regime that promotes their common interests as exporters. In other words, we would expect an exporter alliance to craft an exporter-friendly regime.

No such alliance emerged, and this was because Russia advanced neo-liberal policies while Norway supported policies that provided for an important state role. Norwegian policy was based on what I am calling the state management (SM) approach to the energy sector. In terms of agenda positioning, Russian policy was conventional in that it was very much within the neo-liberal mainstream. Even when it took the lead and made bold demands, they were still within a neo-liberal framework. Meanwhile, in promoting state-oriented policy, Norway's agenda positioning was controversial, and it found itself isolated within the ECH regime. This is puzzling since both in terms of general power and proportion of EU energy imports, Russia was the more powerful state. Russian policy missed any opportunity to revise the neo-liberal design of the regime during this time, whether through an alternative set of investment rules that

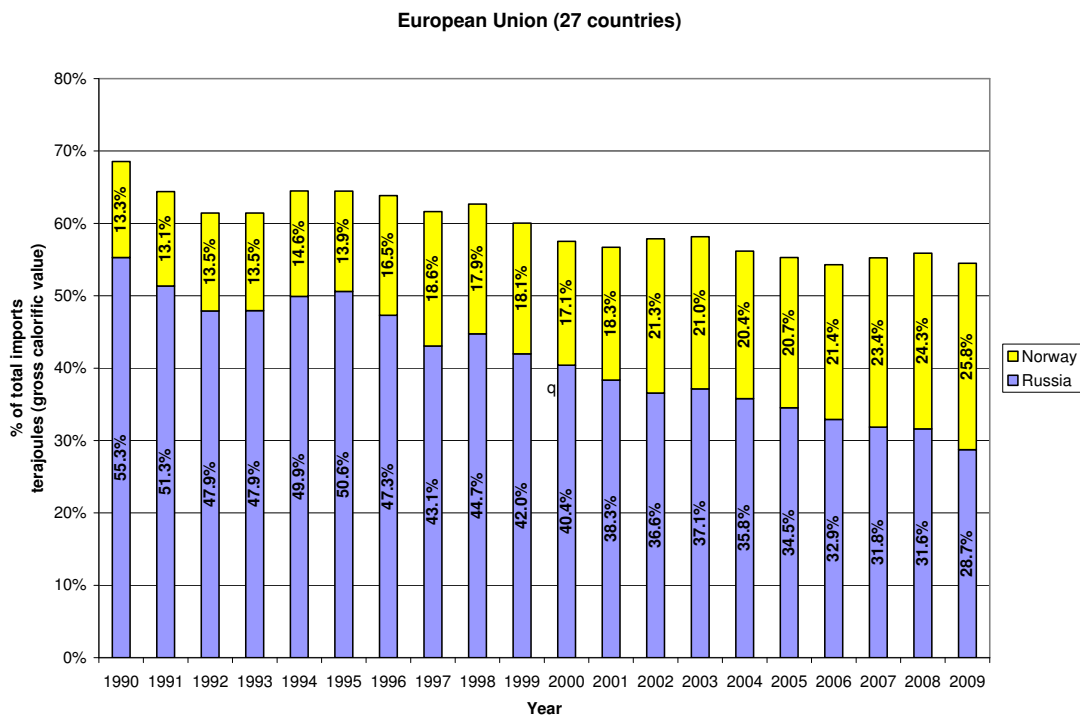
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253 Eurostat statistical database, "Imports (by country of origin) - gas - annual data," accessed December 13, 2011, <http://epp.eurostat.ec.europa.eu/portal/page/portal/energy/data/database>.

**Figure 4-1 : Percentage of total natural gas imports from Russia and Norway (EU-15)**



**Figure 4-2 : Percentage of total natural gas imports from Russia and Norway (EU-27)**



established greater constraints on foreign investment or a sectoral protocol that created a space for state energy policy.

Next, I explore the political strategy for generating support in Russia for the ECT, especially in advance of ratification by the State Duma. I focus on a series of seminars that were co-sponsored by the Russian Ministry of Fuel and Energy and the Energy Charter Secretariat. The logic of this strategy, I argue, was based on a neo-functionalist theory of teaching/learning; the idea was for those well versed in the process (the teachers) to persuade the audience of the merits of the ECT by 1) establishing trust with the audience; 2) presenting the neo-liberal model as inevitable; and 3) showing how the ECT promoted the neo-liberal model to achieve goals desired by Russia (attract foreign investment). In practice, teaching/learning occurred only within state institutions where Yeltsin had authority. Therefore, thinking within the government converged on the neo-liberal model, but no such convergence took place within the opposition-controlled Duma or at Gazprom. As a result, ratification was blocked. Despite signing the Treaty, the Russian state could not follow through on its commitment. The specific reasons for the failure of ratification will be dealt with in greater detail in the next chapter.

Finally, I explore why Russia continued to embrace the neo-liberal approach throughout the 1990s. This continuity is surprising given that the government of “young reformers” – who accepted neo-liberalism as a matter of conviction – fell apart in mid-1992 (when Chernomyrdin entered the government) and was again in power only during a brief period in 1998 (when Kirienko became prime minister from March to August). In fact, the neo-liberal ideological line was institutionalized into the state through the role of being a state official. The idea was that Russia was sending an external signal to investors and other states about the kind of state it had become. The fact that other states and not just investors were also the intended audience is significant because it highlights an important political aspect of Russian ECH policy; accession to the regime was part of a larger project for integrating Russia into the international economy according to frameworks proposed by other powerful states.

In any case, I show how the acceptance of the neo-liberal approach under Yeltsin was institutionalized as a property of the state and that it was independent of government officials’ personal convictions. Neo-liberalism shaped the discourse and policy behavior of Russian officials because it was part of their job, irrespective of their personal convictions. From the perspective of state identity theory, the institutionalization of the neo-liberal approach into the state apparatus constituted Russia’s role identity as a regime taker.

However, this institutionalization was not complete since it did not extend beyond the government to other agents of the Russian state such as the State Duma or Gazprom (in which the state was the largest shareholder). As a result, Russia’s role identity was contradictory; the government was a regime taker, but other parts of the Russian state were not and behaved accordingly.

In examining the Yeltsin period, I refer to state role identity to facilitate the discussion. Strictly speaking, Russia had several role identities. The term “state role identity as understood by the government” is cumbersome, so I have decided to use the simpler “state role identity,” but alert the reader to this linguistic and analytical complexity.

## Organization of chapter

The first section demonstrates the importance of the ECH to Russia and also Russia's importance to the regime. The section that follows focuses on the fact that the Russian government was especially interested in the ECH to attract investment into its energy sector. The third section looks at Russia's approach to the ECH at a general level by examining its first policy statement (February 1992) after taking over negotiations. We can see that its ECH policy was linked to radical domestic economic reforms, and both were informed by the neo-liberal perspective. Moreover, domestic reforms and the ECH were part of a process to integrate into the international economy through accepting the neo-liberal approach. At the same time, while accepting the neo-liberal approach, the new Russian delegation did not just roll over and accept the terms offered by other states; during negotiations on the Treaty, it fully intended to promote Russia's interests as they were understood at the time. However, its demands remained within the neo-liberal framework.

The fourth section examines Russian investment policy, which was to establish national treatment (NT) for foreign investors at all stages of investment, including privatization. NT was the most liberal approach available, favored by the United States, and embraced by Russia because it was consistent with its policy to create competitive markets in the energy sector. At the same time, Russia also foresaw making some exceptions to NT. Some of these were connected to concerns related to state sovereignty. However, closer examination shows that Russia's understanding of state sovereignty was deeply informed by the neo-liberal perspective. This interpretation is also supported by the fact that Russia's position on this question (exceptions) was not controversial during negotiations.

To bring the neo-liberal character of Russia's policy into sharper relief, the section that follows examines Norway's policy during negotiations on the Treaty. It shows that Norway challenged the neo-liberal consensus prevalent within the regime. It also demonstrates that Norway tried to restructure the regime by suggesting that the issue of access to and development of resources was not just a question of capital movement but also of state energy policy, which was related to the broader issue of state sovereignty. This novel conceptual linkage was quite provocative; several states feared that such a restructuring would result in subordination of the neo-liberal approach to one based on a more robust understanding of state sovereignty, understood not just as legal sovereignty but also as direct state authority over the economic decision-making process. They feared that this would undermine the spirit and purpose of the regime: to attract investment into the transition economies. Ultimately, the restructuring suggested by Norway was not accepted.

Analysis of Norway's position also shows how this resource-rich state understood the relationship between foreign investors and the state. For Russia, there was a harmony of interests between the two. By contrast, Norway also saw potential conflicts of interest. Therefore, although Norway did not preclude foreign participation in its energy sector, it also saw an important role for the state in reconciling conflicting interests through political bargaining in venues created by the state. Finally, we can see that Norway also tried to present its interest in the SM perspective as a general interest for all states. However, this bid for hegemony was not successful; Norway was completely isolated in advancing SM.

The next section looks at the fate of the protocols. As we saw in the previous chapter, the ECH states had initially agreed to proceed along a "broad front" to address the crisis in the

Soviet energy sector. This meant working simultaneously on a political declaration, general protocol, and sector-specific protocols. The latter were particularly significant since these were associated with a more state-oriented approach that was concerned with energy policy. Five working groups were established in 1991. Already in October 1991, the general protocol became the focus of everyone's attention and was renamed the Basic Agreement. This reflected that the regime was evolving in a more legal direction. Furthermore, with the exception of the protocol on energy efficiency and environment (in which all states were interested), the other protocols (on nuclear energy and hydrocarbons) did not materialize. Especially interesting was that Norway chaired the working group on hydrocarbons, and this protocol was abandoned early. The evidence suggests that Norway tried to use this forum to promote its policy goals but was unsuccessful; the neo-liberal consensus was too great. The next section examines the outcome of negotiations; of particular interest is that while Russia began provisional application of the Treaty and agreed to international adjudication of investor-state disputes, Norway did neither.

The section that follows examines the ratification process to understand supporters' political strategy for promoting ratification and look more carefully at Russia's regime taking. The main thrust of this strategy was to hold a series of seminars based on a neo-functional logic premised on social interaction, which would generate a cognitive consensus on neo-liberalism and the advantages of the ECT through persuasion. This depended on three elements: 1) the generation of trust through personal relations; 2) the presentation of the neo-liberal approach to the trusting audience as the only way to attract investment; and 3) teaching/learning through presentation of facts about how the ECT promoted the Russian goal of attracting investment. This strategy was not specific to the ECH regime but was part of a general strategy during the 1990s to socialize Russia to accept what were construed as "international norms." However, it appears that cognitive convergence on the neo-liberal framework and acceptance of the ECT were driven more by political than interactional or cognitive factors. Ultimately, this strategy was unsuccessful; no cognitive consensus emerged in the Duma. The Russian legislature was not persuaded; it did not "learn" to embrace the ECT. As a result, it postponed ratification. This section also examines the reasons that were given for this action.

The next section revisits how Russia understood state sovereignty. Analysis of the treaty negotiations showed that for Russia, state sovereignty referred primarily to the state's exclusive authority to make laws. The discussion of the ratification process allows us to expand this insight; sovereignty also meant that 1) states had the exclusive authority to make international laws; 2) states were bound by international laws once they committed to them; and 3) all states were equal in their relations to one another. Interestingly, the idea of being bound by law also included the right of investors to resolve disputes and receive damages, a novel concept from a historical perspective and one that the ECT incarnated through very specific articles on dispute resolution. Moreover, this provision is the basis for the lawsuit against the Russian state by GML Ltd. (formerly Group Menatep Ltd.), which represents the shareholders of the expropriated former oil company Yukos.<sup>254</sup> With potential damages estimated at between \$30 and \$100 billion (depending on when expropriation is determined to have taken place), this is the largest

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254 GML owned 60 percent of Yukos. Interview with Tim Osborne, CEO of GML (ex-Yukos shareholder). "Russia Bound by Energy Charter Treaty," *Europolitics* 3762, May 29, 2009. Seventy percent of GML is owned by L. Nevzlin, to whom Khodorkovsky's shares were transferred. Michael D. Goldhaber, "A Lifetime of Litigation," *The American Lawyer*, July 1, 2010.



damages claim in the history of international arbitration.<sup>255</sup> I will return to this issue in the final chapter. Ultimately, Russia's understanding of state sovereignty was intimately connected to its acceptance of neo-liberalism, and the most obvious consequence was that it was willing to forgo recourse to state power. From a broader historical context, it is highly anomalous that Russia would accept such a model.

The point of departure for the remainder of the chapter is that the preceding discussion will have established that Russia accepted the neo-liberal framework and thus had a regime taker state role identity at least until 1997 (the latest moment under examination here). Moreover, Russia contributed to the neo-liberal design of the regime by supporting particular policies during negotiations. Finally, it also supported the ECH regime and Treaty after negotiations were complete. Because the “young reformers” (who accepted neo-liberalism and supported the regime and Treaty as a matter of conviction) were only in power sporadically during this time, this continuity in policy is puzzling. The next two sections explain this persistence by showing how acceptance of the neo-liberal framework and the ECH regime and Treaty were institutionalized into the state apparatus through the ideological line, a term derived from interviews with both participants and observers of the ECH process. As a result, government officials' discourse and policy behavior reflected the neo-liberal approach regardless of their beliefs.

The section that follows connects the institutionalization of the neo-liberal line and supporting the regime and Treaty to the regime taker role identity. The key insight here is that the ECH regime and Treaty were instruments for Russia to signal to the outside world about what kind of state it was. The final section extends this finding by showing that Russia's signal was intended not only for investors but also for other states. Russia was creating an intersubjective understanding that it was a new kind of state, different from the USSR. Moreover, this was part of a broader project to integrate into the international economy and the community of Western states that it desperately wanted to join. In short, Russian ECH policy was certainly about attracting investment, but it was also about inclusion in international society.

### **Importance of the ECH to Russia and vice versa**

From the very beginning of the first Russian republic (1992) and throughout the remainder of the decade, the ECH and ECT in particular were top priorities for the Russian government. This is already clear in its first post-Soviet energy strategy – the Energy Policy Concept of Russia in New Economic Conditions<sup>256</sup> – which states that “Russia's participation in international cooperation must develop in strict correspondence to the obligations undertaken by Russia in connection with the European Energy Charter and other international agreements and accords.”<sup>257</sup> In connection with Russia's relations with other former Soviet republics within the Commonwealth of Independent States (CIS), the document identifies as a specific policy direction “energy policy coordination among CIS states in international organization and

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255 Ibid., “Yukos Could Bankrupt;” Markiy M. Malskyy, “Energy Charter Treaty: a backup plan for investors?” accessed April 8, 2011, [http://arzinger.ua/file\\_collection/en/UJBL\\_info\\_ECT\\_Malskyy.pdf](http://arzinger.ua/file_collection/en/UJBL_info_ECT_Malskyy.pdf). Goldhaber, “A Lifetime of Litigation.”

256256 This document was developed in early 1992, reviewed by an academic and ministerial commission in June 1992, and approved by the government in September 1992. Bushuev et al., *Energy of Russia*, 260.

257 Ibid., 325.

economic-trade relations with other countries, particularly in the framework of the European Energy Charter.”<sup>258</sup>

The importance of the ECH for the Russian government can also be seen by its inclusion in official strategy documents such as Chernomyrdin’s report to the government in September 1992,<sup>259</sup> the Russian Energy Strategy through 2010 approved on October 1995,<sup>260</sup> the Conceptual Guidelines of Russian Energy Diplomacy from 1996,<sup>261</sup> the Agreement on the Problems of Future World Energy (agreed upon at the meeting of energy ministers from the G8 countries),<sup>262</sup> and the Main Guidelines for Russian Energy Strategy Through the Year 2020 from November 2000.<sup>263</sup>

It is clear that the ECH was a foreign policy priority for Russia under Yeltsin. At the same time, Russia’s participation in the regime was also considered important by other actors. During a seminar on the ECT held in the State Duma in February 1997, the EC Commissioner for energy, small and medium enterprise, and tourism, Christos Papoutsis, stated that,

The process of ratification of the ECT by the European Communities is moving full steam ahead. I would like to let you know that the European parliament is holding hearings concerning ratification and there is hope that a positive decision will be taken....In this connection, ratification of the ECT by the Russian Federation takes on a special meaning. What kind of Energy Charter would there be without the active participation of Russia? In such a case, the very basis, the very meaning of the Charter would be undermined<sup>264</sup>.

Russia’s participation in the regime was considered essential by other states, particularly the EU.

### **The ECT as an instrument for attracting investment into Russia**

The ECT was seen first and foremost as a necessary vehicle for attracting foreign investment into the Russian energy sector. This was both a short- and longer term goal. As the new Russian delegation pointed out during a Working Group II (WG II; developing the text of the Basic Agreement) meeting on February 25, 1992, economic production was falling. The oil industry was a case in point: production had fallen from the 1988 maximum of 570 million tons annually to 460 million tons in 1991 (nearly a 20 percent fall) and was forecast to fall to 405 million tons (almost another 10 percent) during 1992. Already in January 1992 output had fallen 14 percent (with respect to production the previous month) as compared to an 11 percent fall during January 1991. The delegation linked the fall in production to capital shortages, specifically, a lack of foreign investment:

The problem of attracting foreign capital into the main sectors of the economy, which are experiencing a steady fall in production chiefly due to a shortage of basic capital funding and the

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258 Ibid., 322-3.

259 Ibid., 344.

260 Ibid., 445.

261 Ibid., 541.

262 Ibid., 603.

263 Ibid., 784-5.

264 C. Papoutsis, “Europe is for Cooperation,” in “Energy Charter Treaty—Parliamentary Hearings,” *Ecology XXI, International Scientific Journal* 1 (2001), excerpts from the transcripts of the February 17, 1997, Federation Council seminar.

actual lack of equipment and materials, is becoming more and more acute. An obvious example is Russia's oil industry which for this reason decreased output.<sup>265</sup> (figures cited above)

It was hoped that near-term investments could reverse this capital shortage, allowing production to grow and exports and foreign exchange revenues (both for firms and the state in the form of taxes) to increase.<sup>266</sup>

Attracting foreign investment was also a longer term goal that, in addition to reinforcing the benefits of the short-term effects just mentioned, would allow Russia to relieve the strain on its energy sector by refurbishing its aging infrastructure, increasing efficiency, reducing the energy intensity of the economy overall, and developing new mineral deposits that were often in geographically complicated and remote (with respect to the markets they expected to supply) regions.<sup>267</sup>

The idea that investment was the main reason for the difficulties in the Russian energy sector was a constant throughout the remainder of the decade. During the seminar to promote ratification of the ECT held in the Federation Council on February 17, 1997, the representative from the government, Deputy Minister of Fuel and Energy and head of the Russian negotiation delegation at the Energy Charter Conference A.T. Shatalov argued that although factors such as the disruption of economic ties within the former USSR, non-payment, an inadequate tax policy, and others were related to the fall in oil production, “nevertheless, in our opinion, the main reason was and remains the chronic lack of investment.”<sup>268</sup>

### **Domestic reforms, the BA, and international integration within a neo-liberal framework**

This section examines an early Russian policy speech made in the context of negotiations on the Basic Agreement (BA), which would become the ECT. The goal is to show that Russia's approach to the ECH was consistent with its approach to domestic economic reforms, and that both were informed by the neo-liberal perspective. Moreover, both were a part of a larger process of integrating into the international economy according to models proposed by other states. However, we can also see that the new Russian delegation was not just rolling over and accepting the terms offered by other states; it fully intended to promote Russia's interests as they were understood at the time during negotiations on the ECT. At the same time, the interests it articulated did not challenge the neo-liberal framework.

Negotiations on the Basic Agreement began almost immediately after the ECH political declaration was signed in December 1991. The Russian delegation made its first policy presentation to other ECH participants during a meeting of WG II on February 25, 1992. This was less than two months after the collapse of the USSR. The statement included a section on Russian policy for domestic economic reform that explicitly spelled out the government's vision

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265 “Statement by the Russian Delegation,” meeting of Working Group II, February 25, 1992, Archive of Travaux Préparatoires Documents, Energy Charter Secretariat, Brussels.

266 Russian Energy Policy Concept (1992) 263,269, 279; Julia Doré and Robert De Bauw, *The Energy Charter Treaty: Origins, Aims and Prospects* (London: Royal Institute of International Affairs, Energy and Environmental Programme; Washington, DC: Brookings Institution, 1995), 29.

267 Bushuev et al., *Energy of Russia*, 261, 263, 265.

268 A.T. Shatalov, “The Russian Fuel and Energy Complex and the Energy Charter Treaty,” in “Energy Charter Treaty—Parliamentary Hearings.”

and linked it to the agreement. The presentation highlighted a number of policies that Russia was pursuing:

This reform envisages pursuing a policy of economic stabilization, transition to market conditions, privatization, and demonopolization with the *fullest possible activization* [sic] and *liberalization* of Russia's economic relations with the outside world.

If these tasks are to be fulfilled, there has to be a consistent course towards an *open economy* and *entry into the world economic community*. In this connection, participation in the Basic Agreement on the European Energy Charter is in line with the course of action announced by the government of Russia.<sup>269</sup> (emphasis added)

In general terms, the reform policy that Russia was announcing was largely inspired by a neo-liberal perspective. This vision was also connected with the idea of Russia's participation in the world economy within a neo-liberal framework. Specifically, integration was supposed to reinforce the domestic reforms that were planned, and the Basic Agreement was a part of this process.

Surely there was an element of bargaining here: Russia was asking to be included into the international economy, and in exchange it was implementing domestic policy that Western actors found favorable. However, as we saw in chapter 2, the USSR under Gorbachev was also asking to be included in the international economy. Both the USSR and Russia wanted to be full participants in the international economy, both believed that this would have a salutary effect on the domestic sphere, and both engaged in bargaining. However, the distinction was that whereas the USSR was attempting to set the terms of its integration - in particular promoting socialist ideals that suggested a socialist market approach with a prominent economic role for the state – Russia's bargaining did not challenge the neo-liberal perspective. The Russian government aimed to liberalize as fully as possible and create an open economy, which represented an acceptance of the neo-liberal perspective and the norms and principles that it embodied.

The statement also addressed the specific question of foreign investment in Russia:

In the area of creating a climate for investment, the first positive results have been achieved.

As you know, as early as last year a law on foreign investments was adopted which laid the foundations for foreign capital operations on the country's territory. A series of amendments to this law are currently being prepared, providing for *additional privileges* for foreign capital and removing a number of obstacles from the investment process. (italics added for emphasis; underline in original)<sup>270</sup>

The text then lists a large number of legislative achievements and plans. Investment policy was also influenced by the neo-liberal approach, and this was captured by the idea of building on already liberalizing RSFSR laws to create more "privileges" for foreign investors. At the same time, the statement clearly reflected the importance of neo-liberalism with its emphasis on the legal aspects of reform; this is consistent with Aslund's observation (chapter 3) that in terms of state action, early reformers prioritized the creation of laws.

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269 Russian policy speech at a meeting of WG II, Archive of Travaux Préparatoires Documents, Energy Charter Secretariat, Brussels, February 25, 1992.

270 Ibid.

Russia also noted the imbalance in the advantages the emerging agreement offered to Western states (which wanted access to resources) as opposed to Russia (which wanted access to financing and consumers):

[T]he agreement has to be worded in such a way that in all of its positions the balance between rights and obligations is clearly felt in regard to access both to resources and to capital and markets. The impression is now forming that the articles on access to resources have been better formulated, and contain stricter obligations.<sup>271</sup>

This shows that even as a brand new state still experiencing a major crisis, Russia was thinking in terms of its interests, and it did not refrain from voicing its intent to change the agreement as necessary. Russia did not merely roll over and accept Western terms. The Russian delegation expended significant effort to shape the Treaty provisions governing access to capital and markets and also transfer of technology in a way that it thought suitable. As we will see shortly, Russia also led the bloc of post-socialist states in boldly demanding and eventually being granted a transition period. However, when promoting its own interests, Russia did so within the neo-liberal framework; with respect to several issues, Russia was more committed to neo-liberalism than many Western states that for a variety of political and economic reasons resisted liberalization in certain areas.<sup>272</sup> Here we can also see the difference between agenda setting (beginning a discussion about a transition period) and agenda positioning (conventional).

### **Russia's neo-liberal policy and investment rules in the ECT: creating competitive markets**

#### *National treatment and competition in energy*

The preceding passage looked at an early, general policy statement from Russia. This section looks at Russian policy toward investment. For Russia, the ECH was seen first and foremost as a vehicle for attracting foreign investment into its energy sector, and as a result it was a top priority throughout the 1990s. To entice investors, it supported the national treatment regime (NT) for the ECT that was proposed by the United States. Moreover, Russia was an exception among the major participating states in that it wanted to extend NT to the “pre-investment”<sup>273</sup> stage to attract foreigners into the energy sector at the very earliest stages of its transformation away from the Soviet system.

Therefore, in the summer of 1992 President Boris Yeltsin traveled to the United States to, among other things, promote foreign investment into the Russian economy, including energy:

Russian President Boris Yeltsin donned the mantle of super salesman yesterday, telling U.S. business executives that his country is a land of profits for them and asserting that Russia's turn toward a free-market economy is "totally irreversible."

Yeltsin said his country is seeking "hundreds of billions of dollars" in foreign investment to aid the switch from communism to capitalism.

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271 Ibid.

272 This included issues such as access to capital and markets, technology transfer, and nuclear energy.

273 The pre-investment stage referred to granting investors access to markets, for example through licensing rounds or calls for tender. The post-investment stage referred to investors already established in a country. Doré et al., *The Energy Charter Treaty*, 28.

And echoing the words of Mikhail Gorbachev, former president of the old Soviet Union, Yeltsin urged Americans "not to be late to the table [so] they will be able to tap the enormous potential of our country."

If they wait beyond 1993, he said, "it will be too late."<sup>274</sup>

In particular, Russian government officials were concerned that if foreigners waited too long to act, domestic investors would grab up Russia's available energy assets and thereby limit the coveted participation of foreigners in ownership. This urgency to attract foreign investors before it was "too late" continued through at least the middle of the decade.<sup>275</sup> In 1999, when a new Law on Foreign Investment (the most general of a series of laws that regulates foreign investment into energy) was finally enacted to replace the 1991 RSFSR law, the new legislation included national treatment for foreigners.

One of the more specific reasons Russia wanted foreign investors to participate in its energy sector from the ground up has to do with its policy of creating markets under Yeltsin. The Yeltsin government was planning a radical structural transformation of the energy sector along neo-liberal lines. First, this implied privatization. Former Deputy Secretary General of the Energy Charter Secretariat Valery Sorokin has written about the essence of privatization:

The programme for 1994 gives a fairly good illustration of what Russian privatization is about.....

Major Aims:

- creation of large numbers of private owners
- maximum participation of the population in buying state and municipal property
- and attraction of domestic and foreign investments into production.<sup>276</sup>

Privatization in Russia was a very controversial and polarizing affair. According to Sorokin, "The new Russian leaders used privatization to the fullest to undermine the existing economic and political system."<sup>277</sup> As the ECT was being negotiated, a major confrontation over the second phase of privatization erupted. Cleavages emerged between the government and parliament and within the government.<sup>278</sup> According to Sorokin,

With the beginning of the "cash" stage of privatization the focus of privatization policy is shifting to denationalization of strategically important enterprises....

[T]he Duma adopted a resolution giving an "unsatisfactory" mark to how the Federal Government carried out the first stage of privatization.

There is a division within the Federal Government itself. The newly appointed chief of the State Property Committee (SPC) tried to introduce important corrections to the philosophy and practice of privatization. This provoked a lot of criticism and led to a sharp reaction from a majority of

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274 Stuart Auerbach, "Pitching Russia's Potential; Yeltsin, Bush Urge U.S. Business Executives to Invest," *The Washington Post*, June 18, 1992, a35.

275 Interviews, Moscow, spring 2009.

276 Valery P. Sorokin, "Why and What Kind of Transition Measures," in Walde, *The Energy Charter: An East-West Gateway*, 588.

277 Ibid., 589.

278 Ibid., 587.

influential Cabinet members. An unprecedented Government statement was issued, asserting the continuity of the Russian privatization policy. The Chief of the Committee was removed but landed at a high level position in the President's Control and Investigation Department.<sup>279</sup>

Having completed the first stage of privatization, the government was moving to larger and more significant enterprises that included the fuel and energy sector. This was part of a broader initiative to transform the structure of the energy sector. Not surprisingly, opposition emerged in the conservative Duma.

More unexpectedly, demands to revise the neo-liberal approach also appeared at the head of the agency responsible for privatization. The new chief, Vladimir Polevanov, who in November 1994 replaced the architect of the first stage of privatization, the neo-liberal Anatoly Chubais, suggested a shift in the philosophy of privatization. This was resisted by other segments within the Yeltsin government. In the end, Polevanov was moved to a different agency, and the president issued an “unprecedented” statement that with respect to privatization, Russia would stay the course. Sorokin concluded that,

Of course, all this does not increase the *tactical* stability in the area of Great Russian Privatisation. But the last developments in their special way only proved that economic reform in Russia has passed a point of no return. *Strategically*, privatization – as the key element of this policy – will endure.<sup>280</sup>

In short, the challenges to privatization created a difficult political terrain. Nevertheless, due to the president's personal intervention, the neo-liberal paradigm for privatization survived.

However, privatization alone could not succeed in creating efficient markets if it reproduced the monopoly structure of the energy industry that Russia inherited from the USSR. According to Aslund, the monopoly structure of Soviet/Russian industry was a top concern for the government.<sup>281</sup> As we saw in the passages earlier, the government was aiming for a “large number of private owners.” It was believed that privatization had to be combined with full liberalization of inward investment so that foreign investors could enter the market. This was one reason why the Russian government was critical of Norwegian arguments in favor of a Most Favored Nation (MFN) regime:

[MFN] would consolidate their monopolistic (or at least dominant) positions on the Russian market under the present conditions, where practically no competition exists. ...[Under NT] competition with foreign investors will become very hard for the Russian (until now) monopolists.<sup>282</sup>

In fact, the Norwegian proposal found a sympathetic audience in many quarters in Russia: “The Norwegian approach...seemed to be quite attractive to a number of administrative bodies and for most of the Russian enterprises producing energy.”<sup>283</sup> Not surprisingly, it was broadly supported by the energy sector (the companies of which at a minimum did not want to see their monopoly rents whittled away through competition). However, it was also supported by state officials who opposed the neo-liberal restructuring of the Russian energy sector proposed by the

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279 Ibid., 589.

280 Ibid., 589-590.

281 Åslund, *How Russia Became a Market Economy*.

282 Konoplyanik, “The Energy Charter Treaty: A Russian Perspective” (English edition), 173.

283 Ibid.

government; the Norwegian proposal was attractive because it was consistent with their ideas about organizing the Russian energy sector.

To summarize the discussion so far, Russia was exceptional among the ECT states in that it wanted an investment regime that was as liberal as possible at all stages of investment because this was consistent with the government's project for creating markets in energy. In particular, the government envisioned that many firms would compete with one another in the energy sector. However, foreign investment was a necessary condition so that mass privatization would not result in markets monopolized (or dominated) by a few Russian-owned firms. As a result, the government supported NT, which included the "pre-investment" stage (applicable to privatization). Because MFN would discriminate against foreign investors in favor of domestic investors, it was not sufficient given Russian structural policy. As a result, the Russian government was not receptive to the Norwegian proposal for MFN.

*Exceptions to NT: sovereignty within a neo-liberal framework*

Although the Russian government wanted NT, it would be inaccurate to suggest that it envisioned completely unlimited investment opportunities for foreigners. There was an understanding within the government that such a sphere of freedom needed to be limited to a certain extent, and as a result Russia anticipated that there would be exceptions to NT. The NT investment regime proposed by the United States foresaw that states could maintain some exceptions that were already enshrined in domestic legislation. Although having exceptions to NT did violate free market norms, this was not controversial within the context of negotiations because all the states, even the United States, which was the leading advocate for a NT investment regime and a free market approach, understood that they were necessary. By contrast, Norway was not interested in exceptions to NT; as the next section shows, it wanted a much less liberal regime.

Russia embraced the possibility of exceptions for a number of reasons. First, the possibility of exceptions to NT would allow it to temper domestic opposition to the agreement. According to Doré:

Although the Russian delegation re-emphasized its support for the national treatment principle, it did not see itself able to undersign this commitment without sufficient national legislation in place to guarantee compliance with the Charter and without full parliamentary endorsement of the major investment principles. It would have been useless or even counterproductive for the Russian delegation to sign up to a Treaty that would not be welcomed, much less ratified, by Parliament.<sup>284</sup>

A second reason for exceptions to NT was that Russia's legislation at the time already had some provisions in place for limiting foreign investment in energy. The 1991 RSFSR Law on Foreign Investment, a holdover from the Soviet period, granted NT but also emphasized the possibility of making exceptions.<sup>285</sup> Moreover, in August 1992, Yeltsin issued a decree that privatization in energy would be "special":

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284 Doré et al., *The Energy Charter Treaty*, 31.

285 Konoplyanik, "The Energy Charter Treaty: A Russian Perspective" (English edition), 173.



Presidential decrees were to be made on a case by case basis. They had to specify two key aspects: distribution of shares (what is the government's package; limits for foreign participation) and management structure.<sup>286</sup>

Other measures were also in place. For example:

The Federal or Subfederal Governments must rule on participation of foreign investors in defence, oil, gas, production and processing of strategic raw materials, precious and semi-precious stones, non-ferrous metals, radioactive and rare earth elements, transportation and communication. And if a foreign investor wins a tender, its organizers give information on the winner to the Federal Government and to the Federal Anti-Espionage Service. The FAES has the right to transmit to the Federal Government a relevant conclusion, on the same basis of which the Government makes a Ruling.

Generally, foreign investments are not allowed into privatized enterprises which are located in restricted areas. In every case of privatization of an energy company a limit is set for foreign participation. In the oil sector, this is usually 15 per cent. For Gazprom it is nine percent.<sup>287</sup>

Therefore, the Russian delegation could not accept a regime that did not provide for any restrictions on investment because it would have contradicted the laws existing in Russia at the time. This was also related to the problem of parliamentary approval, since the legislature was much less likely to ratify an international agreement if the agreement contradicted many laws already on the books.

Russia also argued that it should have a transition period during which it would be able to create additional restrictive legislation:

[National treatment] could be accepted only if Russia was accorded a transition period, during which the elaboration of our new legislation and of our Government's policy in the realm of foreign investment could be more or less completed. In the course of this transition period, the number of exceptions from the national treatment regime needed to be extensive, and this would be, we supposed, an inevitable consequence of the building up of a "legislative framework" within our country.<sup>288</sup>

The idea of a transition period, which was proposed by Russia for all the post-communist states, was a major source of contention during negotiations and "caused a deadlock of negotiations over the summer months of 1993."<sup>289</sup> (Ultimately, the Russian position prevailed, and a finite transition period, during which many ECT provisions would be in abeyance for all Eastern states, was allowed.) However, in contrast to the Norwegians, who emphasized the importance of direct state management of energy resources, Russia's reasons for exceptions were less focused.

In describing the logic behind the Russian position, Dr. Andrei Konoplyanik<sup>290</sup> wrote:

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286 Sorokin, "Why and What Kind of Transition Measures," 587.

287 Ibid., 589.

288 Konoplyanik, "The Energy Charter Treaty: A Russian Perspective" (English edition), 173.

289 Doré et al., *The Energy Charter Treaty*, 31.

290 Dr. Konoplyanik was a deputy minister of fuel and energy in Yeltsin's first government. In 2002, he became the deputy secretary general of the Energy Charter Secretariat, the organization within the ECH regime. In Russia, he is informally known as one of the "fathers" of the ECH. Konoplyanik is an academic economist and has published extensively on the ECH process. I had the chance to interview him by telephone in the fall of 2009.

In the *investment* sector it was in the interest of Russia to lay down in the Treaty and the protocols, provisions stimulating foreign investors to transfer capital to the Russian fuel and energy sector and connected branches. Moreover, it was indispensable to have in mind the Russian legislation in force and in a state of elaboration as well as the national interests in these sectors of the economy. The exclusive sovereignty of Russia over its national resources had to be safeguarded, *and the legislative mechanisms and practical decision making on such questions in developed energy-producing countries had to be taken into account.* It was in the interest of Russia to see to it that the right of free access to and exploitation of energy resources, to be included in the Treaty, was reasonably limited. This was facilitated by clauses giving the possibility to safeguard the security of the State, warranting [sic] ecology and enabling the receiving country to issue special normative acts, forbidding or limiting free access in cases where this would cause serious danger for the life or health of the population, do serious harm to industrial objectives, or would be harmful to the environment. *Of course, the right to issue such normative acts must be subject to the conditions that are enacted,* taking into account the principles of goodwill and of reasonableness, in comparison to the potential amount of danger and injury.<sup>291</sup> (emphasis added)

It would be inaccurate to say that Russia was not thinking of sovereignty, state interests, or even industrial policy (meaning industrial objectives) in connection with foreign investment in energy. However, these were part of a broader argument that also included other factors (public health and the environment). In addition, although state/national interests were mentioned, the meaning of these terms and the logic that underpinned them were not elaborated. This is very clear when we compare Russia's vague argument in favor of state sovereignty to the very detailed and concrete Norwegian defense of the state's role in the economy, which we will examine shortly.

Moreover, whatever concerns Russia had about preserving its sovereignty were articulated primarily through the state's right to create legislation, which would in any case be inspired by the experiences of "developed energy producing countries." That the examples were to be producers and not specifically exporters is significant. First, this signified that the exporter/importer cleavage was not salient for Russia in that discussion. Second, it also implied that the pool of examples from which Russia wanted to learn included not only Norway, the Netherlands, Canada, and Australia, but potentially also the United States and United Kingdom. No less interesting is that the idea of learning from non-developed countries such as Saudi Arabia –the hegemon around which OPEC is organized, the policy of which is strictly state-oriented – was not even suggested. Finally, it is worth re-emphasizing that Russia's arguments, although not strictly liberal, were not controversial within the ECH context. No participants protested that states should not have the right to limit investment to prevent serious harm to the health of its population, the environment, industry, or state security.

Russia also claimed the right to make exceptions because other states would enjoy them simply by virtue of having developed the legal infrastructure of a market system earlier. Sorokin wrote:

The problem for countries like Russia was that they had no appropriate legislation and no exceptions which come with it. If they agreed to accord national treatment to the making of investments, they would have practically agreed to no exceptions at all. And this is while market economies have dozens of exceptions of their own.<sup>292</sup>

From this perspective, exceptions for Russia were necessary simply to have an equitable agreement. In fact, the only real disagreement between Russia and the United States concerning

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291 Konoplyanik, "The Energy Charter Treaty: A Russian Perspective" (English edition), 169.

292 Sorokin, "Why and What Kind of Transition Measures," 585.

investment rules was whether Eastern bloc countries including Russia would get a transition period. The US proposal foresaw that legislation already in place would be the basis for exceptions to NT but also wanted immediate “standstill” (no possibility for future restrictions) in legislation. Russia wanted a transition period to catch up:

The position of the United States...seemed to us to be excessively rigid. It could be accepted only if Russia was accorded a transition period...In the course of [which] the number of exceptions from the national regime needed to be extensive, and this would be, so we supposed, an inevitable consequence of the building up of a “legislative” framework within our country...prepared and brought forward to the Russian parliament by a range of political and administrative bodies.<sup>293</sup>

Finally, Russia wanted the possibility for exceptions to ease the process of transformation. This argument was used to justify a transition period in general:

We actively strove to profit as much as possible from the concept of “transition period,” laid down in the Treaty, to make the adaptation of Russia to the norms and rules of the elaborated text as easy as possible.<sup>294</sup>

The idea of easing the process of transition would have been consistent with some of the other reasons for exceptions mentioned earlier, particularly those concerning domestic opposition and serious harm to industrial objectives.

In any case, Russian demands for exceptions to NT were not motivated by a wish to create a central economic role for the state. In fact, the government was trying to constrain even the state’s *legal* prerogatives in the realm of investment. This is another reason why it preferred NT to MFN:

[S]uch an approach would hardly be attractive to foreign investors...the most favored nation regime grants the State more liberty in legal questions and in the admittance of investments. As a consequence of this a certain amount of doubt may arise for investors as to the stability of conditions for their business activities.<sup>295</sup>

Russia wanted to constrain even the state’s legal “liberties” to make investment attractive to foreign firms. There is no question that the legislative exceptions Russia envisioned were informed by the neo-liberal approach.

The Russians also foresaw some state economic action in the form of state-owned enterprises. However, this was part of a broader and much more significant policy of destatization. Moreover, state companies would have the same status as any other firm. This can be seen in the delegation’s position concerning how the ECT might deal with competition policy. According to Konoplyanik,

[T]he Russian delegation principally advocated a demonopolization by stages in the sectors of extracting, processing, and transporting energy. Our negotiating position was oriented toward the gradual renunciation of the practice to give State subsidies, to define prices by State disposition, and other direct or indirect forms of State support to the energy industry. The introduction of free and fair competition into all sectors of the economy and the *equalization of conditions for the*

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293 Konoplyanik, “The Energy Charter Treaty: A Russian Perspective” (English edition), 173.

294 Ibid., 170.

295 Ibid., 174.

*activities of all firms in the Russian market, whether State or privately owned was taken as the leading idea.*<sup>296</sup> (emphasis added)

Yeltsin's competition policy in energy (and in general) consisted of taking the state out of the economy by creating as much of a free market – characterized by competition, free prices, and hard budget constraints – as possible. Moreover, should state-owned firms persist, they would operate under the same constraints as any other firm. As we shall see, this was a radically different approach from the one adopted by Norway.

We can conclude that the Russian position did not dismiss the state and sovereignty entirely; in fact, Russia embraced the idea of sovereignty on numerous occasions, including during the debate on the ECT investment regime. However, its understanding of sovereignty was legalistic: the state has the exclusive power to make laws, and only state laws have authority domestically. Its approach to sovereignty was also procedural in the sense that the state reserves the exclusive prerogative to make laws, but to no particular end. By contrast, Norway's understanding was substantive: it invoked sovereignty to legitimate the state's interest in managing the energy sector. Finally, Russia's understanding of sovereignty was transitional; once the transition period was over, the state would not have the right to enact laws that impinged on the interests of private actors, as it would be constrained by international law as represented by the liberal investment provisions within the agreement. We will return to the question of Russia's understanding of sovereignty later in the chapter.

This discussion allows us to conclude that Russia's understanding of sovereignty was informed by the neo-liberal perspective and not controversial within the ECH context. Whatever demands Russia made in the name of state sovereignty did not take it out of the neo-liberal mainstream within the regime. Ultimately, Russia was not promoting a SM role. By contrast, Norway was an outlier that challenged this consensus by promoting a SM approach. The next section examines Norwegian thinking about state authority over economic decision making in energy to explain why.

### **Norway, state management, and investment in the ECT: energy policy and sovereignty**

This section examines Norway's policy on investment to bring Russia's commitment to neo-liberalism into sharper relief. Not only did Norway challenge the conventional wisdom, it also proposed a novel conceptual linkage – between access and development of resources and state energy policy – on the basis of which it argued that the agreement should be restructured. Previously, access and development had been treated only as issues of capital movement and investor protection, and this was reflected in the emerging structure of the document. This was a provocative intervention in the debate, one potential implication of which was to subordinate the neo-liberal approach to a much more robust understanding of state sovereignty.

Generally, we will see that Norway's understanding of state investor relations saw potential conflicts of interest, whereas Russia saw primarily a harmony of interests. This did not mean that Norway wanted to exclude foreign participation in its energy sector, but resolving these conflicts necessitated a key role for the state, which acted in accordance with its own energy policy and broader strategic objectives. Norway tried to present its particular interest as

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296 Ibid.

the interest of all states, particularly those in transition. However, its bid for hegemony failed, and it was completely isolated within the regime.

### *Challenging the conventional wisdom*

Whatever doubts may remain concerning Russia's commitment to neo-liberalism can be cleared up through a comparison with the Norwegian commitment to SM. The differences are striking.

In March 1993, the Norwegians circulated a memo entitled "Access to and development of energy resources, Norwegian position paper." In this memo, they made several arguments that challenged the idea of "free markets" and attempted to revise the neo-liberal perspective. First, they insisted that state ownership, which concerned their state-owned company Statoil, was legitimate and that this needed to be acknowledged legally in the agreement:

As one of the main resource countries participating in the negotiations on the Basic Agreement, Norway attaches the utmost importance to a satisfactory regulation of this field in the Basic Agreement. In our view, the Basic Agreement must take adequately into account the legal situation of state ownership to energy resources and provide for an equitable balance between the interests of states as resources owners and of the investors of other contracting parties.<sup>297</sup>

The memo also challenged the idea that the new regime should make foreign investment into energy as open as possible. In fact, Norway challenged the very premise that maximum liberalization was necessary to attract international investors:

It has been argued that national treatment in the area of access to resources is of importance with a view to promote foreign investments in the development of energy resources particularly in countries in transition.

In Norway's view this is an argument without merit. It is obvious that international industry will only invest in a country if the conditions are acceptable. In other words they want something in return for their use of resources. [Not all of the] factors that are common to most international companies in this respect... can or should be dealt with in the BA [Basic Agreement]...[some] will have to be dealt with in national energy policies, and legal and contractual frameworks.

...[I]t is difficult to see that the provisions in the BA on access to resources or admittance of investments may affect the willingness of international companies to participate in the development of energy resources should the resource state invite such participation.<sup>298</sup>

However, Norway's critique went beyond simply legitimizing state ownership and objecting to NT. From its perspective, NT for investment was in conflict with the principle of state sovereignty, under which management of the energy economy was a basic right of the state. This included the freedom to constrain international investors as necessary. Norway was suggesting that there was a significant tension between full liberalization enshrined in international law and state sovereignty. This concerned primarily the question of state policy over energy:

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297 Norwegian delegation, "Access to and Development of Energy Resources, Norwegian position paper," Archive of Travaux Préparatoires Documents, Energy Charter Secretariat, Brussels, March 1993. BA refers to the Basic Agreement, which was what the Energy Charter Treaty was called during negotiations.

298 Ibid.

It is in the context of international participation in the development of energy resources that the principle of non-discrimination becomes pertinent to the question of access to resources....

Norway is of the opinion that for the purpose of the BA, MFN treatment as a minimum standard would be the most realistic path to follow in the area of access to energy resources....

[N]ational treatment in the area of access to resources would limit [state] options in the establishment of an industrial policy and an energy policy.<sup>299</sup>

*Locating access and development of resources: free capital movement or state sovereignty?*

The Norwegians also argued that the emerging agreement dealt with the issues of access to and development of energy resources only as questions related to capital movement and that this was a flaw in the design of the regime that needed to be corrected:

Norway is concerned by the approach adopted by some of the negotiating parties, namely to consider the issue of access to and development of energy resources solely as a matter of capital movements and admittance of investments. This approach ignores the rights of the state as resource owner and renders impossible any equitable balance be it in the Basic Agreement itself, be it in the national energy policies of resource countries, be it between the interests of resource countries and international companies.<sup>300</sup>

From their perspective, access to and development of energy were also connected to the right of states to implement a domestic energy policy. Thus, the Norwegians were creating a conceptual linkage between the questions of energy access and development and state energy policy.

Furthermore, this linkage suggested that the very structure of the agreement needed to be reconsidered. For Norway, the agreement needed to address the questions of access and development in a separate section, as opposed to the section on capital movement/investor protection; otherwise the regime would be skewed to favor the interests of importer states and their investors. In a section of the memo titled “The place of the question of access to and development of resources in the structure of the Basic Agreement,” the Norwegians stated that:

[T]he allocation of authorizations, licenses, concessions, and contracts to prospect and explore for or to exploit or extract energy resources should be dealt with in article 4a on access to energy resources rather than 16 on promotion and protection and treatment of investments....

[T]he BA should contain *a separate part* on access and development of energy resources consisting of article 4a and the Norwegian proposal relating to article 25. Such a structuring is necessary for the balance of the BA.<sup>301</sup> (emphasis added)

It is clear that this initiative was inspired by a state management perspective that envisioned the state as having significant authority over decision making in the energy economy:

A consequence of state ownership of petroleum resources is that the state has the right to determine how and on what terms it will participate in the exploration and exploitation of its own assets.

[A]s resource owner the state would be free to participate in the development of energy resources through direct participation by the government or through government controlled companies.<sup>302</sup>

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299 Ibid.

300 Ibid.

301 Ibid.

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The discussion of the importance of national energy policy further supports this conclusion. In the section titled, “The Role of the national energy policy,” Norway argued that:

In the drafting of the BA, one should have a clear perception of which factors can and should be governed by the agreement and which factors should be *left to be governed by national energy policies*. This is not least important when dealing with issues related to access and development of resources.

In this area there are important prerogatives of resource states which must be maintained and guaranteed in the BA and also important issues which should be left to national energy policies. In the case of countries in transition, ratification of the BA could never be more than one of several elements in a strategy with a view to promote foreign investment in the development of their energy resources. The most important elements in such a strategy would be the establishment of a national energy policy, of an energy administration, and a legal and contractual framework which all take adequately into account both the specific conditions and goals of the country in question and the desires of international industry.

In establishing an energy policy, the resource country should let industry give priority to issues which are directly related to and necessary to undertake petroleum activities. The resource country should primarily aim at controlling matters in which industry and the country have differing objectives and incentives. (emphasis added)

Norway was arguing that the legal accord the ECT would comprise could not be developed in isolation from national energy policies, an effective state apparatus, and concrete business relations between the state and private economic actors. It is worth highlighting that in contrast to Russia, Norway was imputing value to the state bureaucracy.

Moreover, developing such energy policy was a basic sovereign right of the state that needed to be acknowledged and protected by the agreement:

[T]he Norwegian proposal related to articles 4a, 25, 26a aims at codifying in accordance with existing international law a legal framework which ensures the *most basic prerogatives of resource countries in the establishment of its national energy policy*.

They also aim at keeping the options open for resource countries to maintain or establish a national energy policy which balances their own aims and interests against the desires of international industry.<sup>303</sup> (emphasis added)

Thus, Norway was arguing that energy policy was a question of state sovereignty. By linking the question of access and development to state energy policy (both conceptually and in terms of the structure of the agreement), Norway was making the sovereignty norm more robust in the sense that it included authority that went beyond making laws. Conversely, this meant that the link to the questions of capital movement and investor rights was becoming more tenuous and that the free market norms were diluted. The implication was that free market norms would potentially be subordinated to norms of sovereignty that were more robust. This was an unprecedented innovation within the ECT context given the tenor of previous discussions, and it drew pause from the British, American, and Australian delegations in particular.

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302 Ibid.

303 Ibid.

B. Barkanov

*Resolving conflicts of interests and the primacy of the state*

As the previous passage suggests, the significance of state sovereignty and national energy policy was at least partly related to the fact that the interests of foreign investors did not necessarily align with those of the state that was hosting them. Such a scenario was described in a memo that the Norwegians sent out in August 1994 as the states were finalizing the treaty in advance of a planned signing at the end of the year. The specific example concerns a hypothetical conflict of interest between the state and private investors relating to the optimal rate for resource recovery:

[A]rticle 21 gives the state a right as resource owner to decide the optimization [sic] of the recovery of its energy resources. The intention of this provision is to reconfirm in accordance with the commonly accepted standard of good oil field practice the right of the state as resource owner to decide the necessary measures in order to ensure that the recovery of petrol shall take place in accordance with prudent technical and economic principles and in such manner that waste of petrol or reservoir energy is avoided. Thus if needed for reasons of good reservoir management, the investors may be required to e.g. inject gas or water into a reservoir or to drill a well to enhance oil recovery and to bear the costs of such measures. Another example may be utilization of fuel developments in production.

... In case of conflict of interest between the investor and the resource owner, the state may choose to let *its interests as resource owner prevail*. It is clear that measures taken by the state in accord with article 21 could not be considered as nationalization or expropriation within the meaning of article 15.<sup>304</sup> (emphasis added)

According to the Norwegians, the state has an economic interest in optimizing the use of its resources. In some cases, this might mean requiring private firms to make business decisions that otherwise might not suit their business plan. Buying equipment to inject water to change the rate of depletion in a reservoir might not be a priority for a particular firm; given the profile of its energy producing assets worldwide, its available financial resources, and its business strategy, the firm might prefer a rate of depletion that is different from what the state deems optimal.<sup>305</sup>

From the Norwegian perspective, the interests of the state can prevail over the interests of business in such instances. Moreover, Norway was arguing that such state actions were not examples of expropriation, and the ECT needed to acknowledge this by resolving the tension between the articles on sovereignty and investor guarantees in the agreement. This is a very different view of organizing the energy sector from the Russian one. For Norway, optimal

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304 Memo by Norwegian delegation, Archive of Travaux Préparatoires Documents, Energy Charter Secretariat, Brussels, August 1994.

305 For example, the deposit might have been acquired to be developed as a “cash cow” to balance other deposits that would receive greater investment. In short, private actors optimize their business given a particular set of resources and goals. However, a strategy that suits a business might not be adequate for the state, which likely has a different set of resources and goals.

Another example concerning conflicts of interest between private firms and the state became manifest in Russia during the 1990s. During my interviews, a common refrain was that international investors acquired assets in Russia not to develop them but merely to put them on their balance sheets. Demonstrating that they owned resources helped support the value of their shares even though they did not necessarily plan to exploit them in the short and medium term (perhaps because prices were low). This conflicted with the goals of the Russian state, which under Yeltsin was desperate to increase energy extraction to, among other things, increase state revenues through taxes. Interviews in Moscow, fall 2007, 2008-2009.



economic outcomes in energy came from virtuous state action. For the Russian government, pressure from competitive markets with foreign participation was responsible for good outcomes, and this required the absence of the state as much as possible.

The August 1994 Norwegian memo was written in the context of a debate about whether and how the revisions proposed by the Norwegians might serve as a loophole to dilute the neo-liberal approach and weaken state commitments to investors. The fear was that these would undermine the efficacy of the agreement as a legal instrument to protect investors as well as the broader spirit of the regime. In response, the Norwegians stressed that the right of the state to intervene for policy purposes was not unlimited and in particular had to take into account the economic interests of private actors:

The right of the resource owner under article 21 to decide on the optimalization [sic] of the recovery of its energy resources is not unlimited. The decision should primarily be based on what is considered economical both from the point of view of the investor and the resource owner.

On the other hand it must also be clear that article 21 does not give the state a right as resource owner or in the exercise of its administrative powers to impose any decision on an investor without regards to the consequences of such decisions economically or otherwise. Part 3 including article 15 provides the investor with an adequate protection against abusive interpretations of article 21.<sup>306</sup>

According to the Norwegians, the other articles in the agreement sufficiently addressed the interests of investors. Additionally, private firms would be protected from arbitrary action and state constraints that are overly burdensome because relations with firms would be regulated in legal terms. In fact, the state's right to intervene at the level of business decisions would be regulated by concessions and contracts that would provide for such action: "Companies who are granted concessions and licenses are required to agree to the terms with respect to participation." Ultimately, businesses would be free to take it or leave it under terms set forward by the state in advance.

However, ultimately, such conflicts of interest would be resolved politically through negotiations between the state and its investors. This is suggested in an earlier (March 1993) memo, which lists as an important consideration for international investors, "*participation in the commercial decision-making process* in accordance with the size and nature of their engagement in the country." (emphasis added) Important foreign investors would be given a seat at the table where state energy policy decisions were considered.

Norway also alluded to additional factors that would lead to state restraint during negotiations with companies. It suggested that the state would develop "a national energy policy which balances their own aims and interests against the desires of international industry." According to this vision, the interests of the state as expressed by its energy policy also include the consideration of the interests of businesses as vital participants in the energy sector that cooperate with the state to achieve policy goals. Relatedly, business would be protected from abuse because the presence of international investors would presumably be part of a larger state investment policy to invite foreign participation in the development of its energy sector: "The resource country must of course take duly into account its political goals in the area of foreign investment and international participation in the development of its energy resources."

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306 Memo by Norwegian delegation, Archive of Travaux Préparatoires Documents.  
B. Barkanov

Therefore, states would necessarily have to consult private actors and consider their interests to ensure their continued cooperation.

The Norwegians were certainly not arguing against the participation of private, foreign actors. In fact, such actors might very well be necessary partners to achieve state goals and as such their interests needed to be taken into account. To this end, a political space needed to be created by the state where states and firms could bargain to resolve conflicts of interests. Such bargaining would take place within a larger strategic framework that foresaw continued cooperation between the state and firms, including international investors. The fact that such long-term cooperation was ultimately in the state's interests was a key element to assuring that private actors would not be abused. Ultimately, however, the state, not private firms, would have the authority to decide how the energy sector would develop, and the Norwegians insisted that this be incorporated into the ECT. Whereas Russia saw a harmony of interests between international investors and the state, Norway emphasized potential conflicts of interests and suggested that these would be resolved through bargaining in a space created by the state. In short, for Norway a harmony of interests between foreign capital and the state was not natural but emerged as a result of state action.

*Failed hegemony: state management as a general interest?*

As might be expected of a resource-owning state, Norway was presenting a serious challenge to the neo-liberal consensus that emerged within the regime after the collapse of the USSR. However, Norway was not just protecting its own interests. It was also arguing for an institutional design that created room for state management of energy within the regime more generally and insisted that this promoted the interests of the transition states in particular. Regarding the question of MFN or NT, Norway claimed that MFN was preferable for the Eastern bloc states because:

[T]he choice between national treatment and MFN treatment in the area of access to resources is of particular importance for countries in transition especially with respect to privatization and new and restructuring industries....

Such a loose solution [as MFN] would give all resource states sufficient flexibility to establish or maintain energy policies which strikes an equitable balance between the interests of states as resource owners and the interests of the investors of other contract parties. It would provide *the countries in transition with much desired flexibility in the establishment of an industrial policy and an energy policy with a view to ensure a smooth transition to market economy* without putting in jeopardy their existing industrial base in the energy sector and to allow for conversion of existing industries and the establishment of new industries. (emphasis added)<sup>307</sup>

The authority of the state to manage its energy sector by intervening in economic decision making and the importance of energy policy were at the heart of this argument.

Within the context of negotiations over the ECT, this was construed as a debate about sovereignty and state ownership, and Norway was completely isolated. According to Doré,

Negotiation took much more time than initially expected, because of the complexity of the issues involved and the difficulty of reaching agreement on many highly sensitive points. ...Concerns

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307 Norwegian delegation, "Access to and Development of Energy Resources, Norwegian position paper." B. Barkanov

about national sovereignty over natural resources led to fierce debates between Norway and others.<sup>308</sup>

However, for Norway the stakes were considerably higher. It was desperately trying to balance the influence of the neo-liberal perspective by highlighting the importance of policy and state economic management over energy for all the participants. In so doing, it was legitimating state authority over economic decision making in the energy sphere. However, no allies were available to support its preference for state management.

### **Treaty vs. protocols: the dominance of the neo-liberal perspective**

The previous sections compared the Russian and Norwegian positions concerning the investment question in the ECT. Norway attempted to at least partially subordinate the question of investment to norms of sovereignty. Russia did not share Norway's approach, and no other allies were available, so the attempt failed. In terms of the substance of the Treaty, the regime continued to evolve on a neo-liberal track. However, there was potentially another opportunity to influence how the regime evolved: the sectoral protocols.

When the ECH process began at the international level in 1991, the states agreed to work on a broad front to address the urgent situation in the energy sector of the USSR. This meant developing a general protocol and also protocols that addressed sector-specific concerns. Already in October, the center of gravity in negotiations moved to WG II, which was designing the Basic Protocol (renamed the Basic Agreement in November 1991, and finally named the Energy Charter Treaty (ECT) after negotiations were complete). The ECT became the centerpiece of the regime, a result of the dominance of the neo-liberal perspective. By contrast, the sectoral protocols that were planned during the early stage of negotiations were quickly abandoned. This was significant because the protocols were an opportunity to develop state energy policy to deal with sectoral concerns and thus potentially make the norm of sovereignty more robust within the regime. Therefore, the different fates of the two types of agreements reflected that the neo-liberal perspective had prevailed over the SM approach. Again, Russia and Norway adopted different approaches. This prevented the emergence of a potential exporter alliance in favor of sectoral protocols and so shaped the evolution of the regime.

The additional protocols were not abandoned immediately. Work on negotiating additional protocols in energy efficiency (WG III), hydrocarbons (IV), and nuclear energy (V) had already begun in late 1991<sup>309</sup> and continued after the start of 1992. However, by the time the ECT was finally signed in December 1994, the only protocol that was completed (and also signed) was on "Energy Efficiency and Related Environmental Aspects" (PEEREA). The success of the PEEREA negotiations reflected the fact that there was a convergence of interests across many states – including Western states and Russia – who wanted to increase energy efficiency and protect the environment. However, there was also a consensus concerning what kind of state policy was a legitimate means for achieving these ends.<sup>310</sup> At the same time, the content of this protocol was largely declarative and not binding. Due to the "soft law" substance

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308 Doré et al., *The Energy Charter Treaty*, 6.

309 Clive Jones, "The European Energy Charter," *Review of European Community & International Environmental Law* 1, 2: 155.

310 Doré et al., *The Energy Charter Treaty*, 62.

of the agreement,<sup>311</sup> the states did not have to make major concessions, and this also contributed to the successful conclusion of negotiations.

A similar convergence of interests was absent with respect to the nuclear protocol, which was abandoned due to EU concerns about protecting Euratom's position on the European market; these concerns were motivated by both commercial and security considerations.<sup>312</sup> Instead, negotiations with Russia – which believed that it was competitive in nuclear materials and wanted greater market access – and other former Soviet exporters of nuclear materials were moved to the bilateral framework of the Partnerships and Cooperation Agreements (PCA).<sup>313</sup> Therefore, the nuclear protocol failed to materialize because of the opposing interests of importers and exporters and the decision to move negotiations to a different political setting. The latter suggested that the parties agreed to disagree about the nuclear issue but did not want this to interfere with the larger agreement.

Work on a hydrocarbon protocol was abandoned early.<sup>314</sup> According to Doré,

The initial intention of concluding a hydrocarbon protocol was abandoned at an early stage of the negotiations on the Basic Agreement (now the ECT) when it appeared that most if not all issues to be covered in this protocol were of a general nature and could not be solved in a different way.<sup>315</sup>

From this perspective, there was a general consensus that hydrocarbons would be treated in general terms rather than on a sectoral basis. However, Norway was not part of this consensus. Moreover, it appears that Norway, as the chair of the working group charged with negotiating the hydrocarbon protocol, was attempting to use this forum to shape the protocol, and hence the broader regime, in a direction that made state sovereignty norms more prominent. According to Andersen,

Sovereignty and control had been corner stones of Norwegian petroleum strategy for many years. When a large number of consumer countries pushed for rules securing access to resources, this was experienced as the undermining of the domestic control of resource states. Norway had the chairmanship in Working Group IV on hydrocarbons, responsible for the sector protocol on oil and gas. With the new importance of the Basic Agreement this provided little influence, and there was little room to express minority interests concerning state sovereignty.<sup>316</sup>

This organizational platform was eliminated due to a broad consensus that it was not needed. All the other states agreed that there were no sector-specific issues, and this also reflected a convergence on a neo-liberal approach, which tends to portray markets in general terms regardless of sector. Thus, Norway's was the lone dissenting voice – Russia did not side with Norway in support of a hydrocarbon-specific protocol – and it was ignored.

#### **ECT outcomes: signing in December 1994**

After three years of difficult negotiations, Russia signed the ECT in December 1994. According to article 45, Russia began provisional application of the treaty in expectation of

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311 Ibid., 63.

312 Andersen, "East of Market—West of State," 50.

313 Ibid., 51. The status of nuclear materials in the ECH regime is discussed in greater detail in Chapter 9.

314 Doré et al., *The Energy Charter Treaty*, 62.

315 Ibid.

316 Andersen, "East of Market—West of State," 50.

ratification. This also would have consequences for the Russia-Menatep lawsuit and will be discussed in greater detail in chapter 10.

The United States opted not to sign the ECT despite having been a central actor during negotiations that very significantly shaped its provisions. It appears that the biggest problem for the United States was that the investment regime was inadequate. In particular, only soft provisions were drawn up for the pre-investment stage. Canada did not sign the ECT either, invoking relations between the federal government and the provinces as a concern.

Norway signed the treaty six months later; however, it did not begin provisional application.<sup>317</sup> At the same time, Norway also declared in Annex IA to the ECT that it did not accept the last sentence of article 10.1 on investment, indicating that it was not willing to submit state-investor disputes to international arbitration.<sup>318</sup> Norway was joined by Australia, Canada, and Hungary in this derogation from the ECT. To date, Norway has not submitted the ECT for ratification, nor has Australia, Iceland, Belarus, or Russia.

### **Generating support for the ECT in Russia: regime taking and the ratification process**

This section examines the ratification process to understand supporters' political strategy for promoting ratification and look more carefully at Russia's regime taking. Empirically, I examined available documents from the seminars (with particular attention to a seminar held in the State Duma in February 1997). To understand the Duma's reaction, I used a summary document of the conclusions that the deputies reached after the hearings (in June 1997). I also used evidence from interviews with participants in the seminars and ratification process. I argue that this strategy was based on a particular theory of learning, or teaching to be precise, that was ultimately unsuccessful since the Duma did not ratify the agreement as the government had requested.

#### *Promoting the ECT: persuasion and the seminar strategy*

Russian government officials working on the ECH did not fool themselves that ratification would be easy. During a conversation on the sidelines of a meeting organized by the State Department between senior Russian tax officials and US energy sector investors, then Deputy Minister of Fuels and Energy Andrei Konoplyanik discussed opposition to the Treaty in Russia with David Brown, an official at the State Department and the head of the US delegation to the Conference. A recollection of the conversation comes from a memo from Brown in the Secretariat archive:

I asked Konoplyanik if any in Moscow were antagonistic to the notion of a Basic Agreement. Yes, he replied. They fall into two groups. First there are the politicians of conservative or

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317 Craig S. Bamberger, "Overview," in Walde, *The Energy Charter: An East-West Gateway*, 29.

318 According to a 2006 OECD report, making a declaration under Annex IA "allows the contracting parties to opt out of the final sentence of Article 10(1) by not permitting their investors to submit a dispute concerning this provision to international arbitration." OECD, "Interpretation of the Umbrella Clause in Investment Agreements," Working Papers on International Investment, Number 2006/3, accessed April 8, 2011, <http://www.oecd.org/dataoecd/3/20/37579220.pdf>. The last sentence of 10.1 is an umbrella clause; it states "Each Contracting Party shall observe any obligations it has entered into with an Investor or an Investment of an Investor of any other Contracting Party."

Slavophil persuasion....These tend to see liberal terms for foreign investors as tantamount to a fire sale of Russia's national treasure or neo-colonialism. They object to restrictions on sovereign rights and regard NT as dangerous to home industries. Second, there are Russia's monopolies and quasi monopolies like Gazprom. These see the charter's obligations on governments to promote competition as a dangerous threat and they are, Konoplyanik stressed, a formidable economic lobby.<sup>319</sup>

The political strategy to generate domestic support in Russia appears to have been three-fold. Internally, Russian government officials responsible for ECH policy during negotiations consulted with domestic actors (both firms and state agencies) who would be affected by the agreement.<sup>320</sup> This meant keeping them informed and also addressing their concerns. Second, the delegation worked hard to make sure that the agreement did not violate domestic legislation already in place at the time; to bring on board the parliament, which would eventually have to ratify the agreement, it was necessary to minimize linkages between the ECT and other legislative controversies. The final part of the strategy was to persuade Russian political decision makers of the merits of the ECT through a series of seminars organized jointly by the Russian Ministry of Fuel and Energy and the Secretariat. In this section I focus on this third strategy.

Persuading decision makers through the seminars was an important strategy for advancing the ECH process on the Russian side. The (early)<sup>321</sup> seminars were closely watched by Washington. In a memo to Secretary General Clive Jones, David Brown from the US Department of State wrote:

I have been following with great interest the preparation for the workshop for the former...[socialist bloc] participants in the charter conference. The *curriculum* looks to be exactly right... Andrei Konoplyanik has been in Washington and has told me of substantial success in drawing several more of the republics into the process.... [His comments] may supplement what you have heard through [deputy secretary general] Valery Sorokin. I conclude that there is reason for some optimism but that we are still in a very fragile stage. *We simply must succeed via the planned workshop in convincing a cadre of key senior officials in the various republics of the importance of full commitment to the Charter, or else we are all wasting our time.*<sup>322</sup> (emphasis added)

Here we can see not only the attention that the United States paid to the seminars, but also that the seminars were a central part of the strategy to promote the ECH in Russia.

The seminars in Russia were not unique; they were also held in other states and in Brussels. The audiences at these seminars varied in nationality and functional role. In principle, the seminars were open to all the participating states.<sup>323</sup> In practice, they appear to have been targeted to all the "transition" states, the post-Soviet states, and finally only nationals from a

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319 David Brown, "Memo to File," Archive of Travaux Préparatoires Documents, Energy Charter Secretariat, Brussels.

320 For a list of participants, see A.T. Shatalov, "Introductory Remarks on the Energy Charter Treaty" in "Energy Charter Treaty—Parliamentary Hearings."

321 The United States signed the 1991 political declaration and was a key participant during negotiations on the Basic Agreement (later the ECT). However, at the last moment the United States decided not to sign the Treaty. Most likely, US attention to the ECH process, including the seminars, waned after it essentially withdrew from the regime. At present the United States holds the status of an observer to the Energy Charter Conference.

322 Memo to Clive Jones from David Brown, Archive of Travaux Préparatoires Documents, Energy Charter Secretariat, Brussels, April 28, 1992.

323 Interview in Brussels, winter 2010.

particular former Eastern bloc state (for example the seminar in the State Duma). In terms of functional roles, early seminars appear to have been aimed at government officials and negotiators, while later ones were targeted toward a broader set of decision makers, particularly deputies from parliaments who would have to ratify the agreement.

In any case, the effort was international. One seminar was held in the State Duma in February 1997, several months before the ratification hearings in the summer of that year. It was co-sponsored by the Russian Ministry of Fuel and Energy and the Secretariat. Among those testifying were C. Papoutsis, the EU Commissioner for energy, small and medium enterprise, and tourism; P. Schutterle, general secretary of the Secretariat; L. Ervik, director of questions related to negotiations, Secretariat; P. Vlaanderler, Secretariat; E. Paasivirta, Secretariat; and C. Rutten, chairman of the Conference. Six of the fifteen testimonies were by foreigners either from the EU or the Secretariat.

*The logic of persuasion: trust, necessity, and teaching/learning*

The explicit goals of the seminars were two-fold. First, they aimed to make sure that national governments in the East understood the logistics of the process; this was particularly important before negotiations on the Treaty were concluded because it was important that “transition” states, the post-Soviet states in particular, were able to participate in a productive way, as effective negotiators, for example. Recounting his conversation with Konoplyanik, Brown stated that:

By means of a seminar organized in Moscow in mid-April, eight of the CIS republics “now can be said to comprehend the scope and meaning of Energy Charter negotiations.” Senior people from Kazakhstan, Kyrgyzstan, Tajikistan, Uzbekistan, Armenia, Ukraine, Belarus, and Russia “no longer think it is some kind of technical cooperation agreement. *They understand better the range of experts and offices that need to be mobilized to deal with the issues raised in the charter negotiations.*” (7 republics participated in the meeting organized at Professor Yershov’s institute; the Uzbeks could not get to Moscow in time but afterwards received special *tutoring*).<sup>324</sup> (emphasis added)

The assumption was that the Soviet successor states had very little knowledge about how the process worked. Again, according to Brown:

In organizing this Moscow meeting and prospectively another session prior to the Brussels workshop planned for May 17-19, Russians are intent on preparing their own people and the representatives from other republics enough that they can get optimal benefit from the workshop. Konoplyanik was pleased when I told him that in discussing organization of the agenda with the secretariat, I had emphasized a “zero base” approach and plenty of opportunity for participants to seek further discussion and clarification of points.<sup>325</sup>

The second explicit goal was to make sure that decision makers understood the commitments they were undertaking. In his opening speech at a seminar in Brussels in May 1992, Sydney Freemantle, the chairman of the working group charged with developing the Treaty, stated that:

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324 Memo to Clive Jones from David Brown.

325 Ibid.

[An important] requirement is *to create the right understanding* of the commitments embodied in the Basic Agreement. An agreement signed in ignorance is unlikely to last or to be usefully implemented.<sup>326</sup> (emphasis added)

In addition, the seminars also had a more subtle goal: to create a cognitive consensus at the political level concerning the benefits of a particular economic strategy (neo-liberalism) for the development of Russia's energy sector and the advantages of the ECT, which was an expression of this strategy. This was particularly important with respect to legislatures that did not participate in negotiations but nevertheless had to ratify the agreement. To conclude the February seminar in the State Duma, the chairman of the seminar and the government's representative in charge of ratification, deputy minister of Fuel and Energy A. Shatalov stated:

As the chairman, I want to thank everyone for their participation in the work of the seminar...I leave the seminar with the great satisfaction and with great hope that our opinion on the stabilization of the Fuel and Energy complex coincides with the opinions of the deputies of the State Duma.<sup>327</sup>

The idea of better mutual understanding was also alluded to by Conference Chairman C. Rutten, who was the last speaker during the February seminar: "I hope that now you understand better the goals, aims, and consequences of ratification of this complicated agreement both from an economic and technical point of view."<sup>328</sup>

Essentially the strategy was to persuade decision makers. Persuasion depended on three elements. First, these discussions were supposed to take place in a setting that was less formal than actual negotiations or hearings. The seminars were meant to be a casual setting in which political actors could be "engaged"<sup>329</sup> in the ECH process and learn about the agreement. Thus, during the seminar held in the State Duma in February 1997, Alexander Shokhin, a former first deputy prime minister and the head of the Russian ECH negotiating delegation until leaving to become a Duma deputy in 1993, explained the purpose of the seminar:

I would rather not think of today's seminar as an official discussion, like a parliamentary hearing. Its primary goal is to save our strength, the strength of the parliamentarians, and over the course of a few hours, to give an opportunity to receive full information...directly from the source, from the people who developed this document both on the Russian side and the side of the European Union, our European colleagues. And it will be possible to ask questions to officials representing both sides, and also to the experts working in many working groups.<sup>330</sup>

The seminars were not the first occasion for promoting the ECH in casual settings. This was also a tactic used by the European Commission during the very early stages of negotiations on the political declaration in 1991 that was later inherited by the Secretariat. Using informal ties to advance negotiations has been characteristic of many international processes. According to Anderson,

The organisation of the dialogue and exchange of views between the parties involved can be very important. Large formal meetings are likely to limit openness and complicate the communication

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326 Sydney Freemantle, opening speech at a seminar in Brussels, Archive of Travaux Préparatoires Documents, Energy Charter Secretariat, Brussels, May 1992.

327 "Energy Charter Treaty – Parliamentary Hearings."

328 C. Rutten, "On the Goals of the Seminar" in "Energy Charter Treaty—Parliamentary Hearings."

329 In the memo by Brown cited earlier, the comments about the April 1992 seminar were in a subsection that was entitled "Engaging the other republics in the charter process."

330 A. Shokhin, "About the Energy Charter" in "Energy Charter Treaty—Parliamentary Hearings."



between the parties. Many international negotiations therefore establish sub-groups where there is room for informal exchange. This makes it possible for the parties to establish personal relationships and trust. As a result personal networks are formed that can function also outside the meetings. The Energy Charter Secretariat emphasised sub-groups and informal personal contacts. This created a socialisation effect which also facilitated collective learning.<sup>331</sup>

The idea was to take advantage of informal relations to create a transnational network based on personal ties and eventual trust that would serve as a social foundation for learning.

The second part of the persuasion strategy was to present the neo-liberal model as inevitable for achieving the state's goals; for Russia this primarily concerned attracting foreign investment. The last component was to present detailed information about the ECH process and the substantive contents of the Treaty to show how it could advance Russia's interests. The logic is intuitive: if decision makers (deputies) can agree on a particular model for developing the Russian Fuel and Energy sector, and they can see that the Treaty advances that model, then they should support the Treaty and vote for ratification.

At its heart, the strategy was neo-functional, and at the micro-level it was premised on learning processes embedded in interpersonal social relations that created trust. Therefore, when the neo-liberal model was presented as necessary, the audience was supposed to accept this premise because they trusted the speaker making the claim. Having successfully created a cognitive consensus around the neo-liberal model, it remained only to present exhaustive, detailed, and fully honest information about the Treaty to show that it followed the model and would purportedly produce the desirable outcomes that the model suggested.

In short, a cognitive consensus concerning the virtues of the neo-liberal model was supposed to be created by presenting the model as inevitable to a trusting audience with whom one had personal relations. From there, it was a much easier step to generate support for the agreement by conveying information about how the Treaty advanced the model. To put it differently, Russia was being invited to join an "in group" that enjoyed mutual trust and shared a consensus regarding the neo-liberal approach to the energy economy. However, part of the process of inclusion involved teaching Russia to understand and accept that model and the principles and norms on which it was based.

This strategy was part of a more general approach of using personal relations, trust, and persuasion when dealing with Russia in the 1990s and can be seen in the relations between Presidents Clinton and Yeltsin. The idea that Yeltsin was "our man in Moscow" for the Clinton administration has been well documented.<sup>332</sup> Former US Secretary of State Strobe Talbott also highlighted the personal dimension of the American "Russia strategy" during the 1990s in a series of interviews he has given about US-Russian relations:

[F]or seven of the eight years that President Clinton was in office here, Boris Yeltsin was the president of Russia. He had, by virtue of his office, huge powers. *He also had an extraordinarily strong and consistent commitment to certain principles and objectives that were in the interest of the United States. He was susceptible to the influence of only one man in the U.S. government, and that was Bill Clinton. Therefore, we decided early— President Clinton decided early— that he was going to concentrate his diplomacy on his Russian counterpart. I think that was absolutely the right thing to do. It yielded huge and lasting benefits to the United States.* Yeltsin felt a deep

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331 Andersen, "East of Market—West of State," 10.

332 James M. Goldgeier and Michael McFaul, *Power and Purpose: U.S. Policy Toward Russia After the Cold War* (Washington, DC: Brookings Institution Press, 2003), Ch. 6, especially 121.

ambivalence about the United States. In some ways he regarded us as a beacon, a model, and a friend, and in other ways he regarded us as obnoxious as hell. . . . But the way he resolved that conflict, when push came to shove, was favorable. And that was largely because of the interaction between him and Clinton. . . .

...I think there'll be a high degree of continuity in U.S.-Russian relations, but that doesn't go to the question of chemistry. Bill Clinton bonded with Boris Yeltsin. Big time. And he used that bond to get Yeltsin to do things that were hard for Yeltsin but important to us. That is the story of the last eight years more than any other single thing. . . .

... [W]e had valued and used Yeltsin's special relationship with Clinton to advantage. The chemistry between the two was invaluable as the driving force for steadying what was otherwise a very rocky relationship. Clinton had met with Putin twice at that point, once in Oslo and once in Auckland. And while the relationship was okay, Clinton didn't feel that he had anything like the power of persuasion with Putin that he did with Yeltsin, so we knew we would pay a price.<sup>333</sup> (emphasis added)

Talbott's comments highlight the intensely personal relationship Clinton enjoyed with Yeltsin and how this was leveraged to promote certain policies that the Clinton administration believed were in the US national interest.

His comments also suggest that this personal relationship emerged as a result of a cognitive consensus that pre-dated it. This is also supported by the contrast he makes with Putin, who was not susceptible to persuasion, did not develop a similar relationship with his American counterparts, and in important respects – particularly concerning the legitimacy of state power – did not participate in the cognitive consensus shared by his predecessor and the US president. The key point here is that the seminar strategy was to use trust, inevitability, and information to create a cognitive consensus. In practice, it was the prior existence of a cognitive consensus that allowed trust to develop and learning to take place. The next section develops this idea further.

*The seminar strategy in practice: trust, persuasion, or politics?*

Early on, the target audience consisted of Russian government officials who worked on the ECH and were already sympathetic to the neo-liberal model. A consensus already existed because, as I will argue later, acceptance of the neo-liberal approach was already institutionalized into the Russian state apparatus. Some government officials may have been genuine believers like Konoplyanik. Others may have been converted due to personal relations. What merits our attention, however, is that acceptance of the neo-liberal approach was already institutionalized into (part of) the Russian state. Moreover, since there was already a consensus concerning the neo-liberal model with this audience there was genuine learning, for example, concerning the mechanics of negotiations.

Later, after the Treaty had been negotiated and signed by Russia, the audience also included deputies from the State Duma. Here the goal was not so much to teach about the mechanics of negotiations but to persuade the legislators of the merits of the Treaty that they were supposed to ratify. However, the parliamentary audience was more mixed and included skeptics from the opposition in the Duma. Moreover, whereas institutionalized acceptance of the

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333 Padma Desai, *Conversations on Russia: Reform from Yeltsin to Putin* (New York: Oxford University Press, 2006), Ch. 6, "November 2000" and "January 2001."

neo-liberal approach was a political fact for government officials working on the ECH process, the same cannot be said for the Duma, which was dominated by the opposition. In other words, the institutionalization was only partial: within the government but not the legislative branch.

It is clear that the message being delivered during Treaty ratification discussions – the virtues of the neo-liberal model – was heard by the Duma audience. A summary statement issued by the Duma after the June 1997 hearings declared:

The participants of the parliamentary hearings noted that the conception of the ECT...introduced by the government of the RF for ratification, aims to promote and support the fuel and energy complex and create a stable legal foundation for the sustained inflow of foreign investment into the productive capacity of Russia's oil and gas industry which needs to be modernized and expanded....<sup>334</sup>

However, simply understanding the neo-liberal model, the Treaty which was inspired by it, and the advantages that the Treaty would entail did not lead to its being accepted. Once the discussion became broader and included members of the opposition, convergence on the neo-liberal model became a difficult political question; social relations and trust did not emerge, and teaching/learning were not enough. In short, no persuasion happened.

The fact that creating this consensus was a political question, as opposed to a social or cognitive one, was perspicaciously noted by A.V. Kozenkov from the analytical center of the LDPR<sup>335</sup> faction:

If we distract ourselves from the *political* question concerning which economic path is more advantageous for Russia, and stick to reality, i.e....the economic course that is being pursued at present, then it appears that Russia's participation in this Agreement may very well be sensible, because we are talking about creating the most favorable investment climate to finance a particular type of development.<sup>336</sup> (emphasis added)

In the end, convergence among the decision makers on a neo-liberal model for developing the energy sector did not emerge. In retrospect, this hardly seems surprising since the questions of which model of economic development Russia should pursue and the specific role of the state were terribly polarizing issues during the 1990s. It is hard to imagine that either trust or learning could develop under such circumstances.

More importantly, Gazprom was absolutely not on board; it had its own vision about the development of Russia's gas sector that was not informed by the neo-liberal approach. Furthermore, Gazprom management refused to develop social relations with ECH participants. For example, former Secretary General of the Charter Secretariat Ria Kemper noted that when she came to Moscow, CEO Rem Vakhirev (in contrast to his successor, Alexei Miller) refused to meet with her. Finally, Gazprom managers were simply impervious to learning. As one interview participant from the Secretariat noted about Gazprom's intransigence:

On a number of occasions our leadership and our experts tried to make it clear that there was some kind of miscommunication, misunderstanding [concerning the substance of the Treaty]....It was a

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334 "Recommendations from the Parliamentary Hearings 'On The Energy Charter Treaty'" in "Energy Charter Treaty—Parliamentary Hearings."

335 LDPR stands for the Liberal Democratic Party of Russia. It is headed by the bombastic Vladimir Zhirinovskiy and was known for its largely right-wing nationalism but also had a reputation for delivering votes on a quid pro quo basis.

336 Question from A.V. Kozenkov, "Energy Charter Treaty—Parliamentary Hearings."

bit sad; it reminded me of the saying: don't confuse me with facts, I have my own ideas. It's really unfortunate.<sup>337</sup>

Where Gazprom was concerned, no seminars and no amount of trust, teaching, or facts were likely to persuade the managers of the virtues of the agreement. Absent the pre-existence of a relationship, which, as the Yeltsin case demonstrates, led to trust and learning, a consensus could only emerge politically. This is supported by the case of Viktor Chernomyrdin, who supported the treaty not out of conviction but because that was his job as prime minister subject to the authority of the president. I will return to Chernomyrdin when I discuss the institutionalization of norm taking in the last section.

Given the predisposition of Gazprom managers with respect to the agreement, at a minimum ratification would have required a larger set of instruments; Gazprom had to be brought on board by the government through the usual combination of political tactics, including back scratching, log rolling, beating heads together, threats, inducements, and so forth. In short, ratification required a political, not a pedagogical, toolbox.

According to a deputy minister who worked on ratification of the Treaty in 1997, the government expended considerable energy “lobbying” the Duma to endorse the agreement, and it was almost successful.<sup>338</sup> It is possible that a political toolbox was deployed to bring some reluctant deputies on board. However, as the battles between the government and Gazprom (over gas sector reform and taxes, discussed in the next chapter) show, the state did not have that kind of authority when it came to its largest company.

#### *Neo-liberalism as inevitable: attracting foreign investment*

This sub-section focuses on the ratification discussion (particularly during the February seminar) to illustrate the tactic in action with a special interest in the way the neo-liberal model was presented as inevitable given the goal of attracting foreign investment into the energy sector.

During the seminars and hearings, many arguments were made to support the agreement. To get a sense of the breadth of the logic in favor of the agreement, we can look at the explanatory memo the government submitted to the State Duma upon beginning ratification procedures.<sup>339</sup> The memo noted the following benefits of the ECT (listed in the order in which they appeared):

improvement of the investment climate, creation of favorable conditions for the export of Russian fuel and energy resources to the markets of advanced industrial countries (and Western Europe in particular), acceleration of Russia's accession to the GATT/WTO, solving the problems posed by the transit of Russian energy resources, easing access for Russian outward investment into the fuel and energy complexes of other countries (including the CIS states), maintenance of a privileged regime between CIS countries, the creation of a legal foundation for energy integration with the CIS (which reinforced the broader goal of economic integration in the post-Soviet space) and the EU, the ability to address other issues through additional protocols.

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337 Interview in Brussels, winter 2010.

338 Interview in Moscow, fall 2007.

339 Although this memo was not for a seminar per se, it was submitted with the request for ratification from August 26, 1996. Thus, it was a starting point for discussions during the February 1997 seminar in advance of ratification in June 1997 and captures the arguments in favor of the agreement made by supporters and, first and foremost, the Russian government.

Supporters also tried to disarm opposition by noting that the Treaty did not contradict Russian legislation already in place. In the one area where this was not the case – legal obligation based on the norms of GATT (for example, customs tariffs, anti-dumping measures, export/import duties, subsidies, state enterprises, application of technical norms and standards) – the government noted that this was not a problem, as Russia was currently in the process of bringing its laws regulating foreign economic activity closer to “world practice and the norms of GATT/WTO.”<sup>340</sup>

Here I focus on the question of investment, which at the time was the single most important issue within the regime as a whole and for Russia in particular. The neo-liberal model was proposed to deal with the investment question. It had two main components, the free market norm and the legal norm: 1) economic decisions in general and investment decisions in particular should be made by private actors; and 2) business interests should be protected against political risk through the creation of a legal sphere that was also reinforced by international law. It is clear that this was the dominant model built into the agreement and that political risk referred first and foremost to the state. In an explanatory guide to the Treaty published by the Secretariat, the introduction to the investment section reads:

The investment chapter is a cornerstone of the ECT. Its provisions aim to promote and protect foreign investment in member countries. To this end, the Treaty grants a number of fundamental rights to foreign investors with regard to their investment in the host country. Foreign investors are protected against *the most important political risks, such as discrimination, expropriation and nationalisation, breach of individual investment contracts, damages due to war and similar events, and unjustified restrictions on the transfer of funds*. The dispute settlement provisions of the Treaty, covering both inter-state arbitration and investor-state dispute settlement, reinforce these investor rights.

The perceived degree of political risks in the host country considerably affects the decision of foreign companies whether to make an investment in the first place or not, and what level of return it would require. The higher the perceived risk, the higher the return that the foreign investors demand. Vice versa, the lower the perceived risk, the more capital is likely to be invested and the more potential revenue the host country will gain. By reducing the political risks that foreign investors face in the host country, the ECT seeks to boost investor confidence and to contribute to an increase in international investment flows.<sup>341</sup> (emphasis added)

During the February seminar, L. Ervik, director of negotiations at the Secretariat explained this same logic to the deputies:

From the perspective of investors, *a useful economic agreement must minimize prospective political risk*, while leaving to the economic “acting agents” to deal with commercial uncertainty. A hard definition of political risk does not exist. Usually, it is associated with questions of sovereignty which may make the investment climate unpredictable (for non-economic reasons) or with unfair, discriminatory, non-transparent, or quickly changing conditions and decisions. Not all government action necessarily creates political risk.

The key element to lower risk is predictability in relation to the conditions in which investors conduct business. In particular, it is important for the conditions of contract law to be well known and stable, for investors to be able to use their revenues after paying taxes at their own discretion,

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340 “Explanatory Memo for the Federal Law ‘On the Ratification of the Energy Charter Treaty’” in “Energy Charter Treaty—Parliamentary Hearings.”

341 “The Energy Charter Treaty: A Reader’s Guide,” Energy Charter Secretariat, 19.

including transferring their profits out of the country, and for the negative effects of expropriation to be minimized, i.e.... the payment of appropriate compensation to be provided for.

Prospective risk exerts a strong influence on investors' decisions concerning whether to invest any capital at all, and is also related to the receipt of the desirable level of profits. The more the risk, the higher the rate of profit that is required, and in the majority of cases, the fewer the number of investors that are prepared to participate. Analogously, the lower the risk, the more capital is invested and the more the potential revenue for the state.

.... [A]ny violation of an agreement between an investor and the host state can become a violation of the agreement, giving the investor the recourse to arbitration, the outcome of which will be binding as provided for in the articles on dispute resolution in the ECT.

...The Energy Charter Treaty aims to provide guarantees *necessary* to attract investment. And the more unstable the prospective climate for making investments, the more the government wins from participating in agreements that improve conditions for investment.<sup>342</sup> (emphasis added)

This lengthy excerpt from Ervik's testimony captures all the major elements of neo-liberalism: the vesting of economic decision making with agents distinct from the state; a focus on risk stemming from state action; and legal guarantees including international agreements to protect private investors. The latter also included the historically novel idea that investors should have recourse to adjudication of disputes in an independent (not national) sphere where the state and investors have equal legal standing. The ECT includes this provision in its articles on dispute settlement related to investment.

The neo-liberal logic was repeated frequently and presented as inevitable given the goal of attracting investors. The idea that disputes needed to be adjudicated in a legal sphere where the state had no special status to attract investment can be seen in the February 1997 testimony of C. Papoutsis:

In the global economy, reliable investment conditions and the free movement of goods and services comprise the essential (*неотъемлемым*) conditions for attracting huge amounts of capital, which are indispensable (*необходимы*) for the realization of energy projects. Without the fulfillment of these conditions, investors simply will not be able to realize their projects. This is an absolute reality.<sup>343</sup>

The idea of necessity also appears in the statement by E. Paasivirta during the February seminar:

An international agreement like the Energy Charter Treaty...will have a *higher chance* of success thanks to its strong provisions related to dispute resolution. They create a system of consistent and predictable interpretation of the rules of the ECT for all Contracting parties. They also fortify the confidence of investors....which is *significant* for stimulating investment flows....for which the Agreement was conceived....

Perhaps it is fair to say that investment related dispute resolution through arbitration between governments follows a model similar to models enshrined in a series of other agreements. This model likewise inherits the same deficiency: a dispute between an individual investor and a host country becomes a question of interstate relations and therefore becomes politicized. Arbitrage between an investor and a state provided for by article 26 of the ECT is free of this deficiency....

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342 L. Ervik, "The Investment Regime in the Energy Charter Treaty" in "Energy Charter Treaty—Parliamentary Hearings."

343 Papoutsis, "Europe is for Cooperation."

The advantage of investor-state arbitration is that the dispute is resolved between individual investors and the host country, and does not lead to the politicization of the question through diplomatic relations between states. Of course this is desirable from the perspective of all the parties – the host country, the investor, and the investor’s home country.

The purpose of international arbitrage is not that it creates a preference of foreigners, but that it provides an independent and neutral forum for the resolution of disputes that may arise.<sup>344</sup> (emphasis added)

Paasivirta’s concluding remarks explaining why this model was necessary suggest that it is inevitable given the goal of attracting investment:

States throughout the whole world compete to attract much needed foreign investments in order to increase wealth and stimulate economic development of their country. The attraction of foreign investment *demands*, among other things, provision of sufficient legal guarantees, without which foreign investors will not invest their capital or will do so for a higher price. Access to international arbitration is possibly the single *most important* legal guarantee for foreign investors.<sup>345</sup> (emphasis added)

We can see this strategy – to convince audiences about the value and necessity of the neo-liberal model – again in a speech by Freemantle, the chair of the working group responsible for negotiating the Basic Agreement, who opened the seminar in Brussels held during May 18 and 19, 1993:

One of the early aims of the European Energy Charter was to assist the republics of the former Soviet Union and the countries of Eastern Europe in overcoming the energy problems that they faced. These problems included: physical planning, low or non-existent prices, no appreciation of costs, declining production, environmental degradation, inability to respond to developments in the market, use of outdated technology even when modern processes are available; above all waste....

...[O]ne [difficulty] on the critical path is whether and when the new states of the CIS will be in a position to endorse agreement.

There remains an urgency about the Basic Agreement. The economies of the former Soviet Union are deteriorating daily; western governments cannot do much to help directly. They do not possess the knowledge, the skills, the resources. *Those lie with the private commercial sector.* It is essential to get commercial companies interested in investing and dealing with the countries of Eastern Europe and the former Soviet Union....But the *companies will only play their role if sufficiently assured against political risk.*

That is why we need the BA; that is why we need you to understand the concepts that underlie it; that is why this seminar is so vital and we welcome you to it.<sup>346</sup> (emphasis added)

The same claim of necessity was also made by Russian officials. For example, D.A. Borisov, deputy department head from the Ministry of Economics, argued during the February seminar that:

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344 E. Paasivirta, “Dispute Resolution According to the Energy Charter Treaty: Arbitrage Between a State and International Investors” in “Energy Charter Treaty—Parliamentary Hearings.”

345 Ibid.

346 Sydney Freemantle, Archive of Travaux Preparatoires Documents, Energy Charter Secretariat, Brussels, from seminar in Brussels, May 18 and 19, 1993.

Russia's accepting the international rules of the game in order to not to lose in the competitive battle for investment resources for the fuel and energy complex is a question of *vital necessity*.<sup>347</sup> (emphasis added)

This model was accepted by the Russian government, which also portrayed it as inevitable given the goal of attracting investment. This can be seen in the government's explanatory memo to the State Duma (submitted when the government proposed the Treaty's ratification), in which there was a particular emphasis on the importance of legal guarantees for attracting investment:

The Energy Charter Treaty is an international, multilateral investment-trade agreement that creates for all participants *one set of norms and rules*, which provide legal protection to companies and organizations as they make investments and conduct entrepreneurial activity in the fuel and energy sector....

Ratification of the ECT promotes:

The improvement of the investment climate and the creation of the prerequisites (*предпосылок*) for attracting foreign investment on this basis, which will accelerate the process of eliminating the crisis conditions of Russian energy, modernizing and restoring its productivity and export base. It will likewise contribute to the structural reform of the fuel and energy sector, and likewise the improvement of ecological conditions in the country<sup>348</sup> (emphasis added)

The necessity of the neo-liberal model for attracting international investment was evident in the writings of former Deputy Minister of Fuel and Energy Konoplyanik, who has been cited extensively earlier in this chapter and in the previous chapter.

Finally, it is clear that the imputed connection between the ECT and investment inflows was causal. During the February seminar, P. Schutterle, secretary general of the Secretariat stated that:

For the business world, the attraction of the proposed Treaty's strong support in relation to the protection of investments, free trade in energy goods, transit, and international procedures for dispute resolution will become a real stimulus as soon as the Treaty comes into effect. This will bring big advantages to the Russian Federation, and not just to your companies working abroad, whether in the CIS republics or in the West, but also in terms of attracting foreign investors into Russia. There can be no doubt that without international cooperation, the process of economic stabilization will, without exaggeration, proceed much slower.<sup>349</sup>

This section has focused on the discussion concerning investment into the energy sector to demonstrate that as part of the strategy to promote ratification of the ECT, the neo-liberal model on which the agreement was based was presented as necessary to create a favorable investment climate that would entice international investors. These arguments were made by international participants and the Russian government, which supports the claim that there was a convergence on the neo-liberal model between the Russian government and the other participants (except Norway) in the ECH process.

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347 D.A. Borisov, "The Energy Charter Treaty Investment Regime" in "Energy Charter Treaty—Parliamentary Hearings."

348 "Explanatory Memo for the Federal Law 'On the Ratification of the Energy Charter Treaty'" in "Energy Charter Treaty—Parliamentary Hearings."

349 P. Schutterle, "The Energy Charter Treaty: A General Assessment" in "Energy Charter Treaty—Parliamentary Hearings."



*The Duma's conclusions: ratification postponed*

Ultimately, the strategy was unsuccessful, and the Duma did not ratify the agreement. Transcripts for the summer 1997 hearings are not available to the public, but a summary of the deputies' conclusions concerning the question of ECT ratification is available and helps us understand why the legislature did not endorse the agreement. The Duma made a number of arguments against ratification.

In general terms, the first argument against the agreement was based on the premise that the ECT was an instrument to maintain a gap in economic development between Western advanced industrial countries and Russia. Specifically, the claim was that the ECT perpetuated Russia's position as an exporter of raw (unprocessed) mineral resources. According to the Duma,

There are two very pronounced goals in the foreign economic policy of Western developed countries: a course to support the highly developed countries and a course to maintain an orientation toward the production and export of raw resources in a host of countries. To the latter belongs Russia.<sup>350</sup>

The logic behind this claim was that the Organisation for Economic Co-operation and Development (OECD) countries were energy poor and so needed access to unprocessed natural resources in Russia for export to their home countries. However, this was a problem for Russia, which had to import “high-tech, science intensive goods,” the prices of which were “persistently growing.”<sup>351</sup> As a result, Russia had to export more and more crude resources to pay for imports of finished goods. This conflicted with the goal of processing resources in Russia and exporting them as value-added goods that fetched a higher price on international markets.

The deputies also noted that in terms of investment, the ECT focused on modernizing capacity in the oil and gas sectors, and with respect to foreign trade, it only supported the export of energy carriers; to achieve a “balanced approach to Russia's integration into the international economy” it would be necessary to develop an Industrial Charter and an Industrial Charter Treaty that mirrored the norms and principles in the Energy Charter and ECT. Such a regime would attract investment into Russia's processing industry and allow Russia to supply to Western markets “competitive, high quality, finished goods.” By ratifying both sets of agreements together, Russia would be “genuinely defending its national interests.” Both of these arguments were consistent with the dependency perspective, which saw the ECH as a vehicle for Western states to exploit Russia to obtain natural resources and perpetuate its economic backwardness and geopolitical weakness, that prevailed in the opposition-dominated Duma.

Supporters had touted the ECT as a vehicle for the acceleration of Russia's entry into the World Trade Organization (WTO). However, deputies argued that by ratifying the ECT, Russia was actually undermining its bargaining position with respect to the global trade regime. Since with ECT article 29, Russia had already committed to “endeavour”<sup>352</sup> to begin a standstill on tariffs for certain goods, when it bargained for this same issue (but for a broader category of

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350 “Recommendations from the Parliamentary Hearings ‘On The Energy Charter Treaty’” in “Energy Charter Treaty—Parliamentary Hearings.”

351 Ibid.

352 This is a soft commitment; however, given that tariff reduction is the subject of ongoing bargaining, it can be considered a concession nonetheless. The key point is that this was the argument that the Duma was making.

goods and services) in the WTO setting, it would have already made concessions and therefore lost some leverage in negotiations. Thus, the Duma recommended that ratification of the ECT should be linked to the negotiation process for WTO entry.

Next, the deputies claimed that ECT article 46, which prohibited any qualifications by the state upon ratification, was unusual; many other international agreements did allow states to make qualifications, and Russia had taken advantage of these upon ratification. Moreover, since article 15.4 of the Russian Constitution provided for international agreements that Russia has ratified to trump domestic law, ECT ratification raised the possibility of many “hidden icebergs.”

With respect to investment (article 5), the deputies objected to NT. Since Western companies were “objectively better positioned in terms of finance and technology,” NT represented discrimination against domestic producers. A series of negative consequences were envisioned as a result: 1) lack of development of Russia’s productive and especially processing capacity in energy; 2) increase of Russian exports of energy resources by foreign investors; 3) perpetuation of the trend for lower supply and higher prices of petro-products on domestic markets; 4) higher input prices and production costs for all Russian goods; and 5) a potential critical shortage of energy on domestic markets. All this combined would have “devastating consequences for the Russian budget and the collection of taxes.” This too was consistent with the dependency perspective.

The deputies had two other objections concerning the ECT’s investment provisions. First, article 5 prohibited national legislation that required foreign investors to buy local goods. This contradicted the Russian law on Production Sharing Agreements (PSA), which mandated that a portion of equipment be purchased from Russian producers. Second, it disallowed legislation that limited the export of any goods; this contradicted the Russian law on “State regulation of foreign trade activity,” which allowed export limitations for reasons of national security, the fulfillment of Russia’s international obligations, and the protection of the domestic market.

The deputies objected to the ban on the interruption or reduction of transit in article 6.7. This could be a problem should “Russia build new pipelines or oil tanker terminals, and have to engage in difficult politico-trade disputes with states through which energy is transited at present.” They also objected to article 12, which required the state to “fully compensate foreign investors for losses should a situation of insurmountable force (force majeure) arise, such as military conflict, civil disorder, and other extreme situations.” This was inconsistent with article 401 of the Russian civil code. Finally, the deputies noted that the ECT “did not solve the problem of non-discrimination against Russian uranium exports for use in nuclear installations.”<sup>353</sup>

In conclusion, the Duma recommended that: 1) ratification be postponed until Russia entered the WTO and then be linked to negotiations over mutual concessions related to accession; and 2) the government conduct negotiations with ECH countries over an Industrial Charter and Industrial Charter Treaty based on analogous principles.

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353 Free trade in nuclear materials with Russia would have created significant competition for Euratom, and so, at the EU’s initiative, nuclear materials were taken out of the regime. Instead, Russia and the EU jointly decided to negotiate an agreement within the context of the bilateral Partnership and Cooperation Agreement that governs EU-Russian trade more broadly. To date, an agreement concerning nuclear trade has not been reached by the two parties. For more details, see Chapter 9.

These objections can be reduced to three key ideas. First, the agreement was biased in favor of rich countries at Russia's expense; this was consistent with the dependency perspective that portrayed the ECH as perpetuating Russia's implicitly unfavorable position in the international economy as a "raw material appendage" to the West. Second, the investment regime was inadequate. It was too liberal in that it constrained the state domestically with respect to important areas of regulation. In this respect, the Duma position was very close to that of Norway. In addition, NT resulted in the de facto discrimination against domestic investors, and compensating investors for losses due to "force majeure" situations was too generous. Finally, the ECT hampered the state internationally during negotiations, whether in the WTO or in the future with respect to transit. Clearly, no consensus obtained.

The next section examines the implications of the neo-liberal model for how sovereignty was understood to expand on the insights developed earlier concerning the meaning of sovereignty in Russia under Yeltsin.

### **Sovereignty within a neo-liberal framework**

In the earlier discussion comparing Russian and Norwegian approaches to negotiations, we saw that Russia did not completely reject the idea of state sovereignty. However, this was a particular understanding of sovereignty informed by neo-liberalism in that it saw the state primarily as the exclusive maker and enforcer of laws. This was sovereignty understood as legal sovereignty. The debate from the ECT ratification process supports this claim and also allows us to expand it in several ways. First, not only was the state the maker and enforcer of laws, sovereignty understood in this way conferred equality to all states in international relations. This idea can be seen in the comments made during the February seminar by E.V. Shvets from the Russian Ministry of Foreign Affairs:

The Energy Charter Treaty as a multilateral agreement between states and international organizations is built on the *principle of following international law*.<sup>2</sup> Especially significant in the ECT is the principle of the sovereign equality of states, which constitutes the basis for relations between the Contracting Parties in the sphere of energy resources. The primary social designation of the recognition of state sovereignty – to provide for *the legally equal participation in international relations (related to the ECT – in international economic relations) of all states, independent from economic, social, political, or any other distinctions*. Since the states are legally full-fledged participants in international interaction, they are all endowed in principle *with identical rights and responsibilities*. The provisions of Article 18 (point 1) of the ECT confirm this in full measure.<sup>354</sup> (emphasis added)

These comments by Shvets suggest that sovereignty as understood by the Russian government at the time implied that Russia was just one of many identical states that were all equal.

Second, the ratification discussions also reveal that this understanding of sovereignty included the idea that states were bound by laws. This can be seen in the remarks at the February seminar by then Secretary General of the Charter Secretariat, P. Schutterle:

[T]he Energy Charter Treaty does not replace national policy in energy. It does not touch on the sovereignty of states in questions related to their natural resources. Member countries of the

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354 E.V. Shvets, "The Problems of State Sovereignty in the Energy Charter Treaty" in "Energy Charter Treaty—Parliamentary Hearings."

Treaty will continue to be free to make decisions concerning the methods of exploration, development, transport, and sale of their own resources. *However, the realization of these sovereign rights must, without doubt, be utilized in accordance with the norms of international law and as a function of them. Abiding by these principles comprises an indispensable condition of participation in broader international economic cooperation.* Non-discriminatory (meaning a fair and equal regime for foreign investors) and stable conditions for the trade and transit of *energy comprise appropriate and at the same time the best instruments* for the future development of this key economic sector as a part of the global economy.<sup>355</sup>(emphasis added)

These comments suggest that energy policy remained in the purview of the state as a sovereign actor; however, these sovereign rights were ultimately subordinated to international law. In the abstract, it is not clear whether the sovereign prerogative to develop energy policy is actually constrained; it is necessary to look at the substance of the laws to determine what the state can or cannot do in practice. Accepting the Treaty – since it embodied free market norms – meant that in practice, the state was to be significantly constrained where policy was concerned. This was the Norwegian critique; not that it refused to follow international law or was against private enterprise, but that it would not commit to law that it saw as too liberal and constraining its sovereign right to make energy policy.

Clearly, the notion of sovereignty embraced by the Russian government was informed by neo-liberalism on several levels. First, Russia understood sovereignty as the exclusive authority to make domestic laws needed to protect firms. Second, it saw sovereignty as the authority to make international law. For Krasner, this is a property of legal sovereignty:

If you have international legal sovereignty...you get to sign treaties. It's the international equivalent of liberal thinking at the domestic level. For the most part, as people in a free society, we can enter into any contract that we please. The idea of international legal sovereignty is that states can do the same.<sup>356</sup>

Third, sovereignty meant that states are subject to international laws once they have committed to them. International law was important to reinforce firms' protected status in the event that domestic law failed to fulfill this function. In the ECT, this went so far as to include the novel (in historical terms) provision that in case of a dispute between investors and the state, investors can take the state to court and be awarded damages. Understood in this way, sovereignty did not imply a legal status that was distinct from non-sovereign actors. Finally, neo-liberalism implied that all states were equal, and this followed from the idea that all are subject to international law equally regarding state-investor disputes and state-state disputes, which the ECT also regulates. The key point is that whether in the domestic sphere or internationally, in relations with investors or other states, state power is marginalized, since it is constrained by law, and in this respect all states are equal.

It is clear that it was very much in the spirit of the agreement to constrain sovereignty in this way. If for Hobbes and Bodin sovereignty was fundamentally linked to a power that was not constrained by any superior authority, from the perspective of neo-liberalism this was undesirable. It is worth returning to the comments by Ervik examined above:

From the perspective of investors *a useful economic agreement must minimize prospective political risk*, leaving to the economic "acting agents" to deal with commercial uncertainty. A hard definition of political risk does not exist. Usually, it is associated with questions of

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355 Schutterle, "The Energy Charter Treaty: A General Assessment."

356 Krasner, *Sovereignty: Organized Hypocrisy*.

sovereignty which may make the investment climate unpredictable (for non-economic reasons) or with unfair, discriminatory, non-transparent, or quickly changing conditions and decisions.<sup>357</sup> (emphasis added)

Therefore, it was unconstrained state power that the neo-liberal approach aimed to reduce to attenuate political risk and make investment comfortable for firms. This meant creating a legal regime that constrained state action by its liberal substance and then subordinated state sovereignty to international law, while still recognizing a notion of sovereignty that was constituted in almost every way by its relationship to law.

### **The ideological line and its institutionalization into the state**

#### *The puzzle: continuities in Russian ECH policy*

The previous passages have presented considerable evidence showing that Russia under Yeltsin had a regime taker role identity. Russian policy behavior in the ECH sphere – both in terms of the policies it supported and ultimately accepted as well as the exceptions it demanded – was consistent with this type of role identity. Most notable is that Russia’s agenda positioning, even when it was bold, was still conventional in that it fell within the neo-liberal framework.

This is most obvious when we compare it to Norway’s agenda positioning, which was controversial and left it outside the neo-liberal consensus and totally isolated within the regime. Norwegian policy also differed from Russia’s in two very important respects. First, Norway opted out of provisional application of the agreement; this meant that Norway did not intend to become a contracting party to the Treaty and was not legally bound by its provisions in any way. Second, in an annex to the ECT, Norway indicated that it did not agree to the key provision that investors could take the Norwegian state into binding international arbitration. As we shall see in the last chapter, Russia accepted provisional application and did not opt out of international arbitration with investors, which would become very important more than a decade later in the context of the Yukos case.

During the period immediately after the coup, a particular image of the state – as imperialistic and economically oppressive – prevailed within Yeltsin’s first government of “young reformers.” This rejection of the state was accompanied by an aspiration to build a new Russian state modeled on Western, liberal capitalist, democratic states as the reformers understood them.

For this cohort, liberating market forces by destroying the institutions of the old Soviet economy and radically reducing the state’s role in economic activity was considered the best way to build capitalism. This causal idea animated both domestic economic and ECH policy, and the two reinforced each other. Moreover, the Gaidar government’s commitment to these principles was a matter of conviction.

However, not everyone in the government was a true believer. This was true especially after the revolt of the “red directors” in the spring of 1992, when President Yeltsin conceded to the demands of the managers of Russia’s largest industries and their allies in parliament and

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357 Ervik, “The Investment Regime in the Energy Charter Treaty.”  
B. Barkanov

dismissed the government of young reformers. Energy Minister Lopukhin was a very early victim, dismissed in April 1992 (after only six months in government). He was replaced in May by Viktor Chernomyrdin, the former USSR minister of gas and founder of the state gas concern Gazprom, who temporarily became first deputy prime minister in charge of fuel and energy. In December 1992, parliament approved Chernomyrdin for the post of prime minister, replacing Yegor Gaidar, the architect of reforms (who had been acting prime minister after the Duma refused to ratify his appointment to the actual post). After Chernomyrdin became the head of the new government, Y.K. Shafranik, a Siberian oil man who had gone into politics during Gorbachev's *perestroika*, became the new minister of fuel and energy in January 1993.

Gaidar, Lopukhin, and Konoplyanik saw a special significance in the ECH and believed in the value of universal “rules of the game” and “international standards” as a vehicle for revitalizing the Russian energy sector and integrating Russia into the global energy economy and international system in general. The same cannot be said of officials in subsequent governments, who were more skeptical of radical reform in general and the neo-liberal principles of the ECH in particular. However, Russian governments continued to support the ECH and the neo-liberal approach on which it was based. How do we explain this continuity in policy?

### *The ideological line reconsidered*

The concept of an ideological line is not new when considered from the perspective of Soviet history. During the Soviet period, the communist party articulated a broad vision, and this was the Soviet ideological line. As the ultimate repository of legitimate knowledge and purpose in the USSR, the party's vision was authoritative within the party and within the state, which the party controlled entirely. During earlier Soviet periods, the party-state deployed this ideology to mobilize society. Later, ideology could no longer mobilize society as effectively, but it still created boundaries for social behavior and discourse within the party, state, and society. From a functional perspective, then, the ideological line is a form of social control going from the top of the political hierarchy to the bottom. It indicates the boundaries of the permissible: what is appropriate/inappropriate and what is likely to be allowed/punished.

As an example, any Soviet teenager would have known that private property was considered bad and would also have known to either support this claim in public (toe the line) or expect some sort of negative consequence for transgression. Even in private spaces the ideological line was operative; thus, when violating the ideological line among trusted friends and family, people would whisper or avoid discussion in front of their young children who were not old enough to be politically reliable and might repeat the transgression in public.

Moreover, resistance was also informed by the ideological line. Yurchak has shown convincingly that during the late Soviet period actors intentionally combined Soviet symbols and discourses in unexpected and often absurd ways.<sup>358</sup> The effect was to implicitly but not too overtly mock and therefore subvert Soviet order.

During the Soviet period, the areas of life regulated by the ideological line were extensive. It is probably not an exaggeration to say that all public life was regulated by it. With

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358 Alexei Yurchak, *Everything Was Forever, Until It Was No More: The Last Soviet Generation* (Princeton, NJ: Princeton University Press, 2005).

Yeltsin, the ideological line was completely transformed. Previous ideological revisions in the USSR, no matter how radical, still preserved a discernible ideological core. Yeltsin's contribution was to reject this very core and introduce its opposite: the ideology of liberal capitalism and democracy. This had several implications.

First, the vision that Yeltsin articulated was carefully watched by the bureaucracy, which modulated its behavior and discourse to be in tune with the new ideological line. This is the functional control element of the ideological line and can clearly be seen in a revealing anecdote recounted by Aslund:

“In a *rare moment of openness*, one of these bureaucrats might confide: “I shall tell you frankly. Work was more interesting before. We were building...” The bureaucrat would cautiously stop before the newly *prohibited word* socialism passed his lips.”<sup>359</sup> (emphasis added)

Under the new ideological line, fond recollections of the Soviet bureaucracy were taboo had to be whispered. Such an offense was not serious enough to be punished; however, it was inappropriate and retrograde and so was said in hushed tones. The key point is that the official understood perfectly well what should be said out loud in public and what should be whispered in private.

Second, although the new Russian state did not aspire to control society in the way that its Soviet predecessor did, the ideological line still had social consequences outside the state. Saying at the highest political level that Russia's new economic policy was to liberate private entrepreneurs from the state was to 1) legitimize private entrepreneurship and 2) establish a particular type of relationship between private entrepreneurs and the state. If historically private entrepreneurs had always been the servants of the Russian state, under Yeltsin, they shed this identity and became their own masters. Thus, the public articulation of the ideological line by the leader made salient certain identities rather than others. Of course, this was deeply contested by large segments of the population and the political elite. However, it was legitimate from the perspective of state power (which Yeltsin formally controlled). As a result, when oligarchs publicly threatened to have ministers fired or brought down governments because of an unfavorable privatization outcome, they knew that, under Yeltsin, they were not likely to lose their private property or be sent to jail. After all, such consequences were a Soviet atavism; the new Russia, which was becoming a liberal, capitalist, democratic country did not engage in such practices with respect to its economic elite.

Finally, the ideological line also comprised substantive ideas related to policy. If we combine its functional and substantive dimensions, we can see that it informed policy making within the bureaucracy.

### *Institutionalization*

Although the charismatic (“euphoric”) moment associated with the unequivocal triumph of neo-liberalism in Russia was short lived, as was the time when true believers controlled the government, ECH policy was characterized by continuity nevertheless because the neo-liberal ideological line became institutionalized into the state for the remainder of the decade and into the early Putin period as well.

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359 Aslund, *How Russia Became a Market Economy*, 90.

During the 1990s, the neo-liberal ideological line came from Yeltsin when he articulated very early on his vision for the new Russia: opposite of the USSR, neo-liberal capitalist, democratic, and law abiding like states in the West, especially the United States. For the true believers, this was not problematic. After all, they were largely chosen because of their beliefs in the neo-liberal approach. In Weberian terms, we might say that the ideological line for this cohort of true believers was a charismatic idea that represented an opportunity for salvation and specifically for Russia's redemption from its Soviet past. Ultimately, the true believers adhered to the ideological line due to their belief in the causal relationships between states and free markets. Their discourse and behavior were consistent with the ideological line because of their convictions.

After they were no longer in power, the ideological line became institutionalized into the Russian state through the role of being an official. Even though they might not believe in it personally, government officials understood perfectly well that it was their job to implement it. This was supported by the authority of Yeltsin as the head of the government (the chief).

Although it was initially the property of individual officials who shared a genuine conviction, later it became a property of the state that operated regardless of the personal convictions of the officials within the state. It constituted the state's role identity as a regime taker and was the backdrop for policy making by substantively informing discourse and policy behavior within the government and foreign policy apparatus.

According to Konoplyanik,

[R]epresentatives of the Russian government at different stages of its early period

all supported to a greater or lesser degree a process that started before them and without them. They had no basis to not support it or stop it....

Some people related to the document strictly due to their official position, for example Chernomyrdin, Shokhin, Davydov, Shafranik. While other people related to it not just because of their position, but because they attached special significance to it, for example Lopukhin, Gaidar, and your humble servant....

Everyone fell in line....

For example, in 1993 when we were about to sign the agreement...it was the vice premier Davydov who signed. Not because he supported the process but because at that moment he turned out to be in that place. He was the vice premier responsible for foreign economic ties. Before him it was Shokhin, who was in charge of that direction. So when it was necessary he was brought in accordingly. Before that...it was Chernomyrdin.

...Some did so because it was part of their duties, they had to.... Lopukhin signed the Energy Charter political declaration because he was the minister, he was assigned to do so. But he also actively supported and initiated many processes within the Energy Charter because he understood its significance.<sup>360</sup>

Although they did not necessarily oppose the agreement, those who approached the ECH as simply a part of their job did have a different understanding of it, and in many cases they did not attach the same personal significance to the agreement as did the young reformers.

According to Konoplyanik,

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360 Telephone interview, fall 2009.



People who came after them [the young reformers] into the government, for example Shafranik, for them maybe it was a less significant phenomenon in the context of the larger political tasks that they had to deal with....

...[F]or Shafranik, the charter was a relatively visionary (*nepredovoi*) project. ...based on his previous service, he was from a different sphere....for Shafranik, internal problems – not so much economic, but psychological, organizational problems — were much more important. In other words, in the hierarchy of values that depended on peoples' previous experience, the charter ends up on different level due to the specifics of their impression, careers, and this sort of thing.<sup>361</sup>

Thus, it appears that personal beliefs and experiences contributed to the attitude of many government officials who worked on the ECH after the Gaidar government fell. However, despite the shuffling of personnel and changes in governments, the Yeltsin's Russia still supported the ECH and the neo-liberal approach.

According to one respondent who worked at a middle level in the bureaucracy (head of department), "It did not matter what you personally thought about the Charter. Working on the Charter, promoting a certain set of policies was part of our job."<sup>362</sup> Individuals' personal beliefs did not drive policy. At least in public, they were careful to follow the ideological line as part of their official responsibilities as representatives of the state.

#### *The external function of the ideological line – signaling internationally*

Even high-ranking officials who were not convinced of the causal benefits of the ECH still had to support it as part of their official role within the government. This appears to have been true for former Prime Minister Viktor Chernomyrdin, under whose government Russia negotiated the ECT.

The fall of the Gaidar government beginning in mid-1992 created uncertainty among Russia's partners in the ECH.<sup>363</sup> In the West, Yeltsin's reshuffling of the government was interpreted as portending a potential end to economic reforms. Within the ECH there were concerns that this would affect Russian policy with respect to the regime. However, after settling into his position as deputy prime minister in charge of fuel and energy, Chernomyrdin sent the following statement to Brussels:

All the countries which signed the European Energy Charter committed themselves to transform the political declarations which were embodied in the Charter into practical deeds through working out for this purpose a Basic Agreement the European Energy Charter. We in Russia regard this obligation very seriously and intend to actively cooperate with all interested countries in its preparation.

For Russia...at the current stage, the Basic Agreement must become an instrument for an accelerated exit from the economic crisis and for the introduction of the market system and the progressive transformation of a closed economy into an open type economy which is naturally integrated into the world market.<sup>364</sup>

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361 Ibid.

362 Interview in Moscow, spring 2009

363 Interview in Brussels, winter 2010.

364 "Chernomyrdin Statement, Unofficial Translation," Archive of Travaux Préparatoires Documents, Energy Charter Secretariat, Brussels, September 28, 1992.

Earlier, during a meeting with Clive Jones, secretary general to the Conference, Chernomyrdin confirmed this position, noting that “Russia would certainly continue to support Basic Agreement negotiations...Russia would not hesitate to raise any points that caused [us] difficulties but did not have any basic problems with the current draft text.”<sup>365</sup>

However, in an internal memo to Commissioner for Energy Cardoso e Cunha at the European Commission, Jones expressed his own impressions of Chernomyrdin’s personal attitude toward the ECH:

I thought that Mr. Chernomyrdin was positive toward the Basic Agreement negotiations not perhaps out of intellectual commitments but because he feels that the adoption of the agreement would give the right political signal to governments and investors.

One clear impression was that Chernomyrdin intends to change Russia’s negotiating team.

This could cause us some delays but if the new team is more down to earth and realistic that will be a good thing in our view<sup>366</sup> (emphasis added)

Jones’ confidential assessment is interesting because it supports the interpretations developed here that: 1) after the fall of the Gaidar government, the new officials who replaced them did not have the same kind of personal (intellectual) attachments to the ECH regime; and 2) this did not affect the Russian government’s ECH policy, which was transmitted to the new officials through their official role.

Previous officials had “intellectual commitments” to the ECH; the regime was an expression of the neo-liberal approach, which they believed was the most effective way to rebuild Russia and integrate into the world energy economy. By contrast, the new officials supported the ECH because supporting it was part of their job; Russia’s support of the ECH process, the emerging treaty, and the neo-liberal approach that they represented had been institutionalized into the state. As officials of the Russian state working on the ECH, to not support the regime and Treaty would have been insubordination and a serious political transgression that, if noticed, would probably have invited criticism and perhaps even dismissal.

Finally, as Jones’ comments above indicate, the ideological line also served a third, external function: to send a signal to the outside world that Russia accepted the neo-liberal approach that the ECH represented. More generally, Russia was signaling that it accepted “international standards.” Russia was communicating that it had become a new state that was very different from the USSR. It accepted the “rules of the game.” ECH policy was an opportunity for Russia to express its new role identity as a regime taker, which distinguished it from its predecessor.

After the demise of the USSR, developing a new role identity internationally was an important task for the government. As Yeltsin noted in his memoirs, “Gorbachev represented the Union, the empire, the old power, and I represented Russia, an independent republic, a new and as yet non-existent country. Everyone was waiting impatiently for this country to appear.” Therefore, when Yeltsin took over the reins in Moscow, one of his most important foreign policy decisions was what image to project internationally for the new Russian state. The image that

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365 Ibid.

366 Ibid.

emerged was of a state that rejected its past (the Soviet state) and aspired to become like neo-liberal, capitalist, democratic Western states, especially the United States.

In general terms, the image Russia was projecting was that of a “regime taker.” This affected foreign policy in general. In the ECH sphere, it meant that Russia embraced the neo-liberal approach and supported the process and emerging Treaty. This was true even after the initial government of “true believers” had been dismissed. Thus, when Jones noted that Chernomyrdin supported the ECH – a regime inspired by the neo-liberal approach – not out of intellectual conviction, but because he was sending a political signal to governments and market actors, this was an expression of the fact that the ideological line had become institutionalized into the state apparatus; the Russian state had developed a new role identity as a regime taker. Upon becoming deputy prime minister and later prime minister, Chernomyrdin signaled this identity. Continuing to support ECH policy and embracing the neo-liberal approach that it incarnated was one of these signals.

### **Signaling, state role identity, and Russia’s international integration**

The ratification discussion made it clear that through the ECH process, and through ratification of the ECT specifically, Russia was sending a signal to the outside world. This was true on several levels. The most obvious sense was to reassure international investors that with ratification of the Treaty, their investments would be significantly protected against political risks. This emerged from the remarks of the EC Commissioner for energy, small and medium enterprise, and tourism, C. Papoutsis:

The Russian Federation has to take advantage of this opportunity in order to send a positive signal to potential investors for attracting the indispensable investments for the long term development of the energy sectors.<sup>367</sup>

However, there was another, more subtle, signal that Russia was sending: that it was a particular type of state that embraced neo-liberal norms of behavior. This can also be seen in remarks made by D.A. Borisov, deputy department head from the Ministry of Economics:

Ratification of the Treaty furthers the improvement of Russia’s image as a country receiving investment. Before us stands the goal of making the Russian Federation a country for foreign investment. Without the Treaty, Russia’s fuel and energy complex and the domestic industrial sectors that are connected to it will not receive foreign investment, which will go to other markets. The Treaty makes its contribution to the formation of a favorable investment climate – it provides clarity, precision and stability to the legal foundation.<sup>368</sup>

The same idea can be seen in Ivanov’s concluding remarks at the February seminar: “These articles likewise imply that the parties that have signed the ECT (49 countries and the EU) believe in international arbitration as a neutral forum for the resolution of disputes.”<sup>369</sup> When Ivanov refers to parties that signed the agreement, he is talking about state actors. Moreover, he claims that the signature represents a state belief. Specifically, he is referring to the Russian

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367 Papoutsis, “Europe is for Cooperation.”

368 Borisov, “The Energy Charter Treaty Investment Regime.”

369 I.D. Ivanov, “Trade Problems in the Energy Charter Treaty” in “Energy Charter Treaty—Parliamentary Hearings.”

state's acceptance of the treaty provisions that allow investors to sue the state in a forum where the state and non-state actors have equal legal status.

The belief that support for the ECH represented a signal about the Russian state that was also destined for a state audience can be seen in the memo by Jones cited earlier: “[Chernomyrdin] feels that the adoption of the agreement would give the right political signal to governments and investors.”

Finally, Russia's signals in the ECH sphere had a significance that went beyond the regime and Treaty. Signaling that it was a regime taker was also part of a strategy to distinguish itself from the Soviet Union and reverse the general isolation from the West that it inherited from its predecessor. Being a regime taker with respect to the ECH related to a larger project of integrating Russia into the international economy and international society.

That accepting the ECT is connected to joining other international economic regimes can be seen in the guide to the Treaty published by the Secretariat:

For non-WTO [contracting parties], the applicable ECT trade regime is a major step on the way to stable, predictable and non-discriminatory trade rules and a milestone towards WTO membership. The ECT trade regime will have fulfilled its purpose once all member countries have also become members of the WTO<sup>370</sup>.

Defining integration in neo-liberal terms, treating different regimes and processes as organically linked, and identifying benchmarks of progress formed an explicit Western strategy for economically integrating all the post-communist states, including Russia. We can see this in remarks by P. Schutterle, the general secretary of the Secretariat, during the February seminar in the Duma:

.The Energy Charter Treaty will create an atmosphere of confidence and trust so that energy companies undertaking entrepreneurial activity act on a “single field”....

...[f]acilitating the attraction of foreign investment into Russia on conditions based on international standards....

....The significance of the ECT is not limited to energy in the narrow sense. It also attests to a broader aim of the contracting parties – a hard commitment to international cooperation between equals. Participation in world markets on a global scale is one of Russia's goals: she has approached us with a request concerning entry into the OECD and wants to participate in the work of the WTO. There is no alternative to this policy....

....The Charter Treaty has a significance that goes beyond concrete advantages that it brings to the energy sector. Reinforcing economic and political ties between the contracting parties, it is a valuable contribution to general political stability and wellbeing....

...[Lack of investment] cannot be solved until Western banks and financial institutions appear on the Russian market. Foreign direct investment is one of the key elements for integration into world markets. It is a sign of confidence on the part of the international business community in the country's future development and mutual responsibilities of the government in relation to stable economic relations between equal participants in international society.<sup>371</sup>

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370 “The Energy Charter Treaty: A Reader's Guide,” 13.

371 Schutterle, “The Energy Charter Treaty: A General Assessment,”

That Russia reciprocated this understanding of integration can be seen in remarks by Professor Yuri Yershov, an academic economist and a member of the Russian negotiating team since the Soviet period:

The entry into force of the ECT will create more stable conditions for Russia's participation in the global energy system and will promote the sustained integration of Russia into the global economy. In line with this, the ratification of the ECT will allow the realization of many important principles of the OSCE [Organization for Security and Co-operation in Europe] and will promote the creation of a system of international collective energy security, which down the road will include not only the European continent, but also other regions of the world. Russia's participation in the ECT will serve as a convincing demonstration of goodwill after Russia's acceptance into the Council of Europe in relation to the realization of principles of pan-European cooperation.<sup>372</sup>

Yershov's comments clearly indicate that Russia was sending a signal about the kind of state it was trying to become after the collapse of the Soviet Union. Ratifying the ECT meant the realization of broader principles. This was a state that was projecting goodwill. As a result, it could be trusted to participate in collective energy security arrangements. Moreover, this was related to international institutions and processes that were not economic (OSCE).

Russia was projecting that it was a state interested in cooperation according to the terms set by other actors. Unlike Norway, it did not rock the boat by challenging the neo-liberal consensus with controversial notions of state management. Thus, Russia's cooperation was expressed through joining international regimes designed according to models proposed by other powerful states and embracing international norms created by other states. This even included the sovereignty norm understood as legal sovereignty, that emerged from the neo-liberal perspective and is highly constraining of state power. Through ECT ratification, Russia was trying to perform the role of regime taker.

In short, through its behavior in the ECH regime, Russia was producing the intersubjective understanding that it was a new kind of state, different from its previous historical incarnations. This understanding emerged when the USSR collapsed and Yeltsin began building a Russia that was modeled after his perception of neo-liberal states in the West. Since then, Russia had been learning how to become that kind of state, and ECT ratification was a milestone on the path to becoming a full-fledged member of a community of states that accepted Western values, including liberalism and legalism.

## Summary

This chapter has presented evidence that Russia's role identity was that of a regime taker. What began as a charismatic idea for a relatively small cohort of "true believing" individuals who were suddenly elevated to power became a property of the Russian state. This happened because the neo-liberal ideological line became institutionalized into the apparatus of the state through the role of being an official. This meant that officials knew what to say and what policy to develop because it was part of their job, regardless of their personal beliefs. The institutionalization was supported by the authority of President Yeltsin, the head of state, chief of the government and foreign policy establishment, and the one who articulated the ideological

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372 Y. Yershov, "The Energy Charter Treaty," *Ecology XXI, International Scientific Journal* 1 (2001).

line that allowed him to command his officials in substantive policy terms. This explains continuities in Russian ECH policy that would otherwise be unexpected given how frequently government changed under Yeltsin and how briefly the true believers were in power. We can also say that the ideological line constituted the role identity of the state as a regime taker. In this sense it is clear that the role identity was a background factor for foreign policy making.

At the same time, Russian ECH foreign policy was very consistent with the ideological line and this role identity. Even when it raised contrary demands (transitional period) or interests (access to markets), Russian policy still fell within the neo-liberal framework. Russia's agenda positioning, though bold on occasion, was nevertheless conventional. This also meant that its conception of sovereignty was deeply influenced by neo-liberal ideas. The two ideas interacted, and as a result Russia accepted a very constraining understanding of sovereignty that focused almost exclusively on law and was meant to limit state power domestically and internationally.

The neo-liberal character of Russian policy is especially obvious when compared to Norway, which proposed policies that challenged the neo-liberal perspective. However, Norway found no allies within the regime. As a result, it was unable to significantly influence the regime design. In 1994, it signed the Treaty but did not legally commit to its provisions (through provisional application or ratification) or accept that private investors could take the Norwegian state to binding international arbitration where both parties would have equal legal status. Russia decided to do the contrary on both issues, which would have important consequences later, as we shall see in the last chapter.

Interestingly, the ideological line also dictated that Russia would signal internationally that it accepted the "rules of the game" and thus was a very different kind of state from its predecessor. Under Yeltsin, the modus operandi for integration was to learn and demonstrate acceptance of neo-liberal norms and principles about state behavior, and this included adopting the neo-liberal framework within the ECH regime. This part of the ideological line was also institutionalized into the Russian state and constituted its role identity as a regime taker. In this sense, Russian officials were performing Russia's role identity as regime taker through ECH policy.

The purpose was to encourage foreign investment but also to integrate into the international system and reverse the isolation it inherited from the USSR. Integration for Russia meant inclusion in international economy and society. Russia was allowed into the community of "normal," "civilized" states and accepted as a member of the in-group as long as it accepted their terms.

However, since Yeltsin's authority did not extend beyond the government, the ideological line was not institutionalized in the Duma or at Gazprom, which were populated by non-believers. This had several related consequences. First, it meant that the role identity did not apply to these other organs of the Russian state, which sent conflicting signals. The result was that the Russian state did not have a single, consolidated role identity. Second, despite government efforts, the Duma, largely at Gazprom's instigation, declined to ratify the agreement. Because authority was diffuse, other actors could veto government policy. Obviously, Russia could not follow through on its commitments and did not have the capacity to function as a unitary actor. The next chapter develops these ideas further by examining why the ECT was not ratified in 1997 and the relationship between the state and Gazprom more generally.

## **CHAPTER FIVE: RUSSIA AS APPRENTICE UNDER YELTSIN – STATE RELATIONS WITH GAZPROM, LOW SOVEREIGNTY, AND NON-RATIFICATION OF THE ECT**

### **Overview**

The previous chapter examined the position of the Russian government with respect to the ECH regime. Specifically, we examined its policy toward the Treaty, the regime's centerpiece, which the government submitted to the State Duma in 1996 for ratification. A key part of the political strategy for obtaining ratification was to persuade decision makers – especially Duma deputies – of the merits of the Treaty through a series of seminars, the aim of which was to create an informal setting in which proponents developed personal relations and trust with the audience, presented the neo-liberal model as the only way to attract foreign investment, and then provided detailed information about how the Treaty functioned to achieve that aim. The culmination of this strategy was a seminar, co-sponsored by the Russian Ministry of Fuel and Energy and the Energy Charter Secretariat, which was held in the State Duma in February 1997, a few months before the Duma held ratification hearings (June 1997).

Ultimately, the strategy was unsuccessful, and the Duma did not ratify the agreement. Whatever objections the Duma may have presented, it is clear that it was also representing Gazprom's opposition to the ECT. Although transcripts from the hearings are not available, there is no mention in the summary documents of Gazprom's main concern with respect to the Treaty at the time: third party access (TPA) to its pipeline system.<sup>373</sup> In contrast to the second ratification hearings in 2001, when Gazprom was the most visible opponent to the agreement, its opposition to ratification occurred behind the scenes in 1997. However, its objections were crucial to defeating the Treaty.

This chapter examines Gazprom's policy toward the ECH regime and Treaty. The main argument is that Gazprom was able to block ratification because the state had very little authority over its own company. This was true not only with respect to ECH policy, but also in natural gas policy (as represented by the battles over structural reform in gas) and tax relations with the monopoly. Moreover, this relationship between the state and Gazprom was a symptom of a larger problem suffered by the Russian state during the 1990s: it had very low domestic sovereignty. This was an outcome of Yeltsin's early articulation of the state's role in the economy and the negative state-building project that he pursued subsequently. As a result, the state had very little authority when it came to elite economic actors including Gazprom, which identified as masters (rather than servants of the state) when it came to policy. As a result, policy making was a heterarchical process in which actors could veto the state's policy initiatives.

In terms of the main theoretical goals of this dissertation, the previous chapters established that the role identity of the Russian state during the 1990s was that of a regime taker. This chapter demonstrates that the state's corporate identity was characterized by low sovereignty, and this allows us to conclude that its overall identity was that of an apprentice under Yeltsin. We can see how this identity was associated with two types of outcomes:

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373 Interview in Moscow, spring 2009.

inability to commit to international agreements and absence of unitary actorhood, which are related in this case.

The second goal of this chapter involves the discussion of the state's relationship to Gazprom. As discussed in the opening chapter, IR scholars have focused on a state's adoption of one international norm at a time. However, multiple norms (and ideas) are available in international and domestic societies, and so the next direction for research is to explore how different norms (ideas) interact. Especially interesting is how various ideas interact with the central norm of domestic sovereignty.

The previous chapter showed how the neo-liberal framework influenced Russia's conception of norms of sovereignty. This chapter shows the practical consequences of the very limited understanding of sovereignty that emerged: the inability to project state authority over a key actor even though the state interest was at stake. As a result, the state could not overcome resistance to the agreement and was incapable of following through on a previous commitment to an international regime. Obviously, this also indicated that the state could not function as a unitary actor.

More specifically, Yeltsin embraced the neo-liberal approach, which implied 1) state building characterized by destatization; and 2) that business managers were legitimately masters of their domain. The latter even applied to Gazprom, which was privatized, with the Russian state remaining the largest shareholder. When the Russian government submitted the ECT for ratification to the Duma, Gazprom played a key role in blocking it. Despite having formally committed to the ECT by signing it and beginning its provisional application, the Russian state did not have the authority to make the treaty law in Russia (which is the practical result of ratification) even with respect to its own company. The neo-liberal approach focused on destatization, neglected state authority, and turned elite managers of companies into masters, which significantly hampered the state's ability to commit to the very treaty that incarnated that approach. In short, it is important to understand how various ideas interact with the sovereignty norm because it allows us to assess whether states will have sufficient capacity to commit to projects associated with those ideas (and therefore adopt them in practice) in a successful and enduring way.

From a broader historical perspective, we can see that there was an inherent contradiction in the ECH project in particular and the broader project – embraced jointly by Yeltsin's Russia and the West – to integrate Russia into the international economy through the neo-liberal approach. Specifically, the neo-liberal approach required Russia to make strong international legal commitments; this can be seen most clearly in the provisions related to investor protections. However, this approach also promoted very significant constraints on state sovereignty. The latter was associated with a state-building project characterized by undermining the state and the emergence of legitimate master identities among Russia's elites. However, this had the unintended consequence of undermining state authority in an area where it was desirable (law, treaty making, and enforcement), and as a result Russia could not fulfill the commitments that it undertook.<sup>374</sup>

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374 The neo-liberal perspective, which emerged in the West, makes the implicit assumption that states have the domestic capacity to implement policy. This assumption is grounded in reality; for example, in the West we observe states that are both liberal and very strong in terms of capacity. However, when the neo-liberal perspective was transposed to the Russian setting, capacity was assumed. State building to create capacity was a secondary concern



## Organization of chapter

The chapter begins by examining Gazprom's policy toward the ECH regime and Treaty. The first section demonstrates that publicly, Gazprom projected a supportive approach to the ECH regime. Using data from interviews and comparison with a similar policy question (inward investment into the Russian energy sector), the second section establishes that, appearances notwithstanding, Gazprom opposed the ECT behind the scenes and was a key actor in defeating ratification.

The third section examines the reason behind Gazprom's opposition, which was due to three factors: 1) as a large and powerful company, Gazprom did not think it needed the agreement or the universal "rules of the game" and legal guarantees that it established; 2) the Treaty would have interfered with the private interests of Gazprom managers; and 3) Gazprom managers had their own vision of how to organize Russia's natural gas economy and trade with Europe, which conflicted with the government's liberal approach and the competition norms embodied in the agreement.

The fourth section examines how Gazprom developed its autonomy from the state even though it was a state-owned company. In the fifth section, the discussion turns to issues other than the ECH – structural policy in the gas sector, company oversight, and taxation – to show how Gazprom maintained its autonomy during the 1990s despite repeated attempts to re-establish state control. It also demonstrates that state-elite relations were heterarchical (Gazprom was able to veto state policy) in areas that are unrelated to the outcome to be explained. The final section looks very briefly at Gazprom's role in foreign policy to show that its ability to veto ECH regime policy was not exceptional.

## Gazprom's public support for the ECH regime

The CEO of Gazprom, Rem Vakhirev, had a visible role in ECH policy. At first glance, he appeared supportive of the agreement. In November 1996, the Institut Français du Pétrol hosted a gas executive summit conference concerning the liberalization of the EU gas market. At the time, Vakhirev commented that "[i]nternational law is needed to stop Ukraine stealing our gas....Russia should become more closely involved with the European energy charter."<sup>375</sup> These comments were made in the context of a discussion about a future pipeline from the Yamal Peninsula to the European market. Gazprom was interested in this pipeline because it was trying to increase transit capacity to provide for growing demand, but also because it was trying to build export outlets that bypassed Ukraine. In fact, transit problems through Ukraine were a major concern for Gazprom and a policy priority. Vakhirev's comments suggest that he saw the ECT (of which article 7.6 specifically forbids interruption of transit "in the event of a dispute over any matter arising from that Transit") and "international law" as a vehicle to put pressure on Ukraine.

Vakhirev commented favorably on the ECH again in January of the following year. During an interview on the occasion of his visit to Greece following the completion of a pipeline

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that emerged later when the state's inability to collect taxes (among other things) became a serious concern both for the Russian government and international actors participating in Russia's transition.

375 Sebastian Alison, "Europe's gas industry gears up for era of change," *Reuters News*, November 21, 1996.

to carry Russian gas from Strimonochori on the Greek-Bulgarian border to Athens, he stated that “[p]artnership of this kind is in keeping with the intergovernmental agreements that have been concluded and with the European Energy Charter.”<sup>376</sup> For Gazprom, deeper penetration of EU markets (where margins were more attractive than those from selling at the border to national energy companies) was a top priority. The ECT’s provisions concerning free trade are consistent with this goal, and so Vakhirev invoked the agreement to buttress his broader claim about the necessity to cooperate on mutually beneficial terms.

However, appearances notwithstanding, Gazprom opposed ECT ratification in 1997. Whatever positive statements Vakhirev made about the regime were merely expedient under the circumstances. They did not reflect Gazprom’s position as expressed by its policy actions during ratification. The next section examines its opposition to ratification in greater detail.

### **Non-ratification of the ECT in 1997: Gazprom’s opposition and influence in the Duma**

Due to the fact that it was a liberally oriented agreement concerning investment into Russian energy, we might expect the Treaty to be blocked based on a knee-jerk ideological reaction from the nationalist and communist opposition that controlled the State Duma. However, on a different occasion, a conservative Duma did pass liberal legislation concerning investment into Russian energy: the Production Sharing Agreement (PSA) Law. In June of 1995, the State Duma passed the most permissive (from the perspective of foreign investors) version of the PSA law at the time. According to Konoplyanik, “the communist faction supported on numerous occasions the [PSA] law as it made its way through parliament.”<sup>377</sup> Therefore, although the conservative opposition did block laws submitted by the liberal government, the Treaty’s non-ratification was not automatically predetermined by the ideological composition of the lower chamber of parliament.

According to several interview participants, the real dilemma standing in the way of ratification concerned opposition by “serious” economic interests as opposed to ideological objections. One respondent who has worked at the Secretariat since the early 1990s noted that:

It was clear that it was not an easy process....We should not forget...the communists and all these people trying to [assign] blame for selling Russia out...But that was not the most difficult part.....That was demagogy. In reality of course ...there was a real difference of interests, between producers and consumers; this was inevitable and was the most difficult part of [ratification]. In every parliament of course serious interests are represented.<sup>378</sup>

These comments suggest that the interests of economic actors as represented in the Duma were the greatest obstacle to ratification. The same respondent also noted that conflicts of interest related to Gazprom specifically:

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376 Ibid.

377 A. A. Konoplyanik, “The Law Production Sharing has been signed and has come into force: First Conclusions,” *Oil and Gas Industry*, April 1996, accessed April 11, 2011, <http://www.konoplyanik.ru/ru/publications/articles/192.pdf>.

378 Interview in Brussels, winter 2010.

Gazprom has never been favorable, that's also no secret. Because somehow they had this idea from the start that it does not correspond to their interests, which is not necessarily true.<sup>379</sup>

Therefore, Gazprom's opposition is indisputable.

What did Gazprom's participation in ECH regime policy making look like generally? The gas monopolist was indirectly involved in formulating Russia's ECH position from the very beginning. This participation took the form of consultations with the government, which solicited the opinions of the major companies and state agencies that would be affected by the agreement.<sup>380</sup> However, the government was wary of attempts by firms to encroach on the state's authority to make "the rules of the game." According to one interview respondent involved in the process on the Russian side,

During the early stages, since negotiations after all were between governments, there had to be a division of authority....Consequently there had to be a distinction between the authorities which make the rules of the games, and business which plays according to these rules...we tried very hard during that period to avoid even potential attempts by business to make the rules of the game....

There was coordination with [the companies]. And naturally there were also attempts to understand and explain their concerns....and to explain government policy so that there is clarity, transparency, understanding....But to say that companies dictated conditions; naturally that didn't happen and couldn't have happened.<sup>381</sup>

The ratification hearings – when Duma deputies solicited feedback on the agreement from a wide range of actors, including Gazprom – were an occasion for the company to begin directly shaping developments in ECH policy through parliamentary action. However, the company's position was not constructive. The company opposed the agreement and aimed to defeat ratification. According to the same respondent,

The first official documentation showing Gazprom's opinion – which was extremely negative – emerged during the 1997 hearings...the company hadn't participated in the process and didn't understand who was who and what was what. *So the easiest thing for them to do was to bury the process.* When we suggested the need to further develop the agreement, they said "no, we don't want to."<sup>382</sup> (emphasis added)

That Gazprom "had always opposed" the ECT (prior to 2004) was also confirmed by several other interview participants.<sup>383</sup> So, the available evidence suggests that Gazprom was against the agreement in 1997 and that its opposition was key to the defeat of ratification in the lower chamber. That Gazprom could exercise such significant influence on the Duma is not surprising. After all, in terms of energy production, exports, foreign revenue earnings, tax liability, and contribution to Russia's fuel mix, Gazprom was the single most important actor in Russia's energy sector. We will see just how formidable Gazprom's influence with the Duma was later when we examine conflicts between the government and the company over tax payment. In any case, here we can conclude that the company played a key role in blocking the agreement.

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379 Ibid.

380 Shatalov (first Deputy Minister of Fuel and Energy of the Russian Federation, head of the Russian delegation during negotiations within the framework of the Energy Charter Conference), "Introductory Remarks on the Energy Charter Treaty."

381 Interview with Konoplyanik, fall, 2009; interview in Brussels, winter 2010.

382 Interview with Konoplyanik, fall, 2009.

383 Interviews in Moscow, 2008-2009; in Brussels, fall 2007.

What about the Russian oil companies? The oil companies also started paying attention to the ECH and Treaty around the time of the 1997 hearings.<sup>384</sup> This was partly due to the fact that the Duma solicited their opinion. Another factor was that some clarity was finally emerging concerning the question of ownership and control in the oil sector.<sup>385</sup> Previous years had seen intense battles between various stakeholders concerning control over valuable oil assets; one of the most important cleavages was between managers in central headquarters and those at the level of the local production unit.<sup>386</sup> While the question of control was still in play, the ECT was a secondary concern.<sup>387</sup> However, once many of the battles had been resolved and the dust was beginning to settle, inward investment policy took on an increasing importance.

It appears that the oil companies were not against the Treaty and were not an obstacle to ratification in 1997. One of the top concerns for the oil companies was to limit foreign investment into the Russian oil sector at the early stages of its development (privatization, licensing rounds). On the one hand, they were not interested in competing with foreigners for Russia's assets; foreigners often had greater financial resources, and in any case any additional competition would increase prices.<sup>388</sup> This of course was the opposite of state objectives: to increase participation and revenues by selling assets at their maximum market value. At the same time, the oil companies were not interested in the state's anti-monopoly policy. Competition from foreign investors would break up their regional monopolies, hurting firms' revenues and undermining their political influence. Again, this was the opposite of state policy, which explicitly promoted demonopolization.

The foregoing is consistent with their behavior concerning other policy questions related to inward investment. Specifically, the interests of oil companies with respect to foreign investment in Russian energy can be seen in the way the PSA laws were developed. The PSA laws that were eventually passed limited the deposits that were effectively available for international investment; lobbying by oil companies played a significant role.<sup>389</sup> However, the rules established by the ECT only provided for a soft commitment for national treatment in the pre-investment stage. An additional treaty was to be negotiated to deal with the pre-investment stage.<sup>390</sup> Therefore, the main reason to object to the ECT from the perspective of the oil companies – undesirable competition from foreigners in the pre-investment stage – was absent.

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384 Interviews in Moscow, 2008-2009.

385 Andrei Konoplyanik, "The PSA policy of Russian oil companies," *Oil of Russia* 9 (September 2002): 2. Konoplyanik suggests that companies were sufficiently "confident" to develop an interest in foreign investment policy (the PSA law) by early 1996. This is consistent with Lane, who dates the consolidation of the Russian majors to the period 1993-5 (55).

386 Valery Kryukov and Arild Moe, "Banks and the Financial Sector," in *The Political Economy of Russian Oil*, ed. David Lane (Lanham, MD: Rowman & Littlefield, 1999), 56.

387 Interviews in Moscow, 2008-2009.

388 Ibid.; Konoplyanik, "The PSA policy of Russian oil companies," 7.

389 Ibid., 2. In October 1995, the Federation Council declined to endorse the law passed by the lower chamber that summer, and the law was sent to a conciliation commission co-chaired by Boldirev and Glaziev. The commission made a number of changes to the original law that either effectively constrained foreigners' ability to invest under a PSA arrangement or increased the uncertainty and risk of doing so. President Yeltsin signed this revised version into law in December 1995.

390 This was part of a compromise that allowed the ECT to be signed in 1994. However, the second Treaty never materialized.

At the same time, having consolidated control over their companies, many of the managers in the oil sector wanted to attract foreign investment to technologically upgrade their operations and also as a form of insurance against challenges to their newly acquired property.<sup>391</sup> From this perspective, the ECT, which creates a hard commitment to national treatment in the post-investment stage and has very strong provisions related to investor protections, would have been very attractive to the oil companies as an instrument to bring in foreign investors. In fact, the second attempt at ratification in 2001 was partly instigated by the oil companies, which by that time fully supported the agreement.<sup>392</sup>

This section has established that Gazprom opposed ratification in 1997 and was the single most powerful actor against the agreement at that time. The next section examines the reasons behind its opposition.

### **Reasons for Gazprom opposition**

Why did Gazprom oppose the agreement? We can identify three reasons. First, as a large and powerful company, Gazprom did not think it needed the agreement or the universal “rules of the game” and legal guarantees that it established. Second, the Treaty would have interfered with Gazprom managers’ ability to benefit personally (through informal extraction) from the considerable rents that were available to the Russian natural gas monopoly. Finally, Gazprom managers had their own vision of how to organize Russia’s natural gas economy and trade with Europe, which conflicted with the government’s liberal approach and the competition norms built into the agreement.

#### *Powerful players don’t need universal “rules of the game”*

As a large company, Gazprom did not think it needed the agreement or the universal “rules of the game” and legal guarantees that it established. To the contrary, Gazprom preferred direct relations with other energy market participants in which it could leverage its power as a major producer and supplier of gas. According to Konoplyanik,

[The large companies] were not excluded from negotiations....Rather, in the beginning they themselves did not show an adequate interest in participating in this admittedly incomprehensible to many of them “talk shop,” and continued to consider this process the domain of diplomats and other bureaucrats....

During the early stages of work on the ECT, business, especially big companies, held on to a sort of “recidivistic view” about working with the government that emerged in the conditions of the monopoly market....As T. Walde notes.... “one of the beliefs is that the Agreement is not for big companies, but for small and medium businesses that have less political influence and less capacity to manage political risk.” That in my opinion is one of the explanations for Gazprom’s position toward the ECT... [they believed that the company] will always be able to make an agreement with any government, it does not need a “general” regime to minimize investment

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391 The idea was that participation by foreign investors would minimize opportunities for taking away their property, particularly in the form of expropriation by state authorities.

392 Interviews in Moscow, fall 2006, 2008-2009.

(political) risk, individual preferential treatment supported by bilateral “diagonal” agreements is enough.<sup>393</sup>

The same logic motivated its opposition in 1997:

By that time, Gazprom didn’t want to operate according to the [ECT] rules. During the second half of the 1990s, Gazprom was proposing to organize these markets by forcing its own rules of the game on individual countries, and Turkmenistan in particular. Gazprom absolutely did not need universal rules, respectful and equal relations between the parties, or competition and transparency.<sup>394</sup>

The reference to Turkmenistan concerns Gazprom’s nearly two-year embargo (after a commercial dispute) of the largest Central Asian gas producer’s exports, which could only reach markets through Gazprom’s pipeline network. I will return to the embargo later in this chapter to demonstrate that the state’s lack of authority over Gazprom also extended to foreign policy questions other than the ECH.

In wanting to leverage its power to shape market relations to its advantage, Gazprom was not unique. Large companies in Europe were also not favorably disposed toward the agreement early on for the same reason. According to Konoplyanik, this logic applies to powerful actors in general:

At the very beginning of this process, when the negotiation process on the ECT was beginning, a host of Western companies, of international companies lobbied against the process...Big companies don’t need common rules of the game for everyone. Big companies prefer to work based on the fact that they are exceptional...if you look at their revenues, they are greater than the GDP of many states. That is why they can solve any question using their so called “administrative resources.”<sup>395</sup>

Konoplyanik also generalized that this logic applies to powerful states:

Specifically for this reason, many big countries also stayed at the margin of the process.

Why did the US not sign the treaty?...Because they were not satisfied with the rules being developed in the legal agreement...the US prefers a system of bilateral investment agreements because in any single agreement, the US is more equal than the other party, and so can dictate its conditions, creating an agreement that advances all of its interests.<sup>396</sup>

Therefore, Gazprom did not support the ECT because, as a powerful actor, it preferred one-on-one negotiations with its counterparts in which it could leverage its power.

### *The “fiefdom”: informal extraction at Gazprom and the ECT*

The second reason Gazprom opposed the agreement has to do with the managers’ own private interests. We will see later in the chapter that Gazprom managers had significant autonomy from the state concerning the company and questions related to Russian natural gas policy and the firm’s financial policy. Like the other oligarchs who, during Yeltsin’s revolution,

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393 Konoplyanik, *The Energy Charter Treaty: An East-West Gateway* (Russian edition), 37, fn. 2. T. Walde reference from the foreword by the editor of the English edition.

394 Konoplyanik, *The Energy Charter Treaty: An East-West Gateway* (Russian edition).

395 Ibid.

396 Ibid.

found themselves at the reins of valuable companies that previously had been controlled by the state, Vakhirev ran the organization as if it were his own personal fiefdom. Behind most corporate decisions lurked the interests of Vakhirev, his team of managers, and other actors – firms, regional governments – with which the company conspired on Russia’s chaotic markets at the expense of the central state.

From the perspective of Gazprom’s former managers, the ECT was an agreement that regularized the rules of the Eurasian gas trade, promoted transparency, and delegated authority to the international level. In many respects, this conflicted with their personal interests. The situation was a classic conflict of interest between principal (the state as shareholder) and agent (Gazprom managers as trustees of the state’s share). Although Vakhirev was entrusted with managing the company to promote the interests of its main shareholder, the state, in fact he had sufficient autonomy to promote the private interests of his management team instead. As one interview respondent told me, “Vakhirev and his crew had a good thing going. But the treaty would just shine a bright light on all the shady business that was going on and interfere with a lucrative personal business. Why would you let a goat in your garden?”<sup>397</sup>

The problem of personal extraction at Gazprom was also alluded to by Deputy Minister of Foreign Affairs Ivan D. Ivanov during the 2001 ratification hearings:

Ratification will make [the CIS] market more predictable and transparent, and will complicate the use here of intra-firm transfer pricing.<sup>398</sup>

Ivanov’s statements need to be understood within the context of the disorder that was characteristic of the Russian economy during the 1990s and early turn of the century. The comment on intra-firm transfer pricing was a veiled reference to one of the practices that managers deployed to skim value off the gas trade. One example of this was the close relationship between Gazprom’s old management and the private, Florida-registered firm Itera International.<sup>399</sup> The latter bought gas from Central Asia, moved it on Gazprom pipelines through Russia, and then sold it with a hefty mark-up on CIS markets and in some cases through re-export to Europe.

In an academic text he wrote in 2001, Ivanov makes an even broader claim:

Gazprom, with the support of part of the State Duma, is protesting resolutely against the ECT, and in particular its article 7 on transit, because the transparency of transit would complicate the company’s transfer pricing along the entire length of its gas pipelines.<sup>400</sup>

Here the allusion to “entire length of its gas pipelines” suggests that these practices occurred not only for the Central Asian gas trade but throughout Gazprom’s business. In fact, intra-firm transfer pricing was a key component of the barter and offshore strategies of all the major Russian energy companies during the 1990s. The difference is that whereas for private (oil) companies this was a way for them to minimize their tax liability, for Gazprom, this was also a mechanism to divert profits out of the company and earnings away from its main shareholder, the

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397 Interview in Moscow, spring 2009.

398 Ivanov, “The Energy Charter Treaty and the Interests of Russia,” *Ecology XXI, International Scientific Journal* 2 (2001)

399 In May 2002, it was reported that the FBI was conducting an investigation on the company.

400 I. D. Ivanov, *The Economic Interests of Russia and Its Economic Diplomacy* (Moscow: Russian Political Encyclopedia, 2001), 119.

state. For example, in August 2000, the Audit Chamber, the financial investigative arm of the State Duma, found that:

Gazprom paid its taxes to the Yamal-Nenets local authorities in gas, rather than in cash. The local officials then sold the gas for 45 roubles per thousand cubic meters to Itera's local affiliate, Itera-Rus. Itera-Rus then sold the gas to Itera International for \$80/tcm, closer to world gas prices....Itera exported 121 billion cubic meters of gas over the three-year period in question, including 60.5 bcm in 1999, to former Soviet republics....

The Audit Chamber has also recently opened a probe into Gazprom. Evidence of transfer pricing within Gazprom has also been made evident in the gas giant's accounting records.<sup>401</sup>

Thus, the second reason Gazprom opposed the agreement was related to the personal interests of the managers who controlled the company. Insofar as the personal interests of the managers of a company in which the state was the largest shareholder prevailed over the interests of the central state, we can say that the logic of Gazprom, its identity as a corporation, was that of a fiefdom.

### *Gazprom's vision of gas markets and the ECT*

Finally, Gazprom was against ratification because from its perspective the agreement was too liberal. As we saw in the previous chapter, Chernomyrdin was committed to the ECH not out of intellectual conviction, but because he understood that Russia was sending a political signal through its participation in the regime and specifically its acceptance of regime norms and the Treaty, which was the centerpiece of the regime and embodied those norms. Although the prime minister was not anti-market, his approach to markets was not neo-liberal, like that of the reformist government that preceded him. He supported Yeltsin's commitment to creating capitalism; however, his approach was not radical. It was pragmatic in the sense that he was not ideologically committed to a general blueprint for building capitalism. The fact that he was prepared to deviate from neo-liberal orthodoxy also meant that he was able to compromise to create political support to advance reforms. As a result, his approach was also incrementalist.

Moreover, he was considered an ideal former Soviet enterprise manager for the times. On one hand, he was visionary in his understanding that Soviet enterprise could not function according to the old administrative model; this was supported by the fact that he was the first minister to convert his ministry into an enterprise. In addition, he was considered competent in his business; this was supported by Gazprom's relative success during the early post-Soviet period against the backdrop of the catastrophic performance of the Russian economy as a whole and the oil industry in particular. Finally, he was not stridently anti-statist. All of these qualities made him a respectable figure among Russia's industrial elite, who were not against privatization per se (after all, it was the industrial managers – the “red directors” – who were the direct beneficiaries of privatization since they were best positioned to take over ownership of their enterprise), but were against radical reforms that strived to eliminate the state's role in the economy. Thus by choosing Chernomyrdin, Yeltsin significantly expanded the political support for his economic reform program. For all of these reasons, Chernomyrdin was an ideal compromise candidate to replace Gaidar as the new head of the government, and he was welcomed by parliament at the end of 1992.

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401 “All in the Family—Audit Chamber Probe into Itera Alleges Transfer Pricing,” *NEFTE Compass*, August 24, 2000.



The managers of Gazprom shared Chernomyrdin's ideology. They supported economic reforms and a transition to capitalism; however, they did not accept the neo-liberal orthodoxy. Part of this had to do with their personal interests. For example, Nemtsov's 1997-8 neo-liberal program for demonopolization suggested that Gazprom needed to be broken up to isolate the natural monopoly segment of the business (transport, which was to be regulated by the state) from the potentially competitive areas (production and marketing, which were to be allocated to many smaller firms). Obviously, this reduced the significance of the overall organization at the expense of enhanced state regulation and the creation of many small, less powerful firms. For all of these reasons, a neo-liberal approach to the natural gas sector threatened the personal interests of Gazprom management who, as guardians of Russia's largest company, enjoyed both significant political power and access to the no-less-significant rents that the company enjoyed.

However, the management was also against the neo-liberal vision out of ideological conviction; they disagreed that this was the right way to organize the gas sector in Russia. This stemmed from their training as sectoral (rather than liberal neo-classical or new institutional) economists and engineers and their experience working at the company. Gazprom's managers were thus in general opposed to the ECH's liberalizing, orientation, which was explicitly linked to neo-liberal reforms. In a speech at a seminar on the ECT, Freemantle stated that:

The charter process coincided with the process of economic reform which is underway in Eastern Europe and the former Soviet Union. *This reform envisages pursuing a policy of stabilization, transition to market conditions, privatization and demonopolization, with the liberalization of economic relations with the west.* If this is to be fulfilled, there has to be a consistent course toward an open economy and the entry of the CIS republics into the world economic community.

In this connection, participation in the Basic Agreement on the European Energy Charter is in line with the reforms taking place. *The draft Basic Agreement is intended as a liberalizing document necessary if the principles put forward in the Charter itself are to be put on a proper legal basis.* It will be the first agreement binding the ex-Comecon and OECD countries into a cooperative economic agreement based on mutual advantage and recognition of the principles of a non-discriminatory world market. (emphasis added).

In connection specifically to the question of organizing the Russian gas market, Gazprom managers' resistance to the agreement focused on the idea of competition, which was an important element in the regime.<sup>402</sup> From the perspective of the managers, natural gas was not just any commodity. It had special technical and societal features, which meant that opportunities for competition were both limited and laden with risk.

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402 For examples of the competition principle in the Treaty, see Article 3, International Markets, 45; Article 6, Competition, 46. In the Protocol on energy efficiency and environmental aspects, see Energy Charter Protocol on Energy Efficiency and Related Environmental Aspects, Preamble, 141. In commentary about the agreement by the Secretariat, see "An Introduction to the Energy Charter Treaty," 13-20. In the Charter Political Declaration, see Concluding Document of the Hague Conference on the European Energy Charter, Title I, Objectives, 214; Title II, Implementation, "Access to Markets," 217. Interestingly, in the Treaty's Annex T (on transitional measures), relative to competition, Russia expressed an intent to deepen anti-monopoly reforms in the energy sector: "A comprehensive framework of anti-monopoly legislation has been created in the Russian Federation but other legal and organizational measures to prevent, limit or suppress monopolistic activities and unfair competition will have to be adopted and in particular in the energy sector," 119. Thus, not only was the principle of competition enshrined in the agreement, the agreement was linked to a declared Russian state commitment to create competition in the energy sector. All of these documents are from "The Energy Charter Treaty and Related Documents. A Legal Framework for International Energy Cooperation," published by the Charter Secretariat and available online at: [http://www.encharter.org/fileadmin/user\\_upload/document/EN.pdf](http://www.encharter.org/fileadmin/user_upload/document/EN.pdf) (accessed March 29, 2011).

For example, due to its natural properties, transporting gas is challenging. Before entering the transport system, mined gas has to be processed to meet the specifications of the pipelines and also compressed for transmission. Furthermore, the available capacity in a particular segment of the system at any given moment is physically limited. Mistakes can be costly, as natural gas is highly volatile.<sup>403</sup> This is the opposite of oil, which, as Chubais has stated in an interview, “can be poured into a bucket, carried [to market], and sold.”<sup>404</sup>

According to sources close to Gazprom, roughly 80 percent of the cost of Russian natural gas comes from transport.<sup>405</sup> This is the opposite of oil, in which production makes up the largest proportion of cost, and transport is relatively easy.<sup>406</sup> Finally, the bulk of Russia’s present gas production comes from giant fields. This combination of cost structure and physical distribution of resources means that from the perspective of a sectoral economist – and again the managers at Gazprom shared this training and background – it is not obvious that production can or should be distributed among many small firms; the gains in efficiency would be small, whereas the new costs and risks – associated with raising capital<sup>407</sup> and coordination in loading the transport system – would be relatively high.

Finally, by virtue of contributing roughly 60 percent of Russia’s fuel mix, which includes a significant part of the fuel for generating electricity, natural gas has a special social significance. If the gas industry were to malfunction (for example, an explosion in a critical segment of the transport system as a result of improper loading of natural gas for shipping), this would put the state (which depends on gas for, among other things, defense), a large portion of society, and Russian industry in jeopardy. The foregoing is the sectoral perspective shared by Gazprom managers. It is very similar to the perspective expounded by Abalkin, the chief economist in the last Soviet government. The two approaches converge in their understanding that not all goods are the same, and that socially critical goods cannot be governed by market forces alone. In short, they would agree that natural gas is a fictitious commodity. However, they depart in their attitudes toward socialism.

Although the sectoral logic is compelling, it is not necessarily a slam dunk case against demonopolization. Critics would point out that there are significant risks associated with not reforming Gazprom.<sup>408</sup> A very insightful sectoral economist who worked at Gazprom and is now a consultant to high-level executives at the company, the Ministry of Energy, and other government offices acknowledged during an interview that there is more than one way to organize the gas sector to meet the demands associated with the technological features of the underlying good. From the perspective of this respondent, whether one feels it is necessary to reorganize the company is a function of where one sees the risk: is it in the process of change or in preserving the status quo? There is no single, correct model for organizing the gas market

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403 Valery Panyushkin and Mikhail Zigar’, *Gazprom: New Russian Weapon* (Moscow: Zakharov, 2008) 22.

404 Ibid. The idea of carrying oil in a bucket in contrast to the complexity of transporting natural gas was a common refrain among interview subjects who worked in the gas industry. Interviews in Moscow, fall 2007, 2008-2009.

405 Interviews, Moscow, 2008-9.

406 Interviews, Moscow, 2008-9.

407 The costs of raising capital tend to be higher for small firms than for larger ones. Interviews in Moscow, 2008-9.

408 See, for example, the work of the outspoken neo-liberal, former Deputy Minister of Fuel and Energy Vladimir Milov.

based on objective factors that emerge from material (here physical and technical) structures. In this sense, the “correct” model is socially constructed.

In any case, the fact that the ECH regime in general and the Treaty in particular formalized the principle of competition into international law was not welcome by the managers of Gazprom at least in part due to their beliefs about the best way to organize the Russian gas sector. In addition, the management believed that the transit rules in particular (specifically the question of TPA to Gazprom’s pipeline system for competitors) were a threat to its business in Europe, and this was the strongest formal reason for opposing ratification in both 1997<sup>409</sup> and 2001.<sup>410</sup> The logic behind this claim will be discussed in a later chapter dealing with the 2001 hearings during the early Putin period when Gazprom made this argument publicly. However, it is worth noting here that this argument was not completely airtight.

Whether one sees the ECT as a threat to Gazprom’s business due to TPA for its competitors depended on 1) whether one intended to craft the transit protocol and develop domestic legislation to address this concern (as we saw earlier, Gazprom was not interested in developing the agreement); and 2) how one saw the development of the gas market within the EU in the future, specifically, whether EU competition regulations would compel Gazprom to sell its gas to traders before reaching consumers and what role LNG (liquid natural gas) would play on the gas market in the future.

The answer to the second set of questions also depends to a significant extent on whether one sees the Russian state as a regime taker or regime maker. If Russia is a regime taker, then it has no influence over EU domestic initiatives to create gas on gas competition or the global LNG market. If it is a regime maker, it can try to develop arrangements with the EU or national European states that circumvent or attenuate competition principles and try to shape the global LNG market, for example by creating a cartel.

So, ideological differences – concerning both how to organize the Russian natural gas sector and Russia’s gas trade with Europe - were the third reason the company opposed ratification in 1997.

### **Gazprom and the state: liberation and autonomy**

To understand the Russian state’s inability to advance its ECH policy due to opposition by the company in which it was the largest shareholder, we need to examine the relationship between the state and its firm beyond the formal relations created by ownership.<sup>411</sup> This section looks at this relationship.

The broader argument is twofold. First, although the state was de facto the largest shareholder in the company, the company had significant autonomy from the state over decisions related to Russian natural gas policy. All this is consistent with the thesis that in Yeltsin’s

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409 Interview with Konoplyanik, fall 2009.

410 See transcript of 2001 hearings in *Ecology XXI, International Scientific Journal* 2 (2001). The debate about the transit rules will be discussed in chapter 6 on the early Putin period.

411 For a prominent argument that makes a causal link between the type of formal ownership and control to fiscal regimes, see Pauline Luong Jones and Erika Weinthal, *Oil Is Not a Curse: Ownership Structure and Institutions in Soviet Successor States* (New York: Cambridge University Press, 2010).

Russia, authority over economic decision making was vested with firms rather than the state. Second, the state's lack of authority over economic decision making was a general phenomenon during this period; this principle was operative not just within ECH policy or even the natural gas sector but affected energy policy in general across multiple sectors.

As a result, we can say that authority over energy policy during the 1990s was heterarchical rather than hierarchical in the sense that, rather than being vested with agencies of the central state (the government), it resided with many different actors. Insofar as authority over policy was associated with the level of state domestic sovereignty over policy (control by public authorities relative to societal actors), we can say that this heterarchical structure produced a low level of state sovereignty over energy policy.

As discussed in chapter 1, since domestic sovereignty in an issue area is what is distinctive about states, what is at stake here is what Wendt has called the corporate identity of the state. Furthermore, combining this proposition about state corporate identity (low level of domestic sovereignty) with the role of state identity (regime taker, as established in the first chapter), allows us to show that Russia's state identity under Yeltsin during the 1990s was that of an apprentice.

#### *Transforming the gas sector during late perestroika: minister or manager?*

The early origins for Gazprom's managerial autonomy from the state were in Gorbachev's USSR during *perestroika*. According to one interview respondent close to Gazprom and the Russian state, by that time managers "saw perfectly well all the money that could be made in the European gas trade" and were salivating to gain autonomy from the state and develop an independent business strategy. The precursor to Gazprom was the Soviet Gas Ministry, which was created in 1965 when the Communist party decided to intensively develop the natural gas industry.<sup>412</sup> In 1985, Viktor Chernomyrdin was promoted to USSR Minister of the Natural Gas Industry (he was appointed deputy to the Soviet natural gas minister in 1984).<sup>413</sup> In 1989, Chernomyrdin proposed to transform the ministry into a state-owned gas company: State Gas Concern (*концерн*) Gazprom or GGK Gazprom.

The idea of turning a ministry into a company was radical at the time, and Chernomyrdin's initiative was the first of its kind. In a later interview, he recalled his encounter with then Prime Minister Ryzhkov concerning his proposal to transform the Soviet gas sector. Ryzhkov was not only against the idea; at the time, it seemed ludicrous:

The main obstacle — recalled Chernomyrdin — was Ryzhkov....Chernomyrdin recounts that he came to Ryzhkov with his idea for a gas company several times. He drew pictures, explained, and talked-talked-talked until late into the evening.

At the end of one such discussion, Ryzhkov asked: In other words, I am to understand that you don't want to be a minister? He still believed that there was no better occupation in the Soviet Union than to be a minister.

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412 Nadja Victor, *Gazprom, Giant Under Strain*, Working Paper #71, Program on Energy and Sustainable Development, Freeman Spogli Institute for International Studies, Stanford University, January 2008, 46.

413 "Politics Obituaries: Viktor Chernomyrdin," *The Telegraph*, accessed March 22, 2011 <http://www.telegraph.co.uk/news/obituaries/politics-obituaries/8108505/Viktor-Chernomyrdin.html>

No, I do not – answered Chernomyrdin.

And you won't be a member of the government? Ryzhkov asked with bewilderment. And you understand that you are giving up everything? Dachas, privileges?

Yes, I understand....Nikolai Ivan'ich, you have to understand, these days, you don't have to be a minister anymore. We'll make a company.

Ryzhkov was doubtful: How many deputies do you have at present?

Three first deputies and eight ordinary ones, answered Chernomyrdin.

You see, if I'm going to let you go, you will take twenty deputies with you!

Why would I? I don't need twenty. Two deputies are fine.<sup>414</sup>

Ultimately, Chernomyrdin's idea for a company prevailed, and on August 15, 1989, he was selected CEO at the company's founding meeting.<sup>415</sup>

Although the ministry became a company, this did not mean that it developed the same level of autonomy that the company enjoyed under Yeltsin. While it is incontrovertible that the authority of the late Soviet state under Gorbachev had decreased tremendously, this was most significant with respect to the Union republics. Of course, the battle over sovereignty between the republics and the center created a favorable environment for firms since many republics, particularly the RSFSR, tried to enlist support from firms by offering them more favorable conditions for doing business (such as lower taxes). However, this is not the same as being autonomous from the state because the state was not supposed to interfere in economic decision making, an idea which became dominant after Yeltsin prevailed in the struggle with the Union state. Prior to this moment, the idea of private property was still controversial. Moreover, full autonomy from the state in matters of economic policy – whether through private property or a managerial trust agreement to vote the state's shares – would certainly not have applied to valuable natural resources. As a result, even during the waning days of the Soviet Union, there were no high-profile conflicts between the government and Gazprom over policy. This emerged under Yeltsin and will be examined later. The next section examines how Gazprom management's autonomy from the state grew under Yeltsin. The section that follows examines policy battles between the state and Gazprom.

### *Establishing autonomy from the state under Yeltsin*

There are a number of indicators of the extent to which Gazprom was autonomous in the gas business. The main turning points occurred early during Yeltsin's tenure as president (1992-3) when the state 1) transformed Gazprom from a state-owned company (concern) to a joint stock company; 2) delegated the voting rights the state enjoyed as a shareholder to Rem Vakhirev, the new CEO; 3) gave Gazprom control over Russia's domestic gas assets; 4) gave Gazprom control over the lucrative foreign energy trade; and 5) gave the company control over

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414 Panyushkin and Zigar', *Gazprom*, 18.

415 "Biography of Viktor Stepanovich Chernomyrdin," accessed March 22, 2011, <http://www.panorama.ru/gov/gov20008.shtml>.

the significant financial resources associated with its business, most notably a large portion of the revenues from its European trade.

The emergence of Gazprom's autonomy from the state in managing the gas business can be seen in how the company was privatized. In November 1992, Yeltsin signed decree no. 1333, which turned Gazprom from a state-owned concern into RAO Gazprom, a "Russian" joint stock company.<sup>416</sup> Shares were sold according to a plan developed by company management,<sup>417</sup> and the initial distribution was as follows: the Russian state was allocated a 40 percent stake until 1999; 28.7 percent was to be sold domestically for privatization vouchers; Gazprom employees were allowed to purchase 15 percent; 10 percent was to be sold later (by Gazprom) on foreign stock exchanges; and finally, 5.2 percent was sold to the inhabitants of the Yamal-Nenets Autonomous District, and 1.1 percent was given to Rosgazifikatsiya (the agency in charge of the social function of expanding access to natural gas nationally).<sup>418</sup> In addition, employees had to get written permission from management to sell their shares to outside investors.<sup>419</sup>

When shares were sold at privatization auctions in 1994, two decisions from the State Property Committee (headed by Anatoly Chubais) concerning deadlines and procedures for the sales effectively closed the auctions. Moreover, the logistics for the auctions were organized by Gazprom itself. As a result, "the company's top managers controlled the number of participants in the auction and, by implication, the distribution of shares." Later, "gas generals" consolidated the major stakes in companies affiliated with Gazprom. In August 1994, Gazprom selected the British investment bank Kleinwort Benson to advise it on the sale of the packet of shares eligible to be purchased by foreign investors;<sup>420</sup> even with respect to the sale of shares to foreigners, Gazprom was in charge.

In addition, Gazprom's new autonomy from the state can be seen in the relations that were established between the state and the management of its largest company after Gazprom became a joint stock company. By the end of 1992, Chernomyrdin had entered the government as prime minister, and his deputy, Rem Vakhirev, was promoted to CEO. In 1993, the state, under the authority of Deputy Prime Minister Oleg Soskovets,<sup>421</sup> concluded a trust agreement with Vakhirev whereby the latter, as CEO of the company, would hold the majority of the state's shares in the company (out of the 40 percent state stake, Vakhirev would hold 35 percent).<sup>422</sup> This meant that the CEO was responsible for representing the interests of the state as the company's single largest shareholder and had the single largest block of votes.

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416 Alexander Radygin, "State-Owned Holding Companies in Russia," OECD, Development Research Centre of the State Council of the PRC Asian Development Bank, January 2000, 16. Only two other companies were accorded the status of Russian joint stock company: the electricity monopoly RAO UES (Unified Energy Systems) and Norilsk Nickel. Yelena Ivanova, "Gas Industry 1991-2000," *Kommersant*, May 2, 2004, accessed on April 13, 2011, [http://www.kommersant.com/p295882/r\\_33/Gas\\_Industry\\_1991-2000/](http://www.kommersant.com/p295882/r_33/Gas_Industry_1991-2000/).

417 Y. Ivanova, "The Growth of Russia's Gas Industry," *The Russia Journal*, July 5, 2002, accessed on April 13, 2011, <http://www.russiajournal.com/node/6373>.

418 Ivanova, "Gas Industry."

419 Hillary Appel, "Is It Putin or Is It Oil? Explaining Russia's Fiscal Recovery," *Post-Soviet Affairs* 24, 4 (2008), cited in Luong Jones and Weinthal, *Oil Is Not a Curse*, 132).

420 Ivanova, "Gas Industry."

421 Peter Rutland, "Battle Rages over Russia's Natural Monopolies," *Transition* 8 (May/June 1997).

422 The trust agreement was later legitimized through a presidential decree in 1996. Luong Jones et al., *Oil Is Not a Curse*, 133, fn. 20; Jonathan P. Stern, *The Future of Russian Gas and Gazprom* (Oxford and New York: Oxford University Press, 2005), 172.

Moreover, combining the 35 percent state share with the votes of Gazprom employees (who had received a 15 percent stake through privatization but could not sell without permission from company executives) meant that company insiders, as represented by Vakhirev, formally had a blocking majority of votes among shareholders. In practice, this meant little since corporate governance was underdeveloped in Russia at the time and shareholder's rights were routinely violated. At Gazprom, board meetings were rarely convened.<sup>423</sup> Ultimately, it was in his capacity as manager of the company that Vakhirev exercised his authority over decision making. According to Rutland, “[t]he state owns 40 percent of Gazprom ...but effective control...rests with its current management.”<sup>424</sup> In any case, as a result of the way in which privatization was conducted and the relationship established between the state and management (the trust agreement), decision making was vested with management.

Even before privatization, the state had bestowed numerous privileges on the gas company. In early June 1992, presidential decrees 538 (On the United System of Gas Supplies) and 539 (On the Exploitation of the New Gas Reserves on the Yamal Peninsula, in the Barents Sea, and on the Shelf of Sakhalin Island) were promulgated. The former maintained the “unified gas supply system,” preserving Gazprom as a fully vertically integrated company continuing activities in production, transport, and sales. Most importantly, this reaffirmed Gazprom's control over the mainline (long distance) pipeline system, effectively making it a gas monopoly within Russia.<sup>425</sup> The second decree assigned to Gazprom licenses without tender for the development of the most attractive deposits in Russia. Combined, the decrees “gave Gazprom full control of the country's gas assets.”<sup>426</sup> When Gazprom was turned into a joint stock company in November 1992, the decree stipulated that the company would have 100 percent control over gas producing and transporting companies that would become its affiliates.<sup>427</sup> Also, in June 1992, the company received the exclusive right to supply gas under the state's foreign contracts. This was a coveted opportunity because it meant that the company would manage gas exports to Europe, the only solvent and profitable portion of Russia's natural gas business at the time.<sup>428</sup>

The company was no less successful in getting control over its financial flows. In June 1992, Gazprom was allowed to keep 45 percent of the currency it earned from its foreign business, and the turnover on these operations was exempted from taxes.<sup>429</sup> In July 1992, the government also recommended to the Central Bank that Gazprom be allowed to open accounts in foreign banks to repay the foreign debt (\$8.7 billion) that the state promised to take out for Gazprom's development. A month later, Imperial Bank, which was founded by Gazprom under Chernomyrdin, acquired shares from the Central Bank in the East-West United Bank, a former Soviet bank in Luxembourg, through which payments for gas exports to Europe as well as payments for the petroleum products exported by Rosneftgaz were made.<sup>430</sup>

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423 Interviews in Moscow, 2008-9.

424 Peter Rutland, “Battle Rages over Russia's Natural Monopolies,” *Transition* 8, 3 (June 1997).

425 Because Russia only has one such system, and natural gas can only be transported through it, control over this system, and by corollary allocation of pipeline capacity, meant Gazprom could keep competitors out of markets by refusing transport services.

426 Ibid. Y. Ivanova, “Who Owns Russia”

427 Ibid Y. Ivanova, “Gas Industry”

428 Ibid Y. Ivanova, “Gas Industry”

429 Ibid Y. Ivanova, “Gas Industry.” In April, the government had agreed to let Gazprom keep 38 percent of its currency earnings, so the concession became even more generous.

430 Ibid Y. Ivanova, “Gas Industry”

Later, in November 1993, the president signed a decree creating a special stabilization fund into which the company could transfer “up to one-third of the income it derived from the value added above the state price on gas to consumers” for the purpose of financing the development of gas supply infrastructure. This meant that a third of whatever Gazprom earned above the state-regulated price remained with Gazprom. Since the money that went into the fund was not subject to taxation, this was an “unprecedented privilege” for Gazprom.<sup>431</sup>

This section has shown how the foundation for Gazprom’s autonomy from the state and authority over economic decision making was laid during Boris Yeltsin’s first term as president. This can be seen in the way the firm was privatized and the relationship established between the state and management (the trust agreement giving Vakhirev the right to vote in the state’s name). Moreover, Gazprom was maintained as a monopoly and given unprecedented control over Russia’s valuable gas related assets, the lucrative foreign gas trade, and also a large segment of its financial resources. Finally, the company benefitted from several significant tax exemptions. By 1994, Gazprom was in a position to manage Russia’s entire gas sector and foreign trade with Europe.

The flip side of firm/managerial autonomy was that the state had relinquished its sovereignty in these areas. The rest of Yeltsin’s tenure saw heated battles between the government and company management over sovereignty (control) as reflected in the controversies related to domestic gas policy (structural reform) and tax payment. In both cases, Gazprom was largely successful in fending off the government’s initiatives until Putin became president in 2000. Thereafter, Gazprom had to fight to maintain its autonomy and control over policy for the remainder of the decade. The following section looks at these battles. I start with the question of structural reform in gas during the 1990s. I then examine the battles related to oversight and taxes during the same period.

### **Absence of state sovereignty: battles between the government and Gazprom**

#### *Who’s in charge? Russian gas policy (structural reform and demonopolization)*

The struggle over control of gas policy between the government and its own company was an enduring problem under Yeltsin that was finally resolved in late 2003 under President Putin. The first confrontation between the government and the company came during the first months after the collapse of the USSR. In February 1992, the policy idea of breaking up the gas industry to introduce competitive markets was floated for the first time. Specifically, the liberals in Gaidar’s government of “young reformers” proposed to introduce competition in the gas industry by establishing numerous independent, gas-producing companies that would supply gas to a centrally (state) controlled transport system.<sup>432</sup> In addition to portending a radical economic transformation of the Russian gas sector, this move also had significant political consequences; by breaking up the behemoth monopoly, the government was proposing to eliminate the company’s control over the gas industry and dramatically reduce its political influence.

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431 Ibid Y. Ivanova, “Gas Industry”

432 Yelena Ivanova, “Who Owns Russia - The growth of Russia's gas industry,” *The Russia Journal*, July 8, 2002. According to Luong Jones, reforms in gas were designed to “mimic” those in oil.



Russian Minister of Fuel and Energy Vladimir Lopukhin, an academic economist who had worked at the Institute of Economics headed by Gaidar,<sup>433</sup> attempted to implement this policy.<sup>434</sup> The confrontation also touched upon control over the company's significant financial flows. In May, Gaidar ordered an audit of Gazprom's foreign currency accounts and documentation; as mentioned above, the previous month, Gazprom had received authorization to keep 38 percent of its foreign currency earnings abroad.

The battle did not last long, and the government lost on both fronts. Immediately after the audit was completed, Lopukhin was dismissed as minister and Chernomyrdin was named first deputy prime minister in charge of energy.<sup>435</sup> This was the beginning of the "red director" revolt. Subsequently, the two decrees mentioned earlier were issued, keeping Gazprom intact and giving it control over the most valuable domestic resource. In addition, Gazprom's control over significant financial resources from its foreign trade was expanded.<sup>436</sup> By December 1992, Chernomyrdin had been elevated to the head of the government.

Gazprom had to fight the same battle nearly five years later. Upon winning the 1996 presidential elections, Yeltsin's determination to deepen his reforms was renewed, and he appointed a second government of young reformers, which included the liberal Deputy Prime Ministers Anatoly Chubais, Alfred Kokh, and Boris Nemtsov. The latter was given responsibility for reforming the energy sector. According to Hirschhausen and Engerer,

The nomination of the two "anti-gas" Vice-Premiers in Russia in early 1997 was supposed to increase administrative support for reforms; first steps were taken by the new Vice-Prime Ministers A. Chubais and B. Nemtsov, as well as Economics Minister Y. Yasin, who had made energy reform a priority, and publicly attacked Gazprom for inefficient monopoly behaviour.<sup>437</sup>

This initiative coincided with a more general effort to bring order to the Russian economy and especially to improve the fiscal situation of the state by improving tax collection.<sup>438</sup>

In November 1996, an interagency committee on the reform of RAO Gazprom was created under then Minister of Economy Yevgeniy Yasin. An additional government body under Chubais, the Commission on Operational Questions, also participated in promoting policy to reform Gazprom.<sup>439</sup> Before long, the initiative passed to Nemtsov.<sup>440</sup>

Toward the end of 1996, the main contours of the latest attempt at liberalization were outlined in the government's medium term program, Structural Transformation and Economic Growth during the years 1997 to 2000.<sup>441</sup> According to Rutland, the initial logic of structural reform was:

[to force] Gazprom to introduce territorially differentiated prices in order to reflect real production costs. Independent companies will be allowed to bid for the right to develop new gas fields and

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433 Jonathan Steele, "President Yeltsin gives industrial old guard a boost," *The Guardian*, June 4, 1992, 9.

434 Interviews in Moscow, 2008-9.

435 Ivanova, "Who Owns Russia"

436 Ibid.

437 Christian von Hirschhausen and Hella Engerer, "Post-Soviet Gas Sector Restructuring in the CIS: A political economy approach," *Energy Policy*, 26, 15 (1998), 1113-1123.

438 On tax collection, see chapter 6.

439 Natalia Samoilova, "Meeting of the Russian Government," *Kommersant*, May 16, 1997.

440 Rutland, "Battle Rages over Russia's Natural Monopolies."

441 Konstantin Levin, "I'll Fire Everyone!" *Kommersant*, March 28, 1997; "Gazprom's Monopoly: More "Daughters" will be Added, but not Competitors," <http://gazetazp.ru/1997/30/3/>.

will be given access to the gas pipelines....The availability of cheaper supplies should bring down prices, possibly saving some 3 to 4 percent of GDP. ...The introduction of competition should go more smoothly for EES than for Gazprom, which is a more tightly integrated corporation.<sup>442</sup>

Clearly, reform as envisioned by the liberals was inspired by a free market model for organizing the energy sector. The most controversial aspect of this program was the idea of breaking up the monopoly according to the three main functional areas in which it conducted business: production, transport, and sales. Transport, which was considered a natural monopoly, was to be turned over to the state for the regulation of tariffs and allocation of transit capacity (pipeline access). At the same time, the non-monopoly aspects of the business (production and sales) were to see the introduction of competition. The ultimate goal was to reduce costs and increase efficiency through competition. It is worth noting that international actors including the IMF appear to have been pushing the government in this direction; demonopolization featured prominently in the IMF's "1997 economic blueprint for Russia" and was linked to Russia's continued access to a \$10 billion IMF loan.<sup>443</sup>

Nevertheless, very quickly it became clear that radical reform would not happen:

Nemtsov retreated from the initial combative statements he made upon taking office, and by April 4 was making it clear that the government is not contemplating radical surgery on Gazprom.... Prime Minister Viktor Chernomyrdin, the former head of Gazprom, came out in strong opposition to suggestions that Gazprom should be dismantled.<sup>444</sup>

Instead, the government began focusing on restructuring the gas sector.

Ultimately, reform followed a blueprint proposed by Gazprom CEO Vakhirev. None of the competition-inducing measures proposed by liberals were included. In particular, although functional differentiation within the company was acknowledged, all three businesses – production, transport, and sales – were to remain within the company, maintaining the "single technological cycle."<sup>445</sup> This differed significantly from the liberal proposal, which focused on a much stronger form of unbundling and most importantly saw transit (and therefore access to the pipeline and ultimately consumer markets) being taken out of Gazprom's control and passed over to state regulators.<sup>446</sup> According to Vakhirev's plan, Gazprom would also maintain control over transit. At the same time, measures to allow pipeline access to non-Gazprom producers (TPA) were approved.<sup>447</sup> However, since Gazprom would continue to have exclusive control over the pipeline and the allocation of transit capacity, these changes were merely declarative; no significant mechanisms were put in place for TPA to be enforced against Gazprom's will. Thus, Gazprom was preserved as a monopoly. In terms of competition, Vakhirev proposed to divest the company of (small) deposits located near consumer markets. However, this in no way would have created the kind of cost-reducing competition that government liberals had in mind.

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442 Rutland, "Battle Rages over Russia's Natural Monopolies."; see also Samoilova, "Meeting of the Russian Government."

443 Erin Arvedlund, "Nemtsov Fires First Salvo in Monopoly Reform," *The Moscow Times*, March 25, 1997.

444 Rutland, "Battle Rages over Russia's Natural Monopolies."

445 Natalia Samoilova, "Rem Vakhirev has surpassed Anatoly Chubais," *Kommersant*, May 16, 1997.

446 Liberals acknowledged that the transport system was a natural monopoly and therefore believed that its business should be regulated closely by the state.

447 Rutland, "Battle Rages over Russia's Natural Monopolies."

Furthermore, the changes that were significant all benefited Gazprom as an organization. Thus, a centralized payment center was created within Gazprom – Mezhregiongaz –to deal with the problem of non-payment. In addition, Gazprom was given the green light to cut off delinquent customers while also giving discounts to customers that cleared their debts. In many cases, this set of policies allowed Gazprom to conduct debt equity swaps and consolidate control over local distribution networks that had previously passed into the hands of local governments.<sup>448</sup> In addition, Mezhregiongaz was charged with managing the investment process to further develop these local distribution networks in the future.

The reforms also envisaged the gradual increase of domestic tariffs to improve the profitability of Gazprom's domestic business. In the first stage, tariffs would be adjusted by geographical region to take into account the different transportation costs. At a later stage, tariffs would be raised, particularly to households. In addition to allowing Gazprom to recover a greater part of the cost of its domestic business, raising household prices would ease pressure on industrial consumers, who were charged relatively high rates to subsidize the household sector (cross-subsidies).<sup>449</sup> However, with the exception of geographical differentiation, tariff increases were left for the future.

In addition, Gazprom was to divest itself of non-core assets. In the post-Soviet period, Gazprom had developed a multi-functional empire that included many assets not directly related to its core business. These can be divided into three groups: 1) non-core but politically useful holdings, such as national media outlets; 2) businesses unrelated to its core activities with social significance but relatively little political value, such as schools and medical facilities (local social welfare functions) and agriculture; 3) businesses, such as equipment manufactures, that were tangentially related to the company's core business.

The government did not specify which non-core assets were to be sold off; this was left to the discretion of Gazprom management. As a result, Gazprom proposed to divest itself of its social responsibilities (to be transferred to local governments). In addition, it planned to shed activities that were logically related to its business but were either not very profitable or in which Gazprom did not have a competitive advantage. The former included small gas deposits that were near markets (already mentioned above), while the latter included some drilling companies that were to be combined into a single entity, Burgaz.<sup>450</sup>

Finally, Vakhirev proposed to change the format for work on production in the northern regions toward an extended stay, rotational model (the “*вахтовый*” method). It was suggested that this change would save 50 million rubles annually per rotational worker. However, it was also estimated that this reform would lead to the displacement of 100,000 workers.<sup>451</sup>

When asked by Chernomyrdin at a government meeting what effect all these changes would have on tariffs and prices, Vakhirev replied that it was “directly proportional.” According

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448 Interviews in Moscow, 2008-9.

449 In the United States, for example, subsidies from utilities operate in the opposite direction. Higher prices to households subsidize lower prices to industrial consumers. Rutland, “Battle Rages over Russia's Natural Monopolies.”

450 In some cases, Gazprom would retain significant shares in the new companies, so technically these were not divestments. Natalia Samoilova, “Rem Vakhirev has surpassed Anatoly Chubais.”

451 Ibid.

to a journalist who was present, this drew skepticism even from the prime minister.<sup>452</sup> For the second time in five years, the government was unable to restructure the gas monopoly according to its liberal plan. Reforms were blocked by Vakhirev, the main ideologist at Gazprom,<sup>453</sup> and his patron in government, Prime Minister Chernomyrdin. Moreover, the so-called compromise that emerged did not enhance state control over the company. To the contrary, it was Gazprom's control over the gas business, particularly with the creation of Mezhhregiongaz and continued control over the transport pipelines, that was improved.

Greater efficiency through structural reforms was only one aim of the government's reform initiatives. No less important was the goal of re-establishing state control (sovereignty) over its company. During the debate on reform, Deputy Prime Minister Alfred Kokh commented that the company was plagued by opacity and this concerned the government's ability to understand the inner workings of its own company:

[Kokh] noted that he didn't understand the company's active investment policy (for example, Gazprom can afford to buy shares of NTV), at the same time that the joint stock company is a major debtor to the federal budget... in principle all the sums that accrue to its "non-payment account" are supposed to be remitted to the state budget.<sup>454</sup>

Here Kokh was clearly indicating that the government did not have a clear view of 1) how much money Gazprom was receiving or 2) how and why the money was being spent. However, it was clear that money was not being remitted to the state either through taxes or its earnings as a shareholder. These comments are symptomatic of the general state of affairs at the time; control over the gas business was vested with the managers of Gazprom, not the state/owner.

Structural reform would have restored state control by creating numerous small, relatively weak firms to replace a single, politically powerful organization. In addition, the structural reforms proposed by liberals would have returned control to the state because of the key role that monopoly control over transport played in the gas business. During the 1990s, the focal point of everyone's attention was not the domestic monetary value of gas, since officially it was underpriced and in practice was not always paid for. Rather, the value was in controlling the volume itself. A regional government that received gas from Gazprom was then able to allocate the resource within the region to promote policy goals and curry political favor with elites, the population, and local governments, among others. A large chemical or steel producer that had access to gas (which is an input into production) could continue production and maintain employment. On the other hand, the gas could also be exported to earn valuable foreign exchange.

Since Gazprom was the largest producer of gas and had exclusive control over access to the pipeline system, the only way to obtain gas at all was through bargaining with the company. Not only did this produce tremendous political clout for Gazprom as a corporation, it also facilitated the private extraction of rents by company managers and their partners throughout Russia. Many negotiated deals combined the domestic and international. As an illustrative but totally hypothetical example, Gazprom and a region might negotiate the official sale/delivery of 20 BCM of gas per year. However, perhaps only 18 BCM of gas would actually be shipped to the region, while the remaining 2 BCM could be sold on more attractive foreign markets through

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452 Ibid. During that time, government meetings were open to the press.

453 Ibid.; interviews in Moscow fall 2007, 2008-2009.

454 Ibid.

intermediaries. The profits could be divided by the different parties per their negotiations. Most importantly, no taxes would go to the state because the official domestic sales price implied a loss for Gazprom and the profit-making portion of the deal was off the books.<sup>455</sup>

For these arrangements to work, however, it was essential to keep central state authorities at arm's length from the company's operations. By transferring control over the transit business to the state, liberals were proposing to undermine the very foundation of the way the gas business functioned during the 1990s. Even if competition was avoided and Gazprom remained the only major producer in Russia, the only way to commercialize its product, whether within Russia or abroad, was by shipping it through the pipeline system. With the transmission system controlled by regulators, all the important decisions – how much, to what destination, when – would be made by the central state. Whatever power Gazprom had vis-à-vis local governments or industrialists (exercised through bargaining over volumes) would accrue to the central state. Furthermore, it would be very difficult to surreptitiously siphon off volumes for personal gain. Since all gas has to go through the pipeline system, and since loading the system with gas is technically complex and dangerous (too much gas can lead to an explosion), the pipeline system is also an important lever for monitoring all activity (with special attention to measuring volumes) on the gas market. More broadly, since control over transit conferred control over the entire gas business, direct state control of the pipeline system would mean that the government, not Gazprom managers, would be in the driver's seat in terms of both natural gas policy and the distribution of wealth created by the gas business (including payments to the state).

Once the battle over structural reform was largely won by Gazprom, the government began a second battle in the field of company oversight. The next section examines this conflict.

### *Where's the trust?*

As we have just seen, the liberals lost the battle over structural reform. Next, the government turned to the question of company oversight to re-establish its control over the monopoly. During the debate on reform, government officials complained that most of the state's ownership shares in the company (35 out of 40 percent) and the voting rights that this stake conferred were being held by CEO Vakhirev according to a trust agreement concluded under murky circumstances in 1993. Moreover, they contended that there was a conflict of interest insofar as Vakhirev was not promoting the interests of the state as was his responsibility as a trustee but advancing the interests of managers, himself included. At an April meeting of the government, Boris Nemtsov declared that:

35 out of 40% of the state owned shares were transferred to the Joint Stock company without any auction and free of charge in the form of a management trust agreement. The state did not receive a single kopeck from this deal, and does not receive the dividends that it is due, which according to a Presidential decree go toward the technical refurbishment of the company.<sup>456</sup>

Toward the end of the meeting, Nemtsov proposed to immediately bring into accordance with Russian law the charters of joint stock companies in which, "shareholders' rights are clearly being violated," and he specifically identified RAO Gazprom and RAO UES.<sup>457</sup>

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455 Interviews in Moscow, 2008-9.

456 Natalia Samoiloova, "Chubais has defended Goskomimushestvo from Kulikov," *Kommersant*, April 11, 1997

457 Ibid.

One of the elements of the structural reform “compromise” that emerged was that the state’s relationship with management would be revised. Therefore, on May 14, 1997, the presidential decree “On Measures To Ensure State Management over Property Formally Made into Federal Property Through Shares in the Russian Joint Stock Company ‘Gazprom’” was issued. Among other things, the decree established a collegium (*kollegiya*) under the leadership of Nemtsov.<sup>458</sup> The purpose of the collegium was to formulate state policy goals in the gas sector and express these at shareholders’ meetings and to the board of directors.<sup>459</sup> Specific goals that were mentioned at the time included lower gas prices, equal conditions for all gas producers (TPA), and the timely payment of taxes and contributions to the pension fund.<sup>460</sup> Initially, this appeared to be a significant victory for government liberals in the battle to take back state control over the company. According to Nemtsov,

at long last, [Gazprom]... has been taken under state control. It may sound a paradox, but the state has never had a position of its own in the company, has never voiced this position and has had a very weak influence on the company's operations. So the president signed a decree today that says a collegium of state representatives should be set up....

I can add that this result is more than a little bit linked to the fact that the government has totally lost control of the company. And of course my colleagues will deal with introducing some order here. If this is state property, and this property brings profits, then it is the state that should receive these profits....

If we decide to allocate money for the development of Gazprom, for the development of new gas deposits, then this will be our decision.<sup>461</sup>

The decree also proposed to revise the trust agreement between the state and Gazprom management. Nemtsov was determined to move forward on this front. However, when he tried to locate the actual trust document, it was nowhere to be found. The following interview – recorded in the original and performed as a theatrical drama – illustrates the state of affairs between the government and Gazprom:

Act I: Anchorman Yevgeniy Kiselev interviews Boris Nemtsov on NTV's *Itogi* program in April 1997. The state's share in that company must be managed appropriately. The public must have access to information about Gazprom's operation. A detailed financial-economic audit will clarify the company's business dealings.

Q. Is Gazprom making profits or losses?

A. To be absolutely frank about it, *nobody knows anything about Gazprom*.

Q. If [the] 35 percent of shares entrusted to [Vakhirev] earn an income or profits, do these profits go into the state treasury?

A. In order to answer this question, I must see the trust agreement that in all this time I have not been able to locate....Usually agreements on trust management are concluded by the State Property Committee...the State Property Committee possesses no such agreement....I think Rem Ivanovich Vakhirev has it.

Q. What is the state's role in Gazprom?...Is there a state representative in Gazprom who keeps an

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458 Hirschhausen and Engerer, “Post-Soviet Gas Sector Restructuring in the CIS.” (Decree of the President of the Russian Federation: on Measures Providing for State Management of Assets in the Russian Joint Stock Company “Gazprom” that are Federal Property)

459 “First Deputy Premier Nemtsov interviewed on Gazprom, banking, housing,” BBC Monitoring Service: Former USSR, May 14, 1997.

460 Ibid.

461 Ibid.

eye on the state's interests? Is there some sort of mechanism of that nature?

A. Formally there is, but not in reality. It is not a matter of who is in the Gazprom management. It is a matter of whether any functions are carried out on behalf of the government. I believe that state representatives must above all ensure the timely payment of taxes to the budget....*To my great regret, the role of the state in the management of property, including the property of giant enterprises such as Gazprom, has been reduced to naught over these years.* My task is to reinstate the state's role in the management of these large natural monopolies.

Act II (One month later): *Yevgeniy Kiselev interviews Nemtsov on NTV's Hero of the Day program, May 12, 1997.*

Q. About a month ago you claimed that the trust agreement was lost. Have you found it?

A. Two hours after you left, the agreement was delivered.

Q. Who signed it then?

A. Soskovets did, but many state officials were surprised by its contents and the place where it was kept.

Q. Where was it kept?

A. In a secret location. I can only say that the agreement will be revised and Rem Vakhirev, as a representative of the state, will carry out what the government asks him to do....

Q. What revenue does the state receive from Gazprom, if it is not a secret?

A. The revenue is so miserable that it cannot be a secret. Over two years, dividends of state-owned Gazprom shares [40 percent of all shares] have yielded a total of twenty billion rubles.

Q. That is, roughly speaking, four million dollars?

A. It is even less.

Q. It's difficult to believe.

A. This is related to the fact that the government has totally lost control of the company. (emphasis added)

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I have cited at length the Nemtsov interview not because of its tragicomic quality but because it shows in a very vivid way the character of the state's relationship with Gazprom during this period.

Despite having located the original document, renegotiating the trust agreement proved to be elusive. As the battle over control waged, it became clear that one of the cleavages concerned the state's proper role in managing the economy. According to one press report,

Gazprom chief Rem Vyakhirev, by his efforts to avoid signing an agreement on managing the government's shares in the firm, *is making it known that the powerful gas monopoly should be run as a private company and not as a government ministry*, analysts said Wednesday...,

[F]or Vyakhirev, the agreement would impose new governmental checks that could bog the company down in bureaucracy and weaken the chairman's image with foreign investors and business partners at a time when Gazprom is looking overseas for funds and opportunities, some analysts said.

*"This is not about power, it's about a business being run like a business or like a government concern,"* said Gundi Royle, head of European oil and gas equities at Deutsche Morgan Grenfell in London. "I know Vyakhirev, and he would be saying, 'I don't have the time to run back and forth to the White House on every decision.' *He wants to run his business.*" (emphasis added)<sup>463</sup>

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462 "The Mysterious Gazprom Documents: A Drama in Two Acts," in Rutland, "Battle Rages over Russia's Natural Monopolies."

463 Jeanne Whalen, "Exec Fights Gazprom's Return to State Hands," *The Moscow Times*, December 4, 1997.

One of the arguments for not returning control to the state concerned the idea that authority over decision making should be vested with company managers and not state officials, regardless of who the owner is.

The battle over the trust agreement continued for seven months. In November 1997, Vakhirev traveled to Vietnam. This was interpreted as a way to avoid renegotiations concerning his role at the company.<sup>464</sup> The month of November also saw the reformist government suffer a serious blow when in the aftermath of a “book scandal,” Nemtsov and Chubais were removed from their ministerial posts (energy and finance respectively) but kept on as deputy prime ministers.<sup>465</sup> Subsequently, Nemtsov was removed as head of the collegium overseeing Gazprom and replaced by Sergei Kirienko, who was promoted from deputy minister to minister. Moreover, once Kirienko had replaced Nemtsov, Chernomyrdin was able to revise Nemtsov’s proposed trust agreement, diluting some of the new provisions in favor of company management.

The new agreement (or rather the second iteration as revised by Chernomyrdin) was signed in December 1997, when Yeltsin interrupted a state ceremony in Sweden “to order an embarrassed Vyakhirev and Nemtsov to ‘sign it right now.’”<sup>466</sup> Upon returning to Moscow, the new trust agreement was finally signed. According to Nemtsov’s office, the terms of the new trusteeship foresaw that Vakhirev would continue to manage the state’s stake in the company; however, his power to vote on key issues, such as the election of new board members and the payment of dividends to shareholders, was to be limited. Thus, Vakhirev was kept on, but in formal terms the state had increased its capacity to oversee the company through its voting rights as a shareholder.

Ultimately, however, the revised trustee agreement did not have a significant effect on the state’s ability to control the company or advance its specific interests at Gazprom. As mentioned earlier, the board of directors only had nominal significance; Vakhirev’s real influence was as CEO and head of management. The collegium was also ineffective in promoting the interests of the state.<sup>467</sup> Finally, the company did not become more transparent for the government, and tax payments continued to be the object of political bargaining between Gazprom management and the state. In yet another attempt to rein in Vakhirev, the government began focusing on the company’s spotty record of tax payment. The next section looks at the battle over taxes.

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464 Whalen, “Exec Fights Gazprom's Return to State Hands.”

465 Several figures close to Yeltsin and the government had received large book advances from structures associated with the Onexsimbank group. The latter had recently prevailed in a fierce privatization battle over the communications giant Svyazinvest and Norilsk Nickel, the world's largest nickel producer. It is widely believed that the scandal was retaliation by the losing group headed by Vladimir Gusinsky, who was closely allied with Vakhirev. Alessandra Stanley, “Scandal Deepens for Russia's Top Economic Reformer,” *New York Times*, November 15, 1997; Renfrey Clarke, “Corruption scandal hits Russia's 'young reformers,’” *Green Left*, November 26, 1997, accessed March 23, 2011, (<http://www.greenleft.org.au/node/15952>); “Intrigue in the Kremlin—the Shake-Up in the Russian Cabinet,” *PBS Online Forum*, December 5, 1997, accessed March 23, 2011, [http://www.pbs.org/newshour/forum/december97/russia\\_12-5.html](http://www.pbs.org/newshour/forum/december97/russia_12-5.html); “Russian lawmakers postpone vote on draft budget,” *CNN World*, November 20, 1997, accessed March 23, 2011, [http://articles.cnn.com/1997-11-20/world/9711\\_20\\_russia.chubais\\_1\\_anatoly-chubais-boris-nemtsov-deputy-prime-ministers?\\_s=PM:WORLD](http://articles.cnn.com/1997-11-20/world/9711_20_russia.chubais_1_anatoly-chubais-boris-nemtsov-deputy-prime-ministers?_s=PM:WORLD).

466 Whalen, “Exec Fights Gazprom's Return to State Hands.”

467 “RUSSIA—Profile—Rem Vyakhirev,” *APS Review Gas Market Trends*, August 31, 1998.



*The battle over taxes: “A strong Gazprom means a strong state”*

The state’s lack of control over Gazprom can be seen in the persistent battles over tax payments. Once earlier attempts to establish control over Gazprom had fallen short, the reformist government switched gears and turned to the problem of spotty tax collection and poor earnings from the monopolist. This was of course an end in itself; by 1997, improving tax collection to ameliorate the state’s catastrophic fiscal situation was a top government priority.<sup>468</sup> However, it was also potentially another means to re-establish control over the company by getting rid of Vakhirev, who was widely suspected of tax evasion and stealing.

As we have seen, in 1993, Yeltsin signed a decree creating a special stabilization fund that allowed the company to transfer up to one-third of the value that it had to forgo due to state regulations limiting the prices that it could charge domestic customers. Since the money that went into the fund was not subject to taxation, “this was an unprecedented break for Gazprom.”<sup>469</sup> As part of a broader policy to improve tax collection, the stabilization fund was liquidated in September 1995 by then Deputy Prime Minister Chubais.

However, for the remainder of the decade, Gazprom’s tax payments were determined by treaties negotiated with the state. As a result, the company was able to reduce its tax burden through bargaining (by, among other things, leveraging arguments related to chronic non-payment among its customers as well as state-regulated rates for consumers that kept its domestic business from being profitable).<sup>470</sup>

Moreover, it was far from clear that the company would follow through on whatever agreements were negotiated. In early 1998, the government and Vakhirev had made an agreement for the company to pay a part of its tax debt every month. By the summer, the government – headed by Prime Minister Sergei Kirienko after Chernomyrdin’s dismissal in March – had decided that Gazprom was not keeping up its end of the bargain.<sup>471</sup> This battle is particularly interesting because it was waged after Chernomyrdin was dismissed. This allows us to evaluate the hypothesis that Gazprom maintained its autonomy from the state due to the patronage of Prime Minister Chernomyrdin.

In June 1998, the Emergency Commission<sup>472</sup> called a meeting to force Gazprom, the railroad ministry, and the state-owned electricity monopoly RAO UES to pay their taxes, but the monopolists did not even appear.<sup>473</sup> The following month, PM Kirienko “declared war” on

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468 Whalen, “Exec Fights Gazprom’s Return to State Hands”; see also Chapter 5.

469 Ivanova, “Who Owns Russia?”

470 “In the gas war the budget will prevail,” *Kommersant Vlast* 2-3 (January 28, 1997): 208-9, accessed March 21, 2011, <http://www.kommersant.ru/Doc/13243>; Rutland, “Battle Rages over Russia’s Natural Monopolies.”

471 “Kirienko goes to Duma to explain tough line against gas monopoly,” *BBC Monitoring Service: Former USSR*, July 4, 1998; “Kirienko defends government measures against Gazprom,” *BBC Monitoring Service: Former USSR*, July 7, 1998.

472 In 1996, the government created the Emergency Committee under Deputy PM Anatoly Chubais to enforce tax payment. The committee was able to force payment from major delinquents; however, the impact was only sufficiently strong to reverse the decline in revenues for slightly more than a month. Daniel Treisman, “Russia’s Tax Crisis: Explaining Falling Revenues in a Transitional Economy,” *Economics and Politics* 11, 2 (July 1999): 2. The commission targeted large tax-evading corporations that collectively owed the government 4% of GDP. Appel, “Is It Putin or Is It Oil?”

473 “The State’s Biggest Debtors Did Not Show Up at the Session of Emergency Commission,” *A&G Information Services: Comtex*, June 18, 1998.

Gazprom by announcing that he was canceling the CEO's management trust agreement and that the tax service would sequester the company's assets.<sup>474</sup> There is no doubt that the government wanted to collect taxes, but according to at least one commentator, the attack on Gazprom also served as a demonstration of the government's authority:

By launching its psychological attack on Gazprom the Government intended to demonstrate to the nation and the whole world its political clout and its ability to take tough action.<sup>475</sup>

Gazprom management, led by Vakhirev, responded with its own offensive against the government, threatening to “stop gas distribution in the regions and warn[ing] of nationwide strikes, if the government continued with the policy and failed to address non-payments and wage arrears in the gas sector.”<sup>476</sup> Appearing on the NTV<sup>477</sup> program *Hero of the Day* on July 2,<sup>478</sup> Vakhirev hinted that the offensive against Gazprom was due to external pressure on the government – which in the summer of 1998 was negotiating a bailout package with the IMF – to break up the monopoly:

Vyakhirev described as a "provocation" the controversy over Gazprom's tax debts. He charged that the confrontation benefits those who would like to see Russian markets collapse and money flow out of Russia and Gazprom. (Gazprom shares fell nearly 14 percent on the Russian stock exchange on 2 July.) Following his meeting with the president on 3 July, Vyakhirev told journalists that "somebody is behaving unfairly in this case." He charged that Yeltsin was not given full information regarding Gazprom's debts to the budget.<sup>479</sup>

Finally, Gazprom mobilized support against the government in the Duma. On July 2, 1998, the parliament interrupted debate on anti-crisis measures, and parliamentary leaders castigated the government for its actions. Speaker Seleznev was forced to summon the prime minister “to face the angry mob of deputies.”<sup>480</sup> The anti-government mood that prevailed in the chamber is captured by the following series of quotes:

"Government initiatives concerning Gazprom should run into the State Duma resistance," said A. Ryzhkov, vice speaker of the State Duma.<sup>481</sup>

[Communist leader] Zyuganov said "We know that the IMF has demanded breaking up the natural monopolies as condition for the next (loan) tranche, and especially for releasing a sum like \$10-15 billion<sup>482</sup>, Gazprom is a powerful single structure which is disliked by many, and the IMF has long been bent on breaking up the company. But we will not allow this to happen, since the

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474 Tatiana Koshkaryova, “Sergei Kirienko's Last Blunder,” *Nezavisimaya Gazeta*, July 3, 1998.

475 Ibid.

476 Floriana Fossato, “Russia: Chernomyrdin Says Gazprom Leadership Should Not Be Changed,” *RFE/RL*, June 9, 1998.

477 NTV was an outspoken, liberally oriented national television station that belonged to the oligarch Vladimir Gusinsky. The latter had developed close ties with Vakhirev when the oligarchs suspended their internecine fighting to join forces against a common enemy—the communists—and get Yeltsin re-elected in 1996.

478 “Gazprom chief Vyakhirev hits back in tax row,” *BBC Monitoring Service: Former USSR*, July 4, 1998.

479 “Gazprom Head Views Conflict as 'Provocation,’” *RFE/RL Newswire*, 2, 127, Part I, July 3, 1998. However, when asked directly about the IMF's role, Vakhirev backed off with a diplomatic response: “There is no need for that kind of talk here, although there are demands and we need to have good talks with the IMF on a lot of issues and demands. Our experts and I myself have had discussions with the IMF many times. We always found mutual understanding.” “Gazprom chief Vyakhirev hits back in tax row.”

480 David McHugh, “Deputies Protest by Delaying Crisis Plan,” *The Moscow Times*, July 3, 1998.

481 “Government initiatives concerning Gazprom should run into the State Duma resistance,” *AK&M*, July 2, 1998.

482 “Russia Lawmakers Criticize Govt's Gazprom Moves,” *Dow Jones International News*, July 2, 1998.

breaking up of Gazprom and of other natural monopolies would mean the destruction of the Russian Federation, which has in any case been falling apart before our very eyes."<sup>483</sup>

"Let us not consider one law introduced by the government until it gives us a full explanation," said hardline Communist Viktor Ilyukhin, amid wild rumors that Gazprom's phones had been cut off and gas production had been halted.<sup>484</sup>

Deputy Nikolai Ryzhkov, head of the Agrarian Party faction...[and] a former prime minister of the Soviet Union.... said that Gazprom, the RAO UES electricity monopoly and the railroad system were "the three last national monopolies... the carcass of the economy....

Ruin the economy, and you destroy the country."<sup>485</sup>

Deputy Vladimir Medvedev from the gas-rich Tyumen region said in a printed statement that the IMF's goal was "clear, to remove a powerful competitor and exclude Russian natural gas from the European market."<sup>486</sup>

Arriving within a half hour of Seleznev's call and having to raise his voice over "catcalls from the communist and nationalist members,"<sup>487</sup> Kirienko defended the government's attempts to collect taxes from the company:

The state cannot live if people do not pay their taxes....There can be no special enterprises and no blackmail of the government.<sup>488</sup>

Furthermore, although he denied that the government was trying to break up the monopoly at the IMF's behest, he reaffirmed the goal to establish transparency and acknowledged that this was the subject of negotiations over a stabilization loan.<sup>489</sup>

In the end, the attack petered out with an intervention by President Yeltsin. The day of the uproar at the Duma, presidential spokesman Sergei Yastrzhembsky told the press that for the president, "A strong Gazprom means a strong state."<sup>490</sup> It was announced that the trust agreement would remain intact and that a compromise had been found: Gazprom would pay taxes in July, and the state would settle its debt to the firm pending negotiations with the government. According to press reports,

Vyakhirev said he and Kirienko each carried "50%" of the blame for the current row because while Gazprom had failed to pay R2.4bn in May, the government had paid so little for gas in May and June that Gazprom had nearly collapsed.<sup>491</sup>

In August, 5 percent of Gazprom shares were sold to raise cash for the government.<sup>492</sup>

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483 "Communist leader vows to save gas giant Gazprom," *BBC Monitoring Service: Former USSR* (from Interfax), July 3, 1998.

484 McHugh, "Deputies Protest by Delaying Crisis Plan."

485 Ibid.

486 Ibid.

487 Ibid.

488 Ibid.

489 Ibid.

490 "Russia PM -3: Says IMF Pushed For Monopoly Transparency," *Dow Jones International News*, July 2, 1998.

491 "Gazprom chief Vyakhirev hits back in tax row."

492 "Gazprom—At the eye of the storm," *Petroleum Economist*, September 22, 1998.

The confrontation between the government and Gazprom eased after Evgeniy Primakov was appointed prime minister after the August 1998 Russian financial crisis and default. Primakov was one of the few people that Vakhirev respected;<sup>493</sup> however, this did not fundamentally alter relations between the state and its largest company. Therefore, in October, Vakhirev proposed to pay the bulk of taxes owed in goods, further expanding Gazprom's influence over the economy. According to the press:

Gazprom is lobbying to tie its cash tax payments to the share of cash receipts compared with the company's total sales, Vyakhirev said. Currently, Gazprom collects only 16% of all sales in cash, Vyakhirev said, however adding that this has steadily increased from as low as 2%.....As alternative means of payment, Gazprom advocates offsets against gas deliveries to government agencies, Vyakhirev said....Also, he suggested Gazprom pay for some of the taxes in the form of various goods....“We are willing to replenish the budget with Russian goods, for instance, army bases need ammunition and fuel,” Vyakhirev said. “I am willing to take on such supplies, including medicines to the Health Ministry.”<sup>494</sup>

Tax payments continued to be the subject of political bargaining between the state and Gazprom, and when negotiations came to a stand-off the president had to intervene personally to broker a deal that essentially maintained the status quo. Moreover, Gazprom continued to link its tax delinquency to non-payment in the gas sector, even though the 1997 reforms – which created Mezhhregiongaz and gave the company the right to cut off non-paying customers – had enhanced Gazprom's power to collect from consumers. In addition, barter and non-payment in Russia began to decline immediately after the August 1998 default, yet in October 1998, Vakhirev was proposing to expand tax payment in kind from Gazprom. Finally, Vakhirev proposed to conclude a new tax treaty even after Vladimir Putin became prime minister and later president.

This particular battle suggests that although Chernomyrdin was an important figure in establishing Gazprom's autonomy from the state, his incumbency at the head of the government was not necessary for preserving the company's autonomy from the state. Armed with the resources of Gazprom and the ideology about the significance of keeping it intact, Rem Vakhirev was able to ward off the attack from the government on his own.

Moreover, to reduce Chernomyrdin's role as prime minister in the defense of Gazprom and its managers against the interests of the state is to misunderstand the complexity of Russian politics. The prime minister is responsible for a broad range of issues. As head of the government, he also has an interest in increasing state revenues to be able to successfully do his job. According to Konoplyanik:

[Chernomyrdin] understood very quickly that the interests of Gazprom and the interests of the government and country are different things....He matured...and stopped being the manager of Gazprom and became the head of the government very quickly.<sup>495</sup>

In fact, Chernomyrdin and Vakhirev's relationship deteriorated over time, and this was in part due to demands by the prime minister to increase the company's contributions to the budget. An article (based on interviews with a variety of government officials and politicians) entitled “From

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493 Tatyana Lysova, Yulia Bushueva, and Yelizaveta Osetinskaya, “From Gazprom king to second string,” *Alexanders Gas and Oil Connections, Company News FSU/Russia*. 6, 12, accessed March 29, 2011, <http://www.gasandoil.com/GOC/company/cnr12716.htm>.

494 “Russia's Gazprom Lobbies To Pay Most of Its Taxes in Barter,” *Dow Jones International News*, October 6, 1998.

495 Interview by telephone, August 2009.

Gazprom king to second string,” has described Vakhirev’s attitude toward the government in general and Chernomyrdin in particular as follows:

Many of those dealing with Vyakhirev often spoke of his harsh and sometimes rude manner, his supreme confidence and his total lack of respect for politicians.

"He often spoke of the country's leaders -- including prime ministers -- in a disparaging and scornful tone," said one state official. "He would often comment on the stupidity of all the governments with which he had had to deal." Politicians echoed that opinion. "He avoided meeting ministers," said a former State Duma deputy. "The manner in which he spoke to even the most senior officials was quite unpleasant. If you said something he didn't like, he immediately went on the offensive. 'You don't understand, you haven't figured it out,' he'd say."

"In business meetings, he tried to awe interlocutors with his importance," added the former legislator. "He always behaved in such a way as to make it clear to one and all who was the most important person in the country."

...Chernomyrdin...was treated as an equal. Duma Deputy Valery Yazev, who knew Vyakhirev in the later years of Chernomyrdin's tenure as prime minister -- which ended in early 1998 -- said their relations grew increasingly tense because the prime minister levied a large amount from the company for the state treasury.

After Yeltsin dismissed Chernomyrdin's government, Vyakhirev respected his former boss still less....

Like many so-called "red directors" -- holdovers from Soviet management -- Vyakhirev had little respect for the younger generation of politicians.<sup>496</sup>

This section has shown how Gazprom acquired and maintained autonomy from the state during the 1990s. The final section looks very briefly at Gazprom’s role in foreign policy to show that its ability to veto ECH policy was not exceptional.

### **Gazprom’s role in foreign policy**

The battle over domestic policy, taxes, and control illuminates the general relationship and balance of authority between Gazprom and the state under Yeltsin. However, Gazprom also enjoyed significant authority over foreign policy questions that related to natural gas. When a disagreement broke out with Turkmenistan over the terms of trade, Gazprom broke off the relationship, refusing to transit Turkmen gas abroad. Since at the time Turkmenistan had no alternative export channels, this was effectively an act of economic warfare (an embargo), and this policy was not supported by the Ministry of Foreign Affairs.<sup>497</sup> Referring specifically to Gazprom’s policy vis-à-vis Turkmenistan and how it contradicted Russian state strategy, former Deputy Minister of Foreign Affairs I.D. Ivanov argued during the 2001 ECT hearings that:

Our geopolitics consists of attracting onto Russian territory a maximum of transit of Caspian and Central Asian energy resources, and not allow them to bypass Russia under the control of the US. This is what is written in the Russian Strategy for the Caspian, approved by the country’s

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496 Lysova et al., “From Gazprom king to second string.”

497 Ivanov testimony at 2001 hearings.

President, and in the decisions of the Council of Russian Security, and if we do not do this, we will lose both the Caspian and Central Asia....<sup>498</sup>

“But you must understand, if we are trying to channel all the transit through Russia, we have to be competitive as a transit country in the legal sense. If our transit regime remains uncertain, then, naturally, it will be sufficiently difficult to promote this goal, and then the producers, who under different circumstances would agree to transport their exports through Russian territory, will look for alternative outlets onto the world market. This concerns the very same Turkmenistan.<sup>499</sup>

Moreover, Ivanov also connected the contradiction between corporate foreign policies and state foreign policy to the lack of state authority that was a result of the transition process and in particular to the anti-state vision of Russia’s early liberal government:

[I]t is possible to note...specific problems...the roots of which lie in the transition period of the Russian economy and the problems of its reform....[One of these problems is] the emergence in a number of cases (based on the declaration by the romantic marketeers of an economic free for all) of the divergence between state diplomacy and the “corporate” diplomacy of separate companies....

[T]hese problems are not purely and exclusively Russian. However, if in the majority of other countries, mechanisms to prevent them have already been developed...in Russia, they still are hurting the country and its business overall. Thus, one of the premises of “channeling” Central Asian and Caspian energy through Russian territory...and the successful resistance to the expansion of the USA in these regions is the ratification of the ECT... However, Gazprom, with the support of part of the State Duma, is protesting resolutely against the ECT, and in particular its article 7 on transit, because the transparency of transit would complicate the company’s transfer pricing along the entire length of its gas pipelines.

It is natural, that business culture – both in relation to the state and between companies – does not emerge instantly, and its absence or insufficiency is directly related to the degree to which our market is *civilized or functions like an eastern bazaar*. However, both business and the country are paying an extraordinarily high price because of this. That is why the coordination and complementarity of state and “corporate” diplomacy remains one of the most important problems of Russian economic diplomacy.<sup>500</sup> (emphasis added)

Therefore, the violation of state foreign policy by corporations was a general problem of which Gazprom’s policy in Central Asia and resistance to the ECT was a specific expression. In short, Gazprom’s rejection of the rules established by the Treaty – even though the state had participated in crafting them and intended to commit to them through ratification – was not exceptional. Gazprom aimed to create its own rules even though this went against the goals of Russian foreign policy.

Gazprom also played a leading role in the gas trade with Ukraine. According to former management chairman of Naftogaz Ukraine, Igor Bakai, “At a meeting, Vyakhirev told me and [politician] Julia Tymoshenko: ‘I’ve come here to do business, and if we’re going to talk rubbish then I’ll turn around and leave.’ Rem took the initiative in negotiations and conducted them with severity.”<sup>501</sup>

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498 I.D. Ivanov, “The Energy Charter Treaty and the Interests of Russia.”

499 Ibid.

500 I.D. Ivanov, “The Economic Interests of Russia and Its Economic Diplomacy.”

501 Lysova et al., “From Gazprom king to second string.”

Finally, Gazprom's relationship with the state during the 1990s mirrored the state's relationship with other oligarchs. Tax evasion was a chronic problem, as was control over foreign policy. Oil companies competed against each other internationally even when government officials argued that it was in Russia's overall interest for them to coordinate with each other. Oil companies also defied the state in the Caspian region by investing in projects that the government was trying to prevent because it felt they went against Russia's interests.<sup>502</sup>

## Summary

Like most other elites in Yeltsin's Russia, the managers at Gazprom led by Vakhirev identified as masters with respect to the state and did not refrain from blocking state policy when they felt this was necessary. We have seen this dynamic during the debate on reforming Gazprom, state oversight over the monopoly, and improving tax collection from the firm during Yeltsin's second term. Furthermore, even though the ECH was a state foreign policy priority – Russia was using it to send a signal to Western governments and investors – Gazprom vetoed this policy by blocking ratification. As a result, Russia could not follow through on its international commitments and by the same token could not behave as a unitary actor. This was part of a more general dynamic whereby large firms (not only Gazprom) undermined state foreign policy in areas not directly related to the ECH.

That Gazprom was able to veto state policy is indicative of the general nature of state-elite relations in Russia during the 1990s: authority was diffuse, distributed among many different elite actors, and the state was only one, and not necessarily the most significant, actor in this respect. The pattern of authority was heterarchical, and thus state domestic sovereignty was low. As a result, the government would articulate a goal – ratify the ECT, reform Gazprom, collect taxes – but often lacked the capacity to implement policies that would promote that goal. Because authority was distributed among many different actors, the number of veto points increased. Decision making in general, and energy foreign policy in particular, was a heterarchical process, and this shaped how the Russian state behaved during the 1990s. In the ECH sphere, this meant that although the state was trying to send a signal to other states and international investors by negotiating, signing, and ratifying the agreement, it was not able to do so successfully.

Finally, the argument of this thesis is that this state of affairs was a product of the state image that prevailed within the leadership during the formative period of the new Russian state. This image shaped state-building strategies and elite identities. Moreover, this image was consistent with the assumptions concerning state domestic sovereignty that the neo-liberal framework implied. The state's inability to ratify the ECT in 1997 appears to have been an inherent contradiction in the ideational and normative underpinnings of the regime. In particular, ideas about legality demanded that the state make strong commitments to international investors through a ratified treaty. However, ideas about free markets meant that the very state authority that would have been necessary to make such a commitment was neglected. This was possible because there was no careful consideration of how radical destatization might affect state authority in areas where it would be needed. The more general point is that constructivist

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502 See Adam Stulberg, *Well-Oiled Diplomacy: Strategic Manipulation and Russia's Energy Statecraft in Eurasia* (Albany, NY: SUNY Press, 2007).

scholars and those studying norms need to extend their research program by examining how different ideas interact with one another and especially with the sovereignty norm.

Chapters 2, 3, and 4 have examined the emergence of the apprentice state under Yeltsin and the consequences for Russian ECH policy. The next chapter begins to examine what happened after Boris Yeltsin was replaced by Vladimir Putin as president to understand how Russian state identity went from apprentice to mercantilist and the consequences for its ECH policy.



## **CHAPTER SIX: THE RUSSIAN STATE UNDER PUTIN – SOVEREIGNTY, INTERNATIONAL RELATIONS, AND THE NEW IDEOLOGICAL LINE**

### **Overview**

This chapter examines the transformation in the Russian state that began when Boris Yeltsin chose Vladimir Putin to succeed him as president. The new president had a different view of the state than his predecessor. Although he did not reject the neo-liberal line entirely, he had a more favorable understanding of the state as a source of social stability and an important actor in certain areas of the economy, including the energy sector.

Putin articulated this view publicly early in his tenure. Moreover, these views reflected a broad consensus in society, particularly among the elite. Whereas Yeltsin had gone against the grain in pursuing neo-liberal reforms, Putin's views and policy put him in the mainstream of societal opinion. As a result he was able to form a new, broader coalition and reposition the presidency and government politically. This contributed to the end of polarization, which was important to Putin since social consensus was a source of state strength.

He also pursued a different state-building strategy than Yeltsin; rather than undermining state authority and working to radically withdraw the state from society and the economy, the new president increased state authority and its social and economic presence in several key respects. In particular, state building occurred in the central state's relations with the regions, the economic elite, the media, and important sectors of the economy. The energy sector and Gazprom specifically (the president had a keen personal interest in the gas monopoly) were at the top of the list.

Finally, Putin's view of the state also entailed a different relationship between Russia and other states. According to the new president, Russia was a great power that had special external capabilities, which meant that it had options that were not available to other states. For Putin, this was an inherent quality of the Russian state. Moreover, domestic questions would no longer be subordinated to international ones, a luxury that Russia could afford since it was a great power and not constrained in this respect.

This idea was consistent with the imperative of maintaining social consensus, which is more elusive if policy depends largely on international constraints and neglects the interests of important domestic actors. According to the new view, Russia would promote its domestic interests internationally through tough bargaining with other states. Russia was no longer looking for foreign models to support its political and economic development. These ideas about the state's relations to other states would become a prelude for Russia's new role identity as a regime maker.

In short, the new president's view of the legitimacy of state power informed his choice of coalition and state-building strategy. As a result, Russian sovereignty went from low to high, which represented a change in its corporate identity. His views on state power internationally also heralded a change in the state's role identity.

## Organization of chapter

This chapter begins by examining a general measure of Russia state sovereignty – relations in tax collection – to show how it changed from Yeltsin to Putin. We then examine Putin’s views about the state’s role in the economy in general and the energy sector in particular. The following section looks at how state authority was rebuilt over Gazprom. This is a direct measure of state sovereignty with respect to a key actor in the ECH process. The next section explores a key puzzle: why was Putin able to replace the CEO of Gazprom, Rem Vakhirev, when Duma opposition thwarted the same policy by previous governments? This was related to the new president’s views about the state’s role in the economy and the coalitional choices that became possible as a result. The final section investigates the president’s approach to international relations and the sources of state external power, which segues into our examination of the institutionalization of state role identity and changes in Russian ECH policy, discussed in the following chapter.

## State sovereignty and tax collection in Russia (1991 – 2010)

The drama of Russian state domestic sovereignty can be told at the micro-level by examining state-society relations in the area of tax collection. I will concentrate on the period from 1991 to 2010. From 1991 to 2003, the state and societal actors battled over who had authority and control over tax collection. The state’s level of sovereignty was low, and this led to irregular taxation. The period from 2003 to 2010 was characterized by high state sovereignty over taxation. Whereas previously, societal actors rivaled the state for authority and control over taxation, beginning in 2003, the authority and control of the state became supreme.

### *Yeltsin*

When Yeltsin took the reins of the new Russian state in 1991, the tax system was severely underdeveloped. A general tax framework was created by law in 1991 to 1993.<sup>503</sup> External actors played an important role in this process, another indication of the fact that Russia was looking for models and learning from external actors under Yeltsin. According to Hilary Appel,

In the first decade after the dissolution of the Soviet Union, the United States treated Russia as a kind of *pet project* for the contemporaneous creation of capitalism and democracy, in which American lawyers, academics, and newly minted MBAs descended on Moscow to rewrite tax laws, design institutions, and peddle advice. The economy was weak, the Russian president was feeble, and the international financial institutions enjoyed the powerful and authoritative position of the absolute lenders of last resort.<sup>504</sup> (emphasis added)

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503 Appel, “Is It Putin or Is It Oil?” According to Appel, “Several new laws were passed to set the foundations of a capitalist tax system, such as the Law on the Fundamental Principles of the Budgetary System and the Budgetary Process of October 1991, the Law on the Foundations of the Tax System in the Russian Federation of December 1991, and the Law on the Foundations of Budgetary Rights and Rights to Form and Use Extrabudgetary Funds in April 1993,” 303.

504 Ibid.

Despite creating legislation, collecting taxes remained a serious problem. Between 1992 and 1997, federal tax revenues fell from 17.8 percent to 10.1 percent of Russia's GDP. By comparison, this figure is 31 percent in Austria, 27 percent in Germany, and 18 percent in the United States.<sup>505</sup>

How do we explain the fall in tax revenues? First, the economy was going through an unprecedented contraction, which diminished the tax base.<sup>506</sup> Second, lowering taxes was a part of the government's agenda to liberalize the economy. Third, the tax code was full of loopholes and special privileges.<sup>507</sup> Gustafson has described tax collection during that period as a "plea bargain."<sup>508</sup> Tax burdens were not determined by the laws of the state, and the laws were developed in an ad hoc manner as a result of private lobbying via channels created by personal relations at various levels of government.<sup>509</sup> According to Easter,

By 1997, the tax code consisted of nearly two hundred different taxes augmented by twelve hundred presidential decrees and government orders; three thousand legislative acts; and four thousand regulatory acts and instructions from ministries and agencies. In addition, regional governments added more than one hundred of their own additional taxes to the system.<sup>510</sup>

By 1996 the number of exemptions and formal tax concessions for firms reached 7 percent of GDP.<sup>511</sup> The negotiation and renegotiation of the tax regime reflected the acute lack of authority of the central state vis-à-vis regional and industrial elites.<sup>512</sup>

Suffering from acute and persistent shortages of budgetary funds, one of the mechanisms the state used to meet its obligations to the economy early on was the allocation of credits from the Central Bank. These credits were given to companies to forestall bankruptcy and unemployment, creating what Gaddy and Ickes called a "virtual economy" based on soft budget constraints. Which companies received credits, like most everything else, was determined by lobbying through networks of personal relations.<sup>513</sup>

When taming inflation became a priority, the government took control over money emission and stopped these credits. However, a new mechanism emerged in 1994 to allocate credit to the economy in this austere environment: budgetary offsets. Rather than collect taxes

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505 Daniel Treisman, "Russia's taxing problem," *Foreign Policy*, October 1, 1998, 55.

506 EBRD (European Bank for Reconstruction and Development), *Transition Report 2001: Energy in Transition* (London: European Bank for Reconstruction and Development, 2001).

During 1991 and 1998, the economy contracted 42.5 percent. Although these figures are in % of GDP, Treisman has argued that contraction can affect the proportion if different tax bases are affected differently by the contraction. Treisman, "Russia's Tax Crisis," *Economics and Politics* 11 2 (July 1999).

507 Treisman, "Russia's Tax Crisis"; Appel, "Is It Putin or Is It Oil?" 304.

508 Thane Gustafson, *Capitalism Russian-Style*, (Cambridge, UK: Cambridge University Press, 2000).

509 Ibid.; Appel, "Is It Putin or Is It Oil?" 304.

510 Gerald Easter, "Building Fiscal Capacity" in *The State After Communism*, ed. Timothy Colton and Stephen Holmes (Lanham, MD: Rowman and Littlefield, 2006), 32.

511 Clemens Grafe and Kaspar Richter, "Taxation and Public Expenditure," in *Russia's Post-Communist Economy*, ed. Brigitte Granville and Peter Oppenheimer (Oxford, UK: Oxford University Press, 2001), 147.

512 Jorge Martinez-Vazquez and L. F. Jameson Boex, "Fiscal Decentralization in the Russian Federation During the Transition," *ISP Working Paper*, 99-03, International Studies Program, Andrew Young School of Policy Studies, Georgia State University, Atlanta, July 1999.

513 Clifford G. Gaddy and Barry W. Ickes, *Russia's Virtual Economy* (Washington, DC: Brookings Institution Press, 2002).

from regional governments and large enterprises to fill the treasury, the central state used tax debts to offset budget obligations.

Since offsets eliminated money from the transaction, an unintended consequence was that they exacerbated the problem of non-payment in the economy.<sup>514</sup> As a result, an increasingly large share of economic activity moved to the informal sector, where barter and weksels<sup>515</sup> rather than money functioned as payment. This meant that taxation became even more difficult. It became easier to conceal taxable activity, and enterprises, when they did pay taxes, would pay a large amount in non-monetary form (which also overstated the value of the goods being transferred).<sup>516</sup>

Federalism added yet another dimension to the problem of taxation. In line with the logic of “asymmetrical federalism,” tax relations with the regions were characterized by frequent renegotiations motivated primarily by political considerations such as the threat of separatism and support for Yeltsin’s presidency.<sup>517</sup> As a result, the tax regime broadly favored the regions.<sup>518</sup> As Appel noted, “Quite strikingly, Tatarstan and Bashkortostan, particularly resistant regions, even prohibited the federal treasury from opening local branches.”<sup>519</sup>

The problem of federalism combined with the problem of non-payment to further undermine the tax collection efforts of the center. According to Treisman,

Russia's tax crisis is much more of a crisis for the federal government than for its regional counterparts....Available evidence suggests a kind of implicit or covert collusion between regional governments and big taxpayers to keep rubles from leaving their regions.<sup>520</sup>

Because most of federal revenue came from a few taxes shared between the regions and the center, regional actors had an incentive to minimize official tax collections to avoid transfers out of the region to the center. As Treisman noted,

A regional governor eager to please his voters or to line his own pockets has an obvious incentive to collude with such enterprises at the federal budget's expense. If a company can keep money off its books, the region will not have to share tax on that money with Moscow--the governor and enterprise director can split the proceeds between them. As part of the deal, regional governments help defend delinquent enterprises from the federal bankruptcy agency if Moscow tries to tighten the screws.<sup>521</sup>

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514 Surveys of industrial enterprises showed a steady rise in the use of barter and other forms of non-monetary settlements from about 5 percent of all transactions in 1992 to nearly 50 percent in 1997. C. Gaddy and W. Gale, “Demythologizing the Russian Flat Tax,” *Tax Notes International* 14 (March 2005): 983–988.

515 Weksels are promissory notes. Large actors—banks, large companies, and local governments—began to privately emit this particular type of money. Thus, the state lost sovereignty over money. See David Woodruff, *Money Unmade: Barter and the Fate of Russian Capitalism* (Ithaca, NY: Cornell University Press, 1999).

516 Gaddy et al., “Demythologizing the Russian Flat Tax.”

517 Appel, “Is It Putin or Is It Oil?” 306.

518 Ibid.; “Between 1992 and 1994, the share of revenues allocated to regional budgets increased from 47 percent to 70 percent. Despite some recentralization in 1995, revenue transfers to the regions increased again in 1996, approaching the 1992 levels.” Grafe and Richter, “Taxation and Public Expenditure,” 151.

519 Grafe and Richter, “Taxation and Public Expenditure.”

520 Treisman, “Russia's taxing problem,” 59.

521 Ibid.

In this way, the move to barter and local tender (weksels) combined with weak central control over the regions to further impair federal efforts to fill the treasury.

The Yeltsin government began to pay attention to tax collection problems in 1996. Although the government obviously had an interest in improving tax collection, its failure to do so did not go unnoticed by the IMF, which was already pressuring the government on taxes in 1997<sup>522</sup> and made tax reform and collection enforcement a condition for emergency assistance.<sup>523</sup> However, part of the problem was that large companies were able to lobby at various levels of government (the presidential administration, ministries, the State Duma, regional governments) to block tax reform and avoid collection.<sup>524</sup> For example, starting in 1995, the government proposed to introduce new tax laws, but these were repeatedly delayed in the State Duma because of opposition from Yeltsin's opponents (the communists and nationalists) and the oil and gas lobby. As a result, the president tried to sidestep this problem by issuing decrees.<sup>525</sup> However, this also proved ineffective. For example, in March 1997 the oil lobby managed to get the State Duma and the government to reverse a R15,000 increase in the oil excise tax (to R70,000 from R55,000 per ton of crude) pushed through by the Ministry of Finance and the State Tax Service several months earlier.<sup>526</sup>

In 1996, the government formed the Karpov commission to investigate the general problem of non-payment and specifically non-payment of taxes.<sup>527</sup> Following an 18-month investigation of the largest corporations, the results proved to be even worse than expected.<sup>528</sup> As reported by Gaddy,

[O]nly 8 percent of large enterprises paid their taxes with money, 63 percent paid in kind, and 29 percent paid nothing at all. In 1996, according to the State Tax Service, only 17 percent of all enterprises paid their taxes on time. Others estimate that due to under-reporting, barter, and capital flight, 33 percent of firms paid no taxes at all.<sup>529</sup>

The government tried to use various levers to enforce payment: it toughened reporting rules, issued decrees so the state could threaten delinquents, restructured arrears, and warned tax evaders of bankruptcy proceedings, asset seizures, loss of access to oil pipelines, and other difficulties.<sup>530</sup> The government also allocated more resources to tax collection, strengthened the legal and administrative powers of the country's tax collectors, upgraded the administrative status of the tax police, and created a system to control and monitor payment all over the country.<sup>531</sup> In 1996, the government created the Emergency Committee<sup>532</sup> under Deputy PM Anatoly

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522 P. Luong Jones and E. Weintal, "Contra Coercion: Russian Tax Reform, Exogenous Shocks, and Negotiated Institutional Change," *American Political Science Review* 98, 1 (February 2004): 143.

523 US International Trade Commission, "Ammonium Nitrate: A Comparative Analysis of Factors Affecting Global Trade," Investigation No. 332-393, Publication 3135, 1998, 5-26.

524 Appel, "Is It Putin or Is It Oil?"

525 Luong Jones, "Contra Coercion."

526 *Ibid.*, 144.

527 Appel, "Is It Putin or Is It Oil?"

528 *Ibid.*

529 Gaddy, "Demythologizing the Russian Flat Tax"; data from Karpov commission—I have not been able to locate a copy of their report; Grafe and Richter, "Taxation and Public Expenditure," 145.

530 Treisman, "Russia's taxing problem."

531 *Ibid.*, 56.

532 This was the second emergency committee in Russian history. The first was the Cheka that dealt with counterrevolutionary activity in the early Soviet period; eventually, it became the KGB.

Chubais.<sup>533</sup> The committee was able to force payment from major delinquents, but the impact was only strong enough to reverse the decline in revenues for a little more than a month.<sup>534</sup> A second agency, the federal debt center,<sup>535</sup> was created in 1998 to sell the assets of companies that did not pay taxes. This effort too had limited success.

In June 1998, the emergency commission called a meeting to force the railroad ministry, Gazprom, and the state-owned electricity monopoly RAO UES to pay their taxes, but the monopolists did not even appear.<sup>536</sup> The following month, recently appointed Prime Minister Sergei Kirienko “declared war” on Gazprom by announcing that he was canceling the CEO’s management trust agreement and that the tax service would sequester the company’s assets.<sup>537</sup> (See chapter 4.) The attack petered out after Yeltsin met with his over-exuberant government the day after the announcement. Gazprom also mobilized significant support in the State Duma. Shortly thereafter, it was announced that the trust agreement would remain intact and that a compromise had been found; Gazprom would pay taxes in July, and the state would settle its debt to the firm pending negotiations with the government. According to press reports,

Vyakhirev said he and Kirienko each carried “50%” of the blame for the current row because while Gazprom had failed to pay R2.4bn in May, the government had paid so little for gas in May and June that Gazprom had nearly collapsed.<sup>538</sup>

In August, 5 percent of Gazprom shares were sold to raise cash for the government.<sup>539</sup> In October, CEO Vakhirev proposed to pay the bulk of taxes owed in goods. According to the press,

Gazprom is lobbying to tie its cash tax payments to the share of cash receipts compared with the company's total sales, Vyakhirev said. Currently, Gazprom collects only 16% of all sales in cash, Vyakhirev said, however adding that this has steadily increased from as low as 2%....As alternative means of payment, Gazprom advocates offsets against gas deliveries to government agencies, Vyakhirev said....Also, he suggested Gazprom pay for some of the taxes in the form of various goods....“We are willing to replenish the budget with Russian goods, for instance, army bases need ammunition and fuel,” Vyakhirev said. “I am willing to take on such supplies, including medicines to the Health Ministry.”<sup>540</sup>

To summarize, from the perspective of tax policy, the state under Yeltsin had very low sovereignty. Although it was able to collect some taxes, this period was characterized by tax evasion, arrears, non-cash payments with overvalued goods, fiscal decentralization, collusion between firms and regional actors, legislative impotence, and ad hoc private bargains between societal actors and the state officials to whom they had access. As a result, the government had to rely on borrowing, from both private actors and public organizations, to finance itself, and this

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533 Treisman, “Russia's taxing problem.” The commission targeted large, tax-evading corporations that collectively owed the government 4% of GDP. Appel, “Is It Putin or Is It Oil?”

534 Treisman, “Russia's taxing problem.”

535 Ibid.

536 “The State’s Biggest Debtors Did Not Show Up at the Session of Emergency Commission,” *A&G Information Services*: Comtex, June 18, 1998.

537 Koshkaryova, “Sergei Kirienko's Last Blunder.”

538 “Gazprom hits back in tax row.”

539 Isabel Gorst, “Gazprom—At the eye of the storm,” *Petroleum Economist*, September 22, 1998.

540 “Russia's Gazprom Lobbies To Pay Most of Its Taxes in Barter.”

is of course what led to the financial crisis of August 1998 when the government defaulted on its sovereign debt.

### *Putin*

The political relationship with regional actors and oligarchs began to change during Putin's first term. In terms of establishing sovereignty over the regions, four early milestones stand out. The first was the new policy in Chechnya that started in 1999 under Yeltsin when Putin was Prime Minister. The center's determination to end the war and establish its monopoly on the legitimate use of violence and control over its territory had an important demonstration effect for the other regions.<sup>541</sup> The second moment was the establishment by decree of the seven super regions on May 13, 2000.<sup>542</sup> Third, in July 2000, a new law was passed reforming the Federation Council, the upper house of the Russian parliament.<sup>543</sup> Henceforth, regional leaders no longer had the same power to shape federal legislation, including tax laws. As a result, the second part of the tax code could limit the maximum supplemental regional tax rate on corporate profits, something the governors would surely have found objectionable. Finally, after the Beslan school tragedy in September 2003, Putin eliminated local elections for governors, who would from that moment on be nominated and removed – for the violation of tax laws and other federal statutes – by the president.<sup>544</sup>

Reining in the governors had important tax consequences. According to Appel, limiting the powers of governors was instrumental in passing “an expansive set of radical energy tax reforms in 2003-2005 – marking a decisive break from the stalled fiscal reform efforts of the previous decade.”<sup>545</sup> In terms of the distribution of tax revenues between the center and the regions, Appel noted that “Regional leaders at times complained of Putin's reallocation of revenues between the regions and the center in the first years of his presidency, but it was to no avail.”<sup>546</sup> According to Konitzer and Wegren, the period between 1999 and 2005 witnessed a gradual shift of financial resources from the regions to the center.<sup>547</sup>

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541 In particular, when bargaining with the center, the threat of separatism no longer had the same power as it did previously.

542 Five of the seven envoys, and many of the federal inspectors that reported to them, came from the siloviki faction, which in no small measure created a powerful stick for “clipping the governors' wings... on their home turf.” Timothy J. Colton and Michael McFaul, *Popular Choice and Managed Democracy: The Russian Elections of 1999 and 2000* (Washington, DC: Brookings Institution Press, 2003), 210.

543 The assembly would be composed of members selected by governors and regional assembly leaders rather than by the elected officials themselves.

544 Appel, “Is It Putin or Is It Oil?”

545 *Ibid.*, 314.

546 *Financial Times*, June 10, 2002, cited in Appel, “Is It Putin or Is It Oil?” 313.

547 Based on estimates by Lavrov, they claim that 60% of the taxes collected in the regions was distributed back to regional budgets under Yeltsin. But the proportion changed under Putin; starting in 2003, the division of budgetary income between Moscow and the federation subjects was set at roughly 70 percent for the former and 30 percent for the latter. A. Konitzer and S. Wegren, “Federalism and Political Recentralization in the Russian Federation: United Russia as the Party of Power,” *Publius: The Journal of Federalism* 36, 4 (2006): 503-522 (based on data from A. Lavrov, “Budgetary Federalism” in *Conflict and Consensus in Ethno-political and Center-Periphery Relations in Russia*, ed. Jeremy Azrael and Emil Payin (Washington, DC: Rand, 1998): 22-44; and Boris Vishnevskii, “Vsia vlast'—mne! Kak federal'nyi tsentr zanimaetsia peretiagivaniem biudzhethnogo kanata,” *Nezavisimaia Gazeta*, September 3, 2002).

Perhaps the single most important event occurred on August 8, 2004, when amendments to the Subsoil Law were passed, eliminating what was known as the “2 key” principle established during the 1990s, whereby the center and regions both had control over licenses and auctions. Henceforth, only federal approval would be required to hold auctions, issue and withdraw licenses, and set the rate of regular payments for subsoil use.<sup>548</sup> When the commission for delimiting authority among branches of power led by the president’s Deputy Chief of Staff Dmitri Kozak made this proposal public in late 2002, Andrei Konoplyanik wrote that,

[This is a]...*revolution* in Russia’s subsoil use system....The commission proposes federal ownership for mineral deposits (except widespread minerals) and striking out of the Law on Underground Resources provisions concerning joint authority of the Federation and Regions in the subsoil use sphere - "for lack or impossibility of creating a clear mechanism for realising that authority." Hardly any comment is required....[these] initiatives launch yet another stage of re-routing financial flows generated by mineral producers to the federal centre and shifting control of them from regions to federal authorities.<sup>549</sup> (emphasis added)

In addition to the governors, the Putin government was also able to tame the oligarchs who had run roughshod over previous governments. Three key moments stand out. First, the government began a pressure campaign against the oligarchs, especially the two top media magnates Vladimir Gusinsky and the “grey cardinal” Boris Berezovsky.<sup>550</sup> Although many instruments were deployed, a key strategy was to rein in the liberally oriented, oligarch-controlled media. This was something that Yeltsin refused to do on several important occasions. The first was when media opposition played a key role in turning public opinion sour against the state’s first Chechen war. Yeltsin did not order a media crackdown despite the fact that a critical state interest was at stake: the operation aimed to keep Russia territorially intact by opposing the succession of Chechnya. A second occasion was the oligarch battle over acquiring privatized state assets in 1997. When Gusinsky was not rewarded with a rigged auction for his 1996 support of Yeltsin’s re-election, he unleashed his media empire, which turned a book deal into a national scandal and led to the collapse of Yeltsin’s post-election government of reformers. Although an uncensored media is certainly an important value, from the perspective of state building this was unexpected.

Moreover, Putin’s campaign against the oligarchs was widely considered to be legitimate. When Berezovsky began to mobilize against the reduction of regional powers, Boris Gryzlov, the head of the Unity parliamentary faction, warned that “Power and society no longer need mythical figures like Boris Berezovsky.”<sup>551</sup> In an interview with the *Wall Street Journal*, Prime Minister Kasyanov, a carryover from the Yeltsin period, commented that, “Today, oligarchs have no immunity, and that’s why law-enforcement bodies are doing their regular job concerning their

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548 “Legal Update—Amendments to the Subsoil Law,” *Russia and CIS Oil & Gas Newsletter* (August 2004), accessed February 12, 2009, [http://www.whitecase.ru/articles/newsletters/energy08\\_04.pdf](http://www.whitecase.ru/articles/newsletters/energy08_04.pdf). Although regional representatives would be allowed to sit on the relevant committees advising the government, jurisdiction over mineral usage taxes became the exclusive purview of the center.

549 Andrei Konoplyanik, “Kremlin prepares to grab more cash from Russian oil producers,” *Energy* 10 (2002).

550 While most oligarchs accepted the nature of the new relations between the state and big business, Berezovsky and Gusinsky did not and instead went into and remain in exile.

551 Marina Dracheva, “Locked Up—Putin Cracks Down on the Oligarchs,” *NEFTE Compass*, July 13, 2000.



companies....Maybe before, this process did not touch oligarchs. That is why we can now see splashes of emotion.”<sup>552</sup>

Second, on July 28, 2000, Putin convened a 160-minute meeting with the 21 top figures from the Russian business elite to lay down “the rules of the game” concerning state-business relations.<sup>553</sup> However, by 2003 it became clear that the deal was not working, particularly in the area of policy. In particular, legislation concerning structural reforms and taxes was being stalled or revised due to pressure by the oligarchs. According to Tompson, “where big business objected (e.g. oil-sector taxation), government initiatives stalled. If the Kremlin objected (e.g. , gas-sector reform), nothing happened.”<sup>554</sup> However, a situation in which the state and the oligarchs had equal authority would not last much longer because “the oligarchs had done more to lower their political profiles than actually to curb their political activities.”<sup>555</sup>

The third and perhaps most important event was the confrontation between the state and Mikhail Khodorkovsky, the largest shareholder in the oil company Yukos, Russia’s richest man at the time and the most intransigent oligarch. Several of Khodorkovsky’s initiatives had singular importance from the perspective of the state. Khodorkovsky was unilaterally negotiating with American energy companies over selling a large share of his oil company – which he was planning to merge with Sibneft<sup>556</sup> – and also with the Chinese about building his own pipeline,<sup>557</sup> thereby breaking the monopoly on oil transit that the state enjoyed through its ownership of Transneft. Khodorkovsky was the only oligarch who continued to defy the president in public (at least once to Putin’s face) and disregard the idea that he was “bound by any bargain, implicit or explicit, to stay out of politics.”<sup>558</sup>

As Appel noted, several of the additional energy tax reforms that appeared in 2002 and 2003, “were politically quite sensitive, as they would substantially affect the division of profits stemming from the oil and gas sector—in particular, the introduction of the mineral extraction tax.”<sup>559</sup> In 2002, Khodorkovsky was successful in blocking an increase on the excise tax on oil

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552 Andrew Higgins, “‘Immunity’ of Moscow’s Oligarchs Threatened---Business Barons Set for Equal Treatment, Says Prime Minister,” *Wall Street Journal*, July 12, 2000, A21.

553 Richard Sakwa, *Putin: Russia’s Choice* (London and New York: Routledge, 2008), 185-191; also William Tompson, “Putin and the ‘Oligarchs’: A Two-Sided Commitment Problem” in *Leading Russia: Putin in Perspective: Essays in Honour of Archie Brown*, ed. Alex Pravda (Oxford: Oxford University Press, 2005), 179-203. In fact, Yeltsin had also summoned the oligarchs to lay down the rules in September 1997, but not much came of the meeting. During the 2000 meeting, the oligarchs presented President Putin with a three-point declaration in which they asked for a moratorium on revisiting the privatization process and redistributing property, acknowledged that “the business community must undertake to play by the rules, pay taxes and scrupulously obey the law,” asked that government rid itself of corrupt bureaucrats, and acknowledged that they should not use the state or its officials to fight their mutual battles. This meeting followed a meeting with the prime minister on July 24 during which he expressed the government’s wish for support for its reform of the federation council, which happened two days later (July 26). The day before the vote (July 25), “each person attending the meeting reportedly received a note urging them to take action to pass the tax code the following day.” The meeting with the president took place two days after the vote. “Chronology of events, Government and president meet with ‘oligarchs,’” accessed February 12, 2010, <http://www2.nupi.no/cgi-win//Russland/krono.exe?4840>.

554 Tompson, “Putin and the ‘Oligarchs,’” 187.

555 *Ibid.*, 185.

556 Tompson, “Putin and the ‘Oligarchs.’”

557 Appel, “Is It Putin or Is It Oil?”

558 Tompson, “Putin and the ‘Oligarchs.’”

559 Appel, “Is It Putin or Is It Oil?”

in the Duma.<sup>560</sup> During the 2003 battle over oil super profits, Khodorkovsky put unrelenting pressure on the government to create a more favorable tax regime.<sup>561</sup> In an interview, the liberal former Minister of Economic Development and Trade German Gref stated that Khodorkovsky threatened him personally: “Either you withdraw that law or I will make sure you are sacked.”<sup>562</sup> This is very much the expression of a master identity with respect to the state. Nevertheless, after Khodorkovsky’s arrest, in December 2003 the government successfully passed a budget amendment creating a stabilization fund, and in the spring of 2004 it passed legislation establishing the indexation of the oil tax system. According to Appel,

This reform proved to be extremely important and highly favorable to the federal budget since it allowed the state to capture a much larger percentage of the rents of subsequent energy price spikes. Had the 2004 oil tax reforms failed, the state would have collected only a 35 percent tax on oil, rather than the 65 percent marginal tax that applied to barrels of oil selling above \$25. This reform—and the power required to adopt and see through this reform—accounts quite directly for Russia’s fiscal recovery.<sup>563</sup>

The Khodorkovsky affair also allowed the state to take over Yuganskneftegas – Yukos’ largest production unit – and turn it over to the leading national oil company, Rosneft.

Finally, the Yukos affair also had an important symbolic effect. The arrest of Russia’s richest and most powerful oligarch sent a signal to the other oligarchs and society as a whole that there was a new sheriff in town. It is clear that all this was a means to an end: “the redefinition of the Kremlin’s relationship with big business.”<sup>564</sup> It appears that the strategy worked. What liberal former Deputy Energy Minister Vladimir Milov referred to as the “tax terror” succeeded in changing the logic of Russian politics. Taxation was now characterized by hierarchical relations of authority. The state had unilaterally produced considerable sovereignty over taxation. According to Tompson,

Far from being the state’s master, Russian private capital was to be its servant. Putin made it clear that the state expected big business to share the burden of tackling Russia’s social problems and that the resource-extraction industries, in particular, would be required to bear a heavier tax burden than hitherto. The oligarchs, for their part, were at pains to demonstrate their loyalty to the Kremlin and their acceptance of the president’s new line. Where they had previously competed to maximize after-tax profits and market capitalization, oil companies were suddenly competing for official favour once again, at pains to proclaim their readiness to pay more taxes and to support all manner of social initiatives. Lukoil declared with pride that it had abandoned many of its legal tax-optimization schemes and was actually paying more tax than was strictly necessary. BP-TNK, clearly recognizing the need to adapt to the new circumstances, announced plans to move its core holding company on-shore and to maintain its profit-centre in Russia.<sup>565</sup>

According to Appel,

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560 Ibid.

561 Ibid.

562 Josef Pazderka, “Russia: End of a Messy Affair,” *Transitions*, June 1, 2005

563 Appel, “Is It Putin or Is It Oil?” (calculations from *Financial Times*, March 23, 2004); Luong Jones et al. noted that by hiding (according to some estimates) 25% of their proceeds through transfer pricing, despite the increase in oil prices during 1999-2000, “the government only received 22% of the approximately \$30 billion in windfall rent from natural resources sales in 2000, while 78% remained in the hands of oil and gas exporters.” Luong Jones, “Contra Coercion.”

564 Tompson, “Putin and the ‘Oligarchs.’”

565 Ibid.

The government has managed to convince private enterprises and local governments that they must meet their tax obligations. It also achieved a series of tax reforms that enabled the state, rather than Russian oil barons, to capture much more of the extraordinary profits resulting from high world oil prices.<sup>566</sup>

There has been considerable variation in Russian state sovereignty over taxes in the post-Soviet period. The trend has been a movement from low sovereignty to high sovereignty. In particular:

1. 1991-2003 – *Low state sovereignty*

Taxation was characterized by heterarchy; strategic interaction in this area saw relations between the state and societal elites as equally authoritative actors. The state had great difficulties collecting taxes, and federal revenues were captured by large firms and regional governments.

2. late 2003 - 2010 – *High state sovereignty*

The state demonstrated without any doubt the primacy of its authority in the realm of taxation. Strategic interaction in this area came to be characterized by hierarchical relations in which the authority of the central state trumped the authority of societal actors. The state was more effective in collecting taxes.

This measure of sovereignty is entirely independent of Russian ECH policy. Taxation is very important to the state. However, because of its importance to societal elites, it is very difficult to establish state sovereignty. As a setting for strategic interaction it is comparable to energy foreign policy, which presents similar incentives (and difficulties) for the state and societal elites. In this respect it is a reasonable measure of sovereignty in the ECH policy sphere.

Later in this chapter we examine Putin's state-building strategy at Gazprom to demonstrate directly how state sovereignty was established over this key actor in ECH policy. First, we have to understand the rationale behind this state-building strategy, which was grounded in a different view of the state's role in the economy and the energy sector in particular. I discuss this in the next two sections.

### **Putin's approach to the economy: an important but limited role for the state**

When Putin joined the government in 1999, the idea of strengthening the state as an instrument for Russian development would have seemed rational to many observers. In a study of Putin's beliefs, Alfred B. Evans, Jr., has argued that:

By the end of the 1990s, just before Putin's accession to power as president, it may have been reasonable for him to conclude that the main problem threatening to paralyze development in Russia was the excessive weakening of the state apparatus.<sup>567</sup>

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566 Appel, "Is It Putin or Is It Oil?"

567 Alfred B. Evans, Jr., "Power and Ideology: Vladimir Putin and the Russian Political System," *Carl Beck Papers in Russian & East European Studies* 1902 (January 2008): 18-19.

It is also evident that the incoming president held the state in much higher regard than his predecessor. According to Evans,

Another persistent thesis of Putin's speeches is the urgent necessity of strengthening the Russian state. He ascribes the basic causes of all Russia's greatest problems to the "weakness of state institutions" and insists that meeting the challenges facing his country "is impossible without the strengthening of the state"...Even before he became president...he warned that none of the major tasks confronting the government could be resolved "unless basic order and discipline are established in the country and unless the executive chain of command is strengthened." Thus it is not surprising that...[in] December 1999, [he] declared that "the key to the revival and raising of Russia is in the state-political sphere today. Russia needs strong state power and should have it." In that document, he also revealed his conviction that a strong role for the state is among the traditional, "primordial" values of the Russian nation. "Our state and its institutions always have played an exceptionally important role in the life of the country and the people. A strong state for Russia is not an anomaly, not something with which it is necessary to struggle, but on the contrary, a source and guarantee of order, the initiator and main moving force of any changes."...It is the responsibility of the state to provide "an integral system" of regulation of the social sphere as well as the economy, so that the Russian state will be "the efficient coordinator of the country's economic and social forces, ordering the balance of their interests, determining the optimal goals and parameters of social development and creating conditions and mechanisms for their achievement."<sup>568</sup>

This passage demonstrates that the incoming president's understanding of the state was indeed very different from the image that emerges from neo-liberal portrayal. Rather than the state's being the source of Russia's ills, this new image posits that a stronger state is critical to solving many of Russia's problems. From this perspective, the reference above to fear of the state suggests that Putin was challenging the neo-liberal approach to the state directly. For the new Russian leader, a strong state that played an important role in Russian social and economic life was normal, an important part of the country's history, and a key to its success in the future.

During his annual address to the Federal Assembly, Putin stated very clearly that a strong central state was necessary for economic reforms in general:

We are convinced: the indecision of the authorities and the weakness of the state undermine economic and other reforms. The authorities must rely on the law and a single executive vertical which is created in accordance with the law.

We have created islands and separate islets of authority, but have not erected reliable bridges between them. To this day we still have not built an effective way for different levels of authority to interact. We have talked a lot about this. The center and the territories, regional and local authorities are still competing with each other for power....

This vacuum of authority has led to the takeover of state functions by private corporations and clans.....

At the same time, the distinguishing feature of state functions and state institutions from entrepreneurial ones is that they are not supposed to be bought or sold, privatized or handed over for use, for leasing.<sup>569</sup>

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568 Ibid.

569 V. Putin, "Address to the Federal Assembly on July 8, 2000," Moscow, Kremlin, Archive of Appearances, accessed December 6, 2011, [http://archive.kremlin.ru/appears/2000/07/08/0000\\_type63372type63374type82634\\_28782.shtml](http://archive.kremlin.ru/appears/2000/07/08/0000_type63372type63374type82634_28782.shtml).

Very early during his first term, Putin identified that lack of centralized state authority was a major problem in Russia's political and economic development.<sup>570</sup> Later this would come to be called the "vertical of power." From this excerpt we can infer that the problem of state authority originated in both the system of federalism that emerged under Gorbachev and Yeltsin (which saw dramatic devolution of power away from the center) and the relationship between public and private authority, in which the dominance of the latter led to state capture. As we shall see, Putin focused on both of these in building his authority.

At the same time, Putin's vision for a stronger state did not include aspirations for the nearly ubiquitous presence that prevailed during Soviet times.

[I]t is necessary to designate bounded spheres where the state is a rightful and exclusive master. To concisely set forth where it is the final arbiter and also to designate where it should not get involved.<sup>571</sup>

Putin's state-building project entailed creating a strong state, the actions of which would be legitimate in specific spheres. In those areas, the state would be the master. As we shall see shortly, when discussing special spheres for state action, Putin very much had the energy sector, which he saw in strategic terms, in mind. Moreover, as the Steen data presented below demonstrate, Russian elites were very comfortable with the idea of the state being in the driver's seat (master) when it came to energy.

The choice of the word master (*khozayin*) is not trivial; it demonstrates that the idea of superordinate and subordinate relations (here the state relative to private actors in the domestic sphere) was prominent in the thinking of the Russian leadership and supports my broader claim that in energy Russia has developed a different state identity (mercantilist), which originated in elite beliefs.

Nevertheless, compared to the Soviet state, the Russian state would be more limited in two ways. The most obvious difference was that there would be spheres of life in which the state was simply not involved. In other words, in contrast to the USSR, the new Russian state acknowledged the legitimacy of completely private spaces where the presence of the state was illegitimate and effectively nil.

Another, subtler, way in which the Russian state was to be more limited than its Soviet predecessor is related to the character of interaction between the state and private social interests in those spheres where state action was legitimate (public spheres). That the state was master did not mean that private interests were illegitimate and could be ignored. This is a significant difference when compared to the USSR in which Soviet ideology construed all interests as public and necessarily consistent with building socialism. As a result, social interests were by definition consistent with state policy as directed by the party, which was the ultimate reservoir of legitimate knowledge. In the Soviet context, private interests were simply taboo, and all spheres were purportedly public and controlled by the party/state.

Quite to the contrary, in Putin's Russia, private interests were fully legitimate even in important public spheres. The state was the master in the sense that it was the final arbiter, the ultimate decision maker in those spheres pre-designated as public. However, private interests could still be articulated, and bargaining would be allowed. Ultimately, however, the state would

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570 Ibid.; see also Evans Jr., "Power and Ideology," 18.

571 Putin, "Address to the Federal Assembly on July 8, 2000."

have the last word and determine which interests (public and private) prevail and in what concatenations and proportions. Finally, the state would expect private actors to fulfill certain obligations and would exact reciprocity. In this sense, the state proposed by Putin differed from the vision elaborated by Yeltsin in which the dominance of the state over private interests was seen as oppressive and unproductive, and the behavior of private actors was shaped by profit motives. Moreover, separate obligations to the state or the public were not necessary since there was a harmony of interests based on the pursuit of profit.

Concerning the state's role in the economy, Putin also made clear in this early speech that the state would play a key role in certain specific sectors at least temporarily:

We have to admit that in the near term, the state will not be able to walk away from participation in the development of certain sectors of our economy. I mean direct participation by the state. We won't be able to and we should not walk away. Such [sectors] as for example the military industrial complex. Strategically important sectors will fall under the constant attention of the state.<sup>572</sup>

In bringing forth an example of an economic sector where state action was both necessary and desirable, Putin pointed to the military industrial complex, but it is abundantly clear that energy was also to be a strategic sector.

### **Putin's approach to the energy economy: state management over strategic sectors**

Under the new president, the Russian energy sector experienced a gradual but fundamental transformation, changing the very logic of its organization and function. The character of the shift has been captured by Dr. Konstantin Simonov, a close observer of Russian energy politics. His description of the logic of Russian energy politics under Yeltsin and how this began to change under Putin is revealing and worth citing at length:

In the beginning of the 90s, the thesis that state property was ineffective as a form of managing production assets, was popular. The only way out of the situation that was envisioned was the massive privatization of state property...From the rubble of the USSR ministries of energy the new players in the Russian economy began to emerge.<sup>573</sup>

The logical continuation in the process of the transformation of the structure of ownership in the Russian oil and gas complex was a battle for the full exclusion of state representation from the system of managing the "newly created" companies...[The loans for shares auctions] brought about the final self-marginalization of the state from the procedure for managing oil companies.<sup>574</sup>

Gradually the influence of the new owners of the raw material corporations began to grow. They were able to get access to the system of state decision making, and began to meddle in the state policy for cadres, at times changing roles with their former "bosses."<sup>575</sup>

The growth in the financial resources of business was accompanied by the penetration of its representatives into the highest echelons of state authority, which facilitated the establishment of "discretionary rights" and functioned at the level of direct arrangements between large business

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572 Putin, "Address to the Federal Assembly on July 8, 2000."

573 Konstantin Simonov, *Russian Oil, The Last Redistribution* (Moscow: Eksom Algorithm, 2005), 9.

574 Ibid., 11-12.

575 Ibid., 16.

and the apparatus of state management. The unified system of state control had been destroyed and was replaced by a system of economic regulation that was in the shadows.<sup>576</sup>

With the dawn of the Putin era, the Russian oil and gas complex entered a period of radical transformation. Serious changes in the sector are connected with the general conditions of its functioning, as well as with the possibility of redistribution of property. During Putin's first term...the format for interaction between large business and the state changed. After market liberalization ...the pendulum swung in the opposite direction. If the "Yeltsin ten year plan" was marked by the gradual increase in the strengthening of the role of private oil companies, then under Putin, the state is attempting to restore its position in the sector.<sup>577</sup>

This analysis very much supports the argument made here that policy making in energy under Yeltsin had become a heterarchical game. It also supports the claim that the origins of this political dynamic were the beliefs about the state's role in the economy that prevailed in Russia during the early 1990s. Finally, it is clear that this state of affairs began to change when Putin came to power. My argument is that Putin's beliefs about the state and the state's role in the energy sector were a central factor in producing this outcome.

Putin displayed a keen personal interest in the energy complex in general and the gas sector in particular from the very beginning of his presidency. According to Milov and Nemtsov, two former government officials and liberal critics of the former president,

Gazprom became the most important personal project for President Putin. He "put his eye" on this company immediately after coming to power. Even during the course of the 2000 presidential election campaign it became clear that the energy theme and Gazprom were central elements in Putin's political agenda.<sup>578</sup>

Putin's vision of the state's role in energy can be gleaned directly from publications under his name. During his tenure in the administration of former St. Petersburg Mayor Anatoly Sobchak, Putin (who was in charge of international economic affairs) sought advice concerning economic and natural resource policy from the G. V. Plekhanov Saint Petersburg State Mining Institute and Technical University.<sup>579</sup> In 1997, he defended a *Kandidat* of Science degree in economics at the Institute. Although the thesis<sup>580</sup> is not publicly available, Putin did publish several papers and at least one academic article (in 1999).<sup>581</sup>

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576 Ibid., 20.

577 Ibid., 8.

578 Vladimir Milov and Boris Nemtsov, "Putin and Gazprom," *Novaya Gazeta* 63, accessed July 12, 2011, <http://www.novayagazeta.ru/data/2008/63/00.html>.

579 Harley Balzer, "The Putin Thesis and Russian Energy Policy," *Post-Soviet Affairs* 21, 3 (2005): 211. The G. V. Plekhanov Saint Petersburg State Mining Institute and Technical University was founded in 1773 by Catherine the Great and is the oldest university-level technical school in Russia. According to the Institute's website, its initial purpose, to train indigenous specialists concerning the development of mining, which is a "foundational sector for the state," was conceived by Peter I and M.V. Lomonosov. Accessed on July 12, 2011, <http://www.spmi.ru/node/2692>.

580 According to Balzer, the work focuses on the role and nature of strategic planning with respect to the development of the natural resource industry in the context of the economic development of St. Petersburg and Leningrad oblast. Balzer, "The Putin Thesis," 214.

581 At the second Valdai conference in September 2005, after a question by the American economist Clifford Gaddy concerning the influence of the dissertation on Russian energy policy, Putin replied that there was some relationship between the two. Thus, these texts present an opportunity to understand the president's thinking about energy policy and have been the basis for several studies by Western academics interested in this very question. Ibid., 211; see also Martha Brill Olcott, "The Energy Dimension in Russian Global Strategy: Vladimir Putin and the

Olcott has argued that Putin saw natural resources as a strategic sector that was vital to Russia's domestic development as well as its position in the international system. Although natural resources include more than just energy, it is clear that energy was a central component of this emerging strategy. For Putin this meant that the state would ultimately decide Russian energy policy:

Putin argues that Russia's natural resource base will not only secure the country's economic development but will also serve as the guarantor of the country's international position...The state would set the priorities in the oil industry.

Putin argues in the treatise that state planning must be at the core of Russia's resource management. He writes: "The stable development of the Russian economy in the coming years needs to be based on the planned growth of its component parts, including in the first place, the potential of its mineral resources."<sup>582</sup>

Therefore, for the new president, the state was the primary actor in the energy industry. Energy was the foundation on which the rest of the economy and the state rested, and this justified, indeed necessitated, its strategic character. Interestingly, the significance of state planning reflects that there are important similarities between Putin's approach and Abalkin's call for indicative planning in vital sectors a decade earlier (discussed in Chapter 3).

Putin's strategy for organizing the energy economy emerged more clearly in his discussion of reforms. According to Olcott,

Putin argues that, "The structural reconfiguration of the national economy on the basis of the country's existing raw materials will be a strategic factor of Russia's economic growth in the near term." As Putin elaborates, the task of this transformation is complicated by the fact that the Soviet oil and gas sectors...were developed in complete isolation from market forces.

To compensate for this, there must be a fusion of the state and private sectors, which can be achieved by the creation of vertically integrated financial industrial groups established with the assistance of the state and with the explicit goal of developing Russian firms that are capable of competing on equal terms with western multi-nationals.<sup>583</sup>

The energy sector would see very close relations between the state and private actors, and the preferred organizational form was the large, vertically integrated, financial industrial group. Ironically, part of the justification for this approach is the Soviet economic legacy. A second reason for this is related to the belief that the international economy is not only extremely competitive but also politicized. From this essentially realist perspective, large Western multinationals have symbiotic relations with their very powerful states, and the latter extend significant support to their national firms in the international arena. As a result, the Russian state has to extend the same level of support to its own firms operating in the international economy. Sergei Ivanov hinted at this point of view when he was a defense minister:

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Geopolitics of Oil," paper presented at the Baker Institute for Public Policy, Rice University, Houston, TX, October 2004.

582 Olcott, "The Energy Dimension," 17

583 Olcott, "The Energy Dimension," 18.



Ivanov stated that the state's role would include defending the interests of Russian companies in the international arena. Previous governments had failed to act in this realm, but "now we are doing it directly, openly and talking about it honestly."<sup>584</sup>

This approach contrasts with the neo-liberal vision elaborated by Konoplyanik, which saw the energy sector populated by many smaller firms competing with one another and becoming more efficient as a result. The difference in firm size is significant. For Konoplyanik, law was the most effective instrument for regulating the energy sector precisely because the large number of actors required general, arms-length, impersonal rules. Conversely, if the energy sector depends on a small number of large firms, the argument in favor of law as the most efficient instrument becomes less compelling since alternative measures (one-shot, large, political economic deals) may also be effective.

If the state and private sectors are fused, what does the balance between public and private interests look like? Unlike in the USSR, private interests would be legitimate and recognized by the state. However, unlike under Yeltsin, ultimately the state was the master, and this meant state primacy over policy and reciprocity. According to Olcott,

In return for state support, these financial industrial groups will have to provide the country with a steady source of mineral resources and products, increase the efficiency of how mineral resources are used, further develop the material base, and support and expand the country's export potential, in part by changing its structure in favor of trade in processed and industrial products.

These financial industrial groups will operate within the framework provided by the state, and if they serve the state in this way, they can expect to hold onto their assets. From this list of tasks set for the new financial industrial groups, it is evident that Putin views their control of Russia's assets as a form of guardianship from which the management and "owners" are free to profit. It is also clear that Putin does not understand this stewardship as ownership, as it is often construed in the West, where owners have full control of their assets and the authority to determine the direction of their firms' development.

Putin goes on to state this rather clearly: "The state has the right to regulate the process of the acquisition and the use of natural resources, and particularly mineral resources, independent of on whose property they are located; in this regard the state acts in the interests of society as a whole, as well as in the interests of private owners whose interests conflict and who need the help of the state organs of power to achieve a compromise."<sup>585</sup>

So, private interests most definitely exist, are not necessarily incompatible with the notion of strategic sectors, and can be articulated in those spheres. However, they are not absolute. They are tempered by the general obligation for reciprocity vis-à-vis the public (as represented by the state) as well as deference to the authority of the state on specific matters. In the area of policy, ultimately the state is in charge. It is this expanded understanding of obligation to the state that made private property conditional in Putin's Russia. This idea is foreign and illegitimate to many Western audiences and is anathema from the perspective of neo-liberalism, which sees full rights of private property as not only causally necessary for economic development but sacred in their own right.

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584 Balzer, "The Putin Thesis," 213.

585 Olcott, "The Energy Dimension," 19.

The state as final arbiter model – meaning authority is vested with the state – does not mean that in any particular case, government preferences will necessarily trump private interests. State as master implies bargaining and compromise with private actors. In some cases, this will even advance private interests; the example given by Putin is state intervention to overcome collective action problems among private actors. Several of my respondents gave this rationale when asked why the state intervenes in the energy economy. Finally, although state (public) interests prevail in the abstract sense (by definition), private interests can still come out ahead. However, to do so they have to be articulated through the idiom of state interests. More concretely, whereas previously it was legitimate for private actors to make demands based exclusively on their private interests, to get their way under Putin, private actors have to demonstrate how their interests accomplish state goals.

Putin’s vision of a significant state role applies to foreign investment as well.

President Putin was supportive of western investment in the Russian oil industry and actively encouraged the investment of western companies in technologically challenging projects. He was not against western investment in Russian oil firms....His clear preference however was for Russia’s policy on partnership with western firms to slowly evolve over time, setting the limits of what was (or was not) possible on a case by case basis through consultation rather than through the decisions of Russia’s oil magnates....

Putin supports the idea of state-sponsored foreign investment in Russia’s extractive industries ... properly managed large scale investments, including foreign capital....

For Putin, there is no question of Russia giving up full control...[as] “[t]he Russian mineral raw material complex plays an important role in all aspects of the state’s vital functions.”<sup>586</sup>

In foreign investment as well we see the centrality of the state’s role. The state has primacy over domestic private actors in reserving the right to decide to whom Russian owners can sell. Thus, the state exercises final discretion over what foreign investment enters the Russian energy sector. In addition, the state plays an active role in projects with foreign participation. Significantly, the state is seen as an effective economic actor; the proper management of investment projects is a product of state sponsorship. Moreover, the general framework is not guided by laws but rather is ad hoc and depends on the circumstances (“case by case”). Finally, as “consultation” implies, we can also see that bargaining and compromise between the state and private actors is essential.

Again, this vision of the energy sector, state firm relations, and politics in general is very different from what preceded it both during the USSR and under Yeltsin. In many respects, the statist orientation under Putin can be seen as a correction to what by 1999 was widely understood in Russia as an excessive and faulty belief in the power of free markets during the early days of Yeltsin’s rule. Putin alluded to this himself:

At the beginning of market reforms, the state let go of the natural resource complex for a time. This led to a stagnation of the potential of the nation’s natural resources, to a breakdown in the geological sector that had been formed over the course of many decades, as well as having a number of other negative consequences. The pro-market euphoria of the first years of economic reform has gradually given way to a more considered approach, an approach which assumes the possibility of and recognizes the need for the regulating influence of the state on the economy as a whole and on those developing natural resources in particular.<sup>587</sup>

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586 Olcott, “The Energy Dimension,” 18.

587 Ibid., 19. Balzer, “The Putin Thesis,” 218.

The contrast with the Yeltsin period emerges very clearly in Olcott's analysis of the logic that prevailed during the 1990s and how it compares to Putin's own thinking:

To Khodorkovsky or TNK's Mikhail Friedman, the transition from a communist state-owned and hyper-centralized economy is best achieved through the turning over of all property to private individuals. This is a position also held by such reformers as Anatoly Chubais, Yegor Gaidar, and Grigory Yavlinsky....The reformers...share the view of the oligarchs, that, in the long run, the Russian economy will benefit from privatization, as assets held in private hands will generate a more diversified economy and more tax revenues for the state. Reformers and oligarchs alike see the economy in global terms and thus are less concerned with the nationality of the owners.

President Putin most definitely does not share this view. He believes that Russian ownership of Russia's resource base is critical to Russia's economic recovery and to the country's reemergence as an important international actor. Putin does not believe in relying on global market forces to provide the economic opportunities and social supports necessary for the Russian people to make a successful transition from communist rule to a modern, European style economy and political system. Instead he believes that premature globalization of the Russian economy will lead to greater hardship for the majority of Russian people and that it will lead to the concentration of vast wealth in a relatively limited number of hands of people with little or no incentive to reinvest in the Russian economy.<sup>588</sup>

This citation helps us understand two ways in which thinking under Putin changed relative to his predecessor. First it brings into relief the key ways in which the reformers' thinking about markets and the state differed from that of Putin. The analysis above demonstrated that Putin emphasized state action in particular spheres to achieve desirable results. Olcott captures here the beliefs about the consequences of free markets held by the reformers in Yeltsin's first government. Her analysis is consistent with the earlier discussion in chapter 3. Both of these beliefs are implicitly causal since they postulate outcomes as a result of certain actions.

Second, it shows the contrast in thinking relative to the nature of the international economy. As we saw earlier, under Yeltsin, the ideological line held that there was a harmony of interests between states and international actors. As a result, the nationality of the private owner was trivial. More foreign investment and ownership in energy under a liberal regime portended economic growth and development, increased state revenues, and ultimately created a more powerful Russia.

As Olcott argues, for Putin this harmony does not necessarily exist. At first glance the passage above suggests that Putin saw integration from the perspective of dependency theory. However, Putin is not against integration entirely. He recognizes that integration into the international economy also has critical benefits. The key point is that the circumstances and timing of integration matter. In Russia's case, premature integration must be tempered with state action to avoid the negative consequences of globalization. Of course, the idea that the state shapes the international economy beyond creating laws for private actors does not fit well with the neo-liberal approach. Therefore, part of the reason for Russia's new role conception (regime maker) is related to a different understanding of how the international economy operates and the relationship between international private actors and particular states, the understanding that integration has ambiguous effects, and most importantly the idea that the Russian state can and must play a role in shaping the terms of its integration.

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588 Olcott, "The Energy Dimension," 15-16.

In his analysis of Putin’s thinking about energy policy, Balzer comes to very similar conclusions:

Olcott...states the most important point quite clearly: “The primacy of the Russian state in the country’s energy sector is non-negotiable. While Vladimir Putin recognizes the importance of market forces and the need to protect private property, he believes that both must be managed to insure that neither takes precedence over the interests of the state, which exercises its control in the name of the Russian people.” His goal is to “increase its attractiveness to foreign investors while enhancing Russian state control.”<sup>589</sup>

There is one analytical difference that is worth noting, however. In his analysis, Balzer emphasizes the importance to Putin of finding the optimal combination of economic and administrative methods for state guidance of the energy sector:

[T]he most important single passage in the article for an understanding of policy in the resource sector [is]: “The basic strategic tasks for the natural resource bloc involve achieving the transition to a rational combination of administrative and economic methods of government regulation in the sphere of resource exploitation” [my emphasis] (Putin, 1999, p. 7) [sic]<sup>590</sup>

Economic methods are not entirely alien to the neo-liberal approach to political economy; they refer to the state’s ability to shape firm behavior by changing economic incentives, for example through taxation aimed at achieving specific policy goals. At the same time, more intrusive measures are also envisioned. Balzer’s focus on the need to combine both methods is relevant here because it supports the argument that even in strategic sectors where the state is primary, corporate interests count considerably. As a result, a major concern for Putin was what instruments the state should use in managing the energy sector. This deserved attention because the state would still rely on firms (state-, privately, and jointly owned) to achieve many of its economic goals. As a result, ensuring firm compliance was vital, and this meant acknowledging and accommodating their interests. From this perspective, economic methods (which assume that firms want to maximize their own profits) are valuable indeed. Overall, this vision is similar to the one promoted by Norway during negotiations on the ECT.

The preceding two sections have examined the new president’s thinking relative to the state’s role in the economy in general and the strategically significant energy sector in particular. We have also seen that Putin had a very keen interest in the gas monopoly Gazprom. Given his views and interests, it’s not surprising that Putin curtailed the autonomy of Russia’s largest company. The following sections examine his state building with respect to the firm.

### **Establishing control over Gazprom**

It is clear that Vakhirev’s departure was very much related to the arrival of the new leadership and its new policy line on energy:

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589 Balzer, “The Putin Thesis,” 219.

590 Ibid., 218.

After the change in the political system...(the arrival to power of V. Putin), the state component of the former concern was once again fortified. Serious discussions began about restructuring [the company]... and changing its top management.<sup>591</sup>

This is also supported by the statements of Dmitriy Medvedev (discussed below), who was appointed chairman of the Gazprom board.

It is equally evident that the new administration was successful in its goal to get rid of Vakhirev and bring the company under its control. According to Mukhin, “[w]hat is new about Gazprom policy is that this policy is 100% made in the Kremlin.”<sup>592</sup> In this author’s opinion, Mukhin understates the very significant contribution that Gazprom makes toward its own policy, the ways in which the state and company work together, and the bargaining that takes place between them. However, the overall point is uncontroversial: Gazprom no longer had the same level of autonomy from the state, which was now the key actor in policy decision making.

Vakhirev’s departure was a watershed moment in the history of the company:

The retirement of Rem Vakhirev from the post of CEO at Gazprom is not just the exchange of one boss for another. For Gazprom, it is roughly the same as the departure of Yeltsin was for Russia. Now a new person with a new ideology will reform the company.<sup>593</sup>

As the passage from Milov and Nemtsov cited earlier demonstrates, taking control over Gazprom was an early, top priority for Putin. This is also confirmed by observers who are more sympathetic to the former president.<sup>594</sup> The next two sections explore how the new administration removed Vakhirev and why it was successful. After reviewing the sequence of formal events, I return to the political analysis of what happened.

### *Vakhirev’s ouster: bureaucratic legalism on the surface*

Putin’s takeover of the company was both gradual and on the surface legalistic. The first key moment occurred in late August before Yeltsin publicly named Putin as his new prime minister and preferred successor to the post of president (on September 9, 1999). During a meeting of the Gazprom board of directors on August 26, 1999, five state representatives rather than four were elected to the board. This may seem insignificant; however, as we shall see shortly, the government was unable to achieve this same feat only a few months earlier when they were overtly ignored by Vakhirev.

At the June 29, 2000, meeting of the Gazprom board of directors, Dmitriy Medvedev (a lawyer and long-time associate of the president from St. Petersburg, deputy head of the presidential administration as well as head of Putin’s election campaign, and Putin’s successor as president beginning in 2008) replaced Viktor Chernomyrdin as chairman. Recalling his appointment during an interview, Medvedev said,

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591 A. A. Mukhin, *Kremlin Verticals, Oil and Gas Control* (Moscow: Center for Political Information, 2006), 28 (in Russian *Kremlevskie vertikalu neftegazovii kontrol*).

592 Mukhin, *Kremlin Verticals*, 78.

593 “The New Life of Gazprom,” *Vlast Magazine* 22, 424, June 5, 2001.

594 Valery Panushkin and Mikhail Zigar’, *Gazprom: The New Russian Weapon* (Moscow: Zaharov, 2008), 77, 107. Zigar was a journalist for *Kommersant*, and Panushkin was a journalist for *Vedemosti*.

Just remember how much did Gazprom cost then and how was it managed? The government did not have control and the market for its shares was in a shameful state. It was then specifically that we came to the conclusion that control had to be returned to the state.

[A] company such as Gazprom, taking into account its role and function, today has to be managed by one owner: the state.<sup>595</sup>

The meeting saw another significant change in faces on the board: Boris Federov, who was Vakhirev's enemy, having participated in the Nemtsov attack on the CEO only a few years earlier, was also elected to the board.

In July, the Gazprom board approved an amendment to the charter that allowed it to remove the CEO without the latter's consent. Previously, the charter stipulated that the CEO could be removed only through a unanimous vote; since Vakhirev was a board member, this implied that he would have to vote for his own dismissal.<sup>596</sup>

The next key legal moment occurred at the end of the year (December 2000), when the State Duma passed the law "On Corporations," which stipulated that the board could change management with a simple majority.<sup>597</sup>

Finally, on May 30, 2001, the board met to decide whether to renew Vakhirev's employment contract, which was due to expire the following day. No materials concerning this question were sent out to the board members, who were only informed that the discussion would be led by Medvedev. According to Zygar et al., that morning, Vakhirev was invited to a meeting at the Kremlin with the president. Putin thanked Vakhirev and informed him that the company would be managed by a young person who had experience in business, was familiar with contemporary management methods, and had the confidence of the president. Putin also remarked that he expected from the new CEO "the fortification and expansion of the state's participation in Gazprom." Later in the day, three board members and Vakhirev allies<sup>598</sup> – V. Sheremet (first deputy CEO), A. Bekker (head of Stroitransgaz), and V. Tarasov (head of Gazprom Bank) – were also summoned to meet with the president, who informed them about his decision and asked if there were any questions. There were none.

Next, the president met with all the members of the board in the lobby of the Security Council in the Kremlin to express that he wanted the board to vote unanimously in favor of Vakhirev's replacement by Alexei Miller. For this to happen, board member and Minister of Property Relations Farit Gazizulin was urgently recalled from his vacation. The same afternoon, the board met and Medvedev introduced the new CEO. The board then voted unanimously to replace Vakhirev with the president's new appointment. According to a source that was present, "There was no discussion whatsoever." Finally, Medvedev relinquished his position as chairman of the board to Vakhirev, who would hold the position for the next year.<sup>599</sup>

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595 Ibid., 104-5.

596 Ibid., 105.

597 Ibid., 105, 106.

598 Mukhin, *Kremlin Verticals*, 53, 90; Torrey Clark, "Miller Cleans House, Taps St. Pete Natives," *The St. Petersburg Times*, September 4, 2001, 9, accessed on July 13, 2011, [www.sptimes.ru/archive/pdf/701.pdf](http://www.sptimes.ru/archive/pdf/701.pdf).

599 Panushkin et al., *Gazprom: The New Russian Weapon*, 107, 109.

Vakhirev, who understood that his position was in jeopardy, did not relinquish his control without a fight. According to one interview respondent, “Vakhirev was an old style Soviet manager. He thought he would stay at Gazprom forever and afterwards his children would take over.”<sup>600</sup> Commenting on his statements concerning retirement,<sup>601</sup> Panushkin et al. note that:

Vakhirev always wanted to stay at Gazprom and always fought for the company, which, it seems, he completely equated with himself.<sup>602</sup>

In January 2000, Vakhirev announced that he intended to break up the company, separating the production unit from the transportation and other units.

Gazprom chairman, Rem Vyakhirev, created a stir at the end of January when he told Siberian workers at Surgutgazprom that Gazprom would be divided into two separate divisions in 2000. “This year we will divide up into those that make money and those that help make money.” He went on to say that gas production would form one division, with transport and maintenance services to be hived off into separate companies which would then provide their services to Gazprom on a contractual basis.<sup>603</sup>

This was certainly an odd development given that he had spent the previous decade staving off attempts by liberals in government to do the very same thing. According to Panushkin, “[T]his would have allowed him to keep the most profitable part of Gazprom for himself while getting rid of the unprofitable units.”<sup>604</sup>

After its success during the 1999 Duma elections, the government began demanding increased tax payments from the company and introduced a new 5 percent export tariff on gas,<sup>605</sup> so it is possible that the break-up announcement was retaliation for this much tougher attitude towards the company. In response to his announcement, Gazprom shares plummeted by 7.7 percent.<sup>606</sup> Shortly after the announcement, government officials dismissed his proposal. Chairman of the state property fund Igor Shuvalov stated that the announcement was a tactic intended to create instability prior to the March elections. Later, Vakhirev retracted his proposal, saying that reorganization would not involve splitting the company up but only entail the divestment of non-core assets to cut costs of production.<sup>607</sup> Regardless of whether Vakhirev was trying to get a piece of the company, influence elections, retaliate, or kill several birds with one stone, he was very clearly defying the new administration both politically and in terms of policy.

At the June 29, 2000, meeting of the board, he proposed an amendment to Gazprom’s charter that would allow him to not only divest the holding of its daughter firms but also freely sell its shares. According to Panushkin et al.,

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600 Interview in Moscow, fall 2007.

601 Panushkin et al., *Gazprom: The New Russian Weapon*, 108. In late 1999, Vakhirev publicly suggested that he was tired and wanted to retire, and even proposed his friend and deputy V. Sheremet to succeed him.

602 Ibid.

603 “Gazprom chairman backtracks on company restructuring,” *European Gas Markets*, February 1, 2000.

604 Panushkin et al., *Gazprom: The New Russian Weapon*, 104.

605 Ibid., 78.

606 “Gazprom Shares Plummet,” *Daily Financial Service: Headlines*, January 29, 2000.

607 “Gazprom chairman backtracks on company restructuring.”

Vakhirev understood that his contract as CEO was expiring in a year and that to keep his position would not be easy. That is why through measures that rather lacked cunning, he intended to break off from Gazprom for himself a “small souvenir.”<sup>608</sup>

The amendment failed, and as we saw, Medvedev replaced Chernomyrdin as chairman.

Perhaps the most audacious maneuver came in August: Vakhirev announced that Gazprom was running out of gas and stated very pointedly that there would be a fuel crisis in Russia in the next few years:

Rem Vakhirev publicly declared that Gazprom’s gas was ending and as a result, it would be necessary to either raise domestic prices or cut back on exports. Otherwise, the corporation would stop providing gas for the needs of RAO UES [the now defunct electricity monopoly]. “We will make it through this winter. For there to be enough gas for heating in the future, we will have to strain ourselves. During the summer of 2001-2002 we will have serious problems. And a year after we won’t have anything to heat ourselves. However, this will not concern me anymore; I will be retired,” thought Vakhirev, out loud.<sup>609</sup>

Clearly, Vakhirev was threatening the leadership and audaciously sowing the seeds for mass panic.

At the same time, there is also evidence that Vakhirev was trying (unsuccessfully) to ingratiate himself with the new president. According to Panushkin,

As for Putin, Vakhirev was counting on buying him off through rather crude cajolery. For example at the opening ceremony for the Blue Stream pipeline, Vakhirev proclaimed: “Russia has a future, has hope, has goals. A dependable person is at the helm of the country – Vladimir Vladimirovich Putin.

In response, Putin repaid Vakhirev through public disdain. The head of Gazprom volunteered to be a trusted representative for Putin during the presidential election, but was not invited to meetings among Putin’s inner circle. Vakhirev would accompany the President during his trips across the country, but the president would pretend that he did not notice him, and would spend the whole trip interacting with Anatoly Chubais.<sup>610</sup>

In conclusion, as the new administration proceeded with its plans to rein in the company and remove the old management, Vakhirev was engaging in a strategic interaction –alternatively cudgeling and supporting the new president –to demonstrate the risks entailed in removing him and the benefits associated with maintaining the status quo. This is consistent with his previous behavior when his control of the company was threatened by government liberals. On those occasions, Vakhirev prevailed, and his support from the Duma and the media were critical. The following section examines the politics underlying Vakhirev’s ouster to understand why the new administration was successful whereas previous governments had failed.

### *Vakhirev’s ouster: the politics*

At first glance, the new government’s takeover of the company took roughly a year and a half and appears unremarkable. A new leader bringing in his own people or a new “team”

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608 Panushkin et al., *Gazprom: The New Russian Weapon*, 104.

609 Ibid., 105. See also “Gazprom CEO Forecasts Gas Crisis in 2001,” *ROSNEW*, August 8, 2000; “CEO of Gazprom Vakhirev Predicts Outbreak of Gas Crisis in 2001,” *Russian Oil & Gas Report*, August 9, 2000.

108 Panushkin et al., *Gazprom: The New Russian Weapon*, 103-4.



(*kommanda*) is the norm in almost all politics, Russian included. However, this did not mean that changing the management of the state-owned monopoly would be easy. In fact, the politics of the operation were considerable.

As the battle with the government from 1997 to 1999 showed, the key difficulty in establishing control over Gazprom was to get rid of CEO and board member Rem Vakhirev. We saw that previous governments' attempts to rein in Vakhirev failed due to opposition from the Duma and Vakhirev's influence in the media. After the failed Nemtsov attempt in 1997 and 1998, Vakhirev continued to disregard the government and do as he pleased.

During the June 30, 1999, board meeting at Gazprom, Vakhirev ignored then Prime Minister Stepashin and head of the presidential administration Voloshin's personally delivered request to elect five rather than four state representatives to the board.<sup>611</sup> This very open defiance left Voloshin infuriated, and it was reported that he wanted to fire Vakhirev. He refrained from doing so because he feared the scandal this would cause in the media.<sup>612</sup>

Under Putin, Vakhirev did not hesitate to deploy the power available to him to protect his control over the company. Moreover, despite his flattery of Putin himself, Vakhirev continued to snub other officials. For example, he would easily skip meetings at the White House with Deputy Prime Minister Khristenko, claiming that he had overslept and that it was too late.<sup>613</sup>

The challenge for the new leadership was Vakhirev's power as the head of Russia's largest company and his formidable political influence through his ties with politicians and the media. In a study of Russia's oil and gas sector that focuses on the relations between firms and the state, A.A. Mukhin commented that "[T]he "unsinkable" Rem Ivanovich Vakhirev is one the most influential oligarchs from the time of Boris Yeltsin."<sup>614</sup> Ultimately, Putin's takeover strategy would have to address both of these sources of Vakhirev's power to be successful.

### *The media*

Operation "Vakhirev" needs to be understood in the more general context of Putin's attempts to create autonomy for the state by limiting the influence of all the oligarchs. The effort to remove Vakhirev coincided temporally with the effort to rein in the media magnate Vladimir Gusinsky. Gusinsky had already demonstrated his formidable capacity to influence politics during the 1997 book scandal that led to the removal of several high-level government officials and seriously undermined the liberal faction of the government under Deputy Prime Minister Nemtsov.

Additionally, Gusinsky drew the ire of the new president through critical reporting on the second Chechen war by his company NTV. Criticism by the media had contributed to the lack of public support during the first Chechen war and played an important role in shaping the outcome of that conflict: Russia proposed a cease-fire several months prior to the first round of the 1996 presidential election. After Yeltsin was re-elected, there were attempts to resume the operation, but these never materialized. As a result, Alexander Lebed and Aslan Maskhadov

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611 Ibid., 74-5. They argued that the state should have 5 representatives since its 37.4 % share amounted to 4.7 members.

612 Ibid., 106.

613 Ibid., 103.

614 Mukhin, *Kremlin Verticals*, 34.

signed the Khasayvyurt Accords on August 31, 1996, temporarily bringing an end to the fighting but not resolving the political question of Chechnya's status.<sup>615</sup>

During the second war, the Russian media was generally more patriotic; however, NTV was an exception, and this did not go unnoticed by the president. The former head of NTV, Evgeniy Kiselev, has attributed the state's crackdown on his operation to the critical contents of NTV's reporting,<sup>616</sup> which threatened to undermine both the military campaign and Putin's early popularity (which was to a large degree based on the success of the Chechen campaign). We cannot exclude the possibility that NTV's criticism of the president and his family also played a role. In any case, Gusinsky, like Vakhirev, became an early target of Putin's campaign to sideline the oligarchs.

In fact, Vakhirev and Gusinsky were allies with significant business ties. Their relationship began when the oligarchs joined forces to support Yeltsin's re-election campaign. Shortly after Yeltsin's 1996 triumph, Gazprom bought a 30 percent stake in Gusinsky's company Media-Most, which was the parent of NTV. According to Kiselev, the purchase was in many respects an expression of gratitude for NTV's support of the president.<sup>617</sup> Chernomyrdin also played a significant role in advancing the deal.<sup>618</sup> In subsequent years, Media-Most took out loans with Credit Suisse First Boston and Sberbank to expand its business. The loans were guaranteed by Gazprom. The debt to Gazprom then became the formal pretext for the takeover of NTV.

When the state began to act against Gusinsky, he fought back. During an interview with *Le Monde* on March 2, 2000, he stated that NTV was being closed down because of its criticism of Putin. According to Kiselev,

Gusinsky wanted to demonstrate to everyone that the problem was not that he was not managing his business effectively, but rather because he was the owner of a mass media outlet that worked in the critical realist genre. In other words, attacking effectively became a source of defense.<sup>619</sup>

Kiselev's language very much indicates that Gusinsky, like Vakhirev, was engaging in a strategic interaction with the state. His particular weapon was mobilizing international public opinion against the still-interim president.

The conflict escalated shortly after Putin's inauguration when the state prosecutor (*prokurator*) announced an investigation relative to violations in the privatization of the company

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615 Jacob W. Kipp, "Putin and Russia's Wars in Chechnya," in *Putin's Russia*, ed. Dale R. Herspring (Lanham, MD: Rowman and Littlefield, 2005), 215, 217-8. According to Ulrich, "[the] Russian news media... had prided itself on turning public opinion against the first Chechen war with its objective and gutsy reporting—often contradicting official reports." Marybeth P. Ulrich, "Russia's Failed Democratic National Security State and the Wars in Chechnya," in *The Russian Armed Forces at the Dawn of the Millennium*, ed. Michael H. Krutcher, accessed on July 14, 2011, <http://www.dtic.mil/cgi-bin/GetTRDoc?Location=U2&doc=GetTRDoc.pdf&AD=ADA423593>. Petrova also found a robust statistical relationship between independent media and negative public opinion during the second Chechen war. Maria Petrova, "A Formal Theory of Public Opinion in Conflicts," unpublished paper, October 28, 2008, accessed on July 14, 2011, <http://www.cepr.org/meets/wkcn/2/2385/papers/petrova.pdf>. See also Peter Graff, "Once dovish Russia media now Chechnya hawks," *Reuters News Service*, October 20, 1999.

616 Panushkin et al., *Gazprom: The New Russian Weapon*, 85.

617 Ibid., 87.

618 Ibid., 86.

619 Ibid., 88.

Russian Video, which was also owned by Gusinsky. In connection with this case, several Media-Most offices were raided by state officials. NTV and Gusinsky's other media outlets retaliated by sharply escalating their criticism of Putin. During the June 11, 2000, show *Itogi*, Kisilev ruminated: "What will happen to us tomorrow? Where is the country going? The feeling is that we are heading to August 1991." During a later interview, Leonid Parfenov, who worked at NTV at the time, recounted that:

At that time, we all thought that this was yet another media war of which there were many previously. No one thought that this media war would mean an exit for the loser. We imagined that Gusinsky and Berezovsky would continue exactly the same as before: after losing one now, you can make up for it on something else. Everyone was convinced of this until Gusinsky's arrest.<sup>620</sup>

This type of interaction between the oligarchs and the state (and each other) was a familiar pattern under Yeltsin, and at that early juncture the most intransigent oligarchs still were not convinced that this practice (defying state authority) was no longer legitimate, might backfire, and could spell the end of their power and wealth in Russia.

The state's attack on Gusinsky was twofold. First, legal measures were deployed against the magnate directly. These were the pretexts for raiding his companies and ultimately for his arrest in June 2000. Second, the state intended to muzzle Gusinsky's media empire by using Gazprom to leverage its financial relationship to the company. Kremlin and Gazprom legend has it that Gazprom's financial relations with Gusinsky were the subject of one of Putin's first discussions with Vakhirev. According to Panushkin,

When will this end? Are you unable to keep NTV within bounds? Putin asked Vakhirev.

The head of Gazprom started saying something about freedom of speech. The look on the interim President's face became heavy.

You have a blocking share and you can't do anything? Look here, if you [*ti*] don't put him in his place, I'll tear you apart.

Rem Vakhirev, the omnipotent master of the most important company in Russia, probably had never heard such words. He was so shocked that he didn't answer. No less shocked were the many witnesses to the conversation, even though by then he had become famous for his "cap them in the toilet."<sup>621</sup> [Putin's now legendary statement from September 24, 1999, on dealing with Chechen terrorists]

Since the formal vehicle for reining in NTV was Gazprom, Vakhirev was in a pivotal position with respect to the attack on Gusinsky. That Vakhirev did not move fast enough may also have contributed to the president's displeasure with the CEO. In this sense, Gazprom's connection to Media Most was a double-edged sword for both of the oligarchs. Initially, Gazprom was a source of immense wealth for Gusinsky, but by 2000 it had become the vehicle for his downfall. Furthermore, because the debts were real, it added a veneer of legitimacy to the whole operation. For Vakhirev, access to mass media was also a significant source of power. In the end, however, it added to his difficulties with the new administration by putting him in the cross-hairs aimed at Gusinsky.

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620 Ibid., 89.

621 Ibid., 84-85.

According to Vakhirev's account to Panushkin, the CEO was already engaged in negotiations with Gusinsky about NTV on behalf of the state. However, these became serious only after the June arrest, when Gusinsky became inclined to make a deal relinquishing his media assets and when Vakhirev realized that he needed to demonstrate his effectiveness in achieving Putin's goals.<sup>622</sup> In the end, Gusinsky was released from jail to negotiate a deal, which was reached on June 20, 2000. The terms were that the Gazprom daughter company, Gazprom Media, would pay off all of Gusinsky's debts and pay him \$300 million in exchange for all of Media Most. According to Panushkin, relinquishing control over NTV was directly linked to his freedom. Afterwards, his ability to travel was reinstated, and he left the country. Ironically, the head of Media Most who negotiated the details with Gusinsky was Alfred Kokh, who was forced to resign due to the book scandal created by Gusinsky's media.

The defeat and exile of Gusinsky did not prevent Vakhirev from continuing to make incendiary public statements (for example, his August 2000 gas crisis outburst). However, with NTV now out of his ally's hands (and in the hands of his enemy, Kokh), Vakhirev's ability to mobilize public opinion through the media was greatly reduced.

But why was Putin successful in this strategy? Part of the explanation is that Putin's actions were broadly legitimate in society, especially among elites. A related factor has to do with the acquiescence of the Duma. The next two sections develop these arguments.

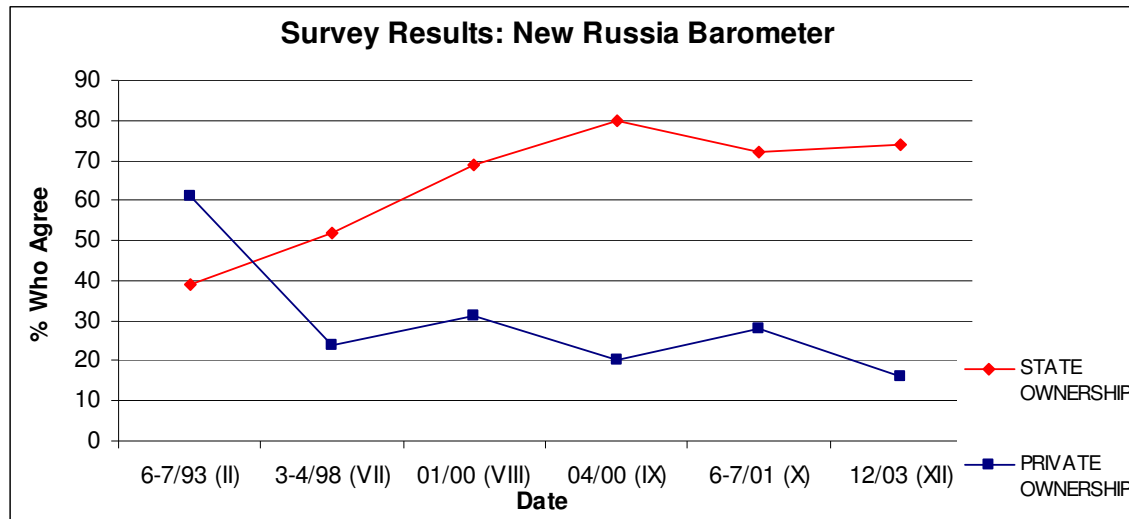
### **Social attitudes toward the state's role in the economy**

By the time Vladimir Putin came to power, Russia was ripe for a correction to the government's approach to the role of the state in economic activity. This is supported by a variety of different data. To begin with, public opinion data suggest that support for a greater state role in the economy had generally increased over time since the beginning of market reforms under Yeltsin.

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622 Ibid., 89-90.

**Figure 6-1 : Public opinion on state vs. private ownership**<sup>623</sup>



Survey respondents were asked “Which are you more inclined to agree with, and how much? State ownership is the best way to run an enterprise, OR An enterprise is best run by private entrepreneurs.” Possible answers were: “definitely prefer state, probably prefer state, definitely prefer private, probably prefer private, don’t know.” This chart compares summed totals for state ownership vs. private ownership.

As we can see in Figure 6-1 immediately prior to the October 1993 showdown between Yeltsin and the Supreme Soviet, a large majority (61 percent vs. 39 percent) of respondents thought private ownership of enterprise was better than state ownership. By the first quarter of 1998, the numbers had roughly reversed (24 percent vs. 52 percent), and by April 2000, support for state ownership of enterprise reached 80 percent.<sup>624</sup> The late turn of the century saw a dramatic change in how the general population saw the role of the state in the economy as measured by preferences related to ownership.

This statistical finding is corroborated by the discourse analytic work of Ted Hopf in the study “Social Construction of International Politics.” To reconstruct domestic identities based on inductively recovered social discourses, Hopf sampled a wide swathe of public texts (Russian daily press, textbooks, and popular novels). These data allow us to make some inferences about beliefs and attitudes toward the state’s role in the economy.<sup>625</sup>

623 Richard Rose, *New Russia Barometer II, VII, VIII, IX, X, XII* (Glasgow : Centre for the Study of Public Policy, University of Strathclyde).

624 Russia Barometer also reported in 1998 that 24% of respondents chose “don’t know.” No value was given for “don’t know” in 1993, 2000, and 2001. It is not clear whether this option was given to respondents during those years.

625 Ted Hopf, *Social Construction of International Politics: Identities and Foreign Policies, Moscow, 1955 and 1999* (Ithaca, NY: Cornell University Press, 2002), 23-37. This exercise allowed him to identify four broad discourses in 1999: 1) New Western Russian, 2) New Soviet Russian, 3) Liberal Essentialist, and 4) Liberal Relativist (157). These categories allow Hopf to examine a much greater variety of questions than are relevant to this discussion. Here, I focus on what inferences can be gleaned from his data relative to the state’s role in the economy.

Broadly speaking, Hopf estimated that, “The currency crisis seemed to have put the last nail in the coffin of liberal market reforms.”<sup>626</sup> Closer examination of the data suggested that there was also universal contempt toward “the real Russian market as it operated in Moscow in 1999.” At the same time, there were also differences concerning “what to do about the markets’ perversions.”<sup>627</sup> Only one of the discourses he found can be construed to have supported the continued marginalization of the state from economic activity at the time. He noted that, “The [New Western Russian] generally understood the market in the West as the ideal aim of Russia....[The liberal market] was accepted by those who looked to the West.”<sup>628</sup> We can also infer that the other three discourses suggested a preference for a greater state role in the economy:

Those who valued the Soviet past [the New Soviet Russian] generally favored a hybrid state market, as did the [Liberal Essentialist], which saw no contradiction in combining elements of the unfettered market with state protection, as was done, in its view, in east Asia and Scandinavia.<sup>629</sup>

[Liberal Relativists] agree[d] with the [New Soviet Russian] in its negative attitude toward western markets.<sup>630</sup>

According to Balzer, by the late 1990s even many liberals felt that the early 1990s saw too strong a turn in favor of markets: “Even the liberals reject the excessive reliance on market forces believed to have characterized the early Yel’tsin years.”<sup>631</sup> All of these data suggest that by the time Putin came to power in 1999, a significant proportion of the population felt a greater state role in the economy was warranted.

### **Elite attitudes toward state participation in energy: a more prominent role**

Ultimately we are interested in whether a greater state economic role in energy was legitimate for elites. Moreover, the specific question that concerns us is the extent to which the causal belief that state economic action in energy was effective was prevalent among elites by the time Putin came to power. The best measure available for the latter is data from a large-n survey study of Russian elites in 1998 and 2000 by Anton Steen, found in Figure 6-2 and Figure 6-3.

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626 Ibid., 154.

627 Ibid., 178.

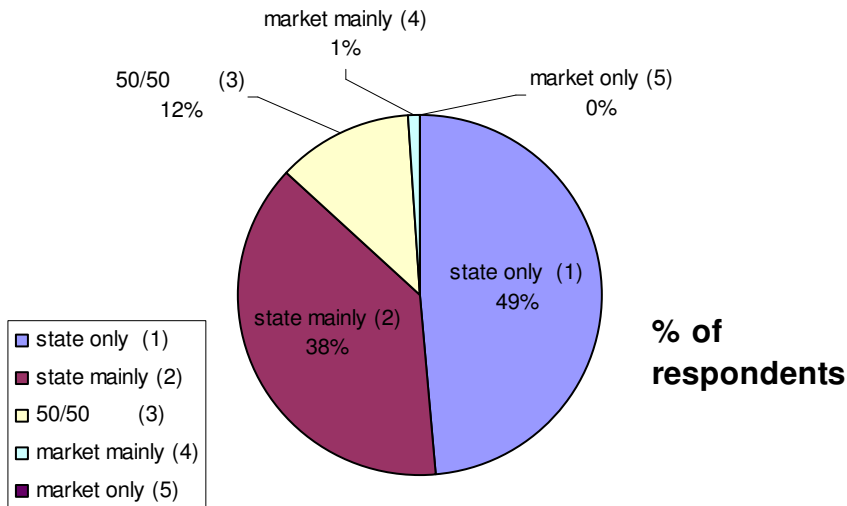
628 Ibid., 178, 180.

629 Ibid., 178.

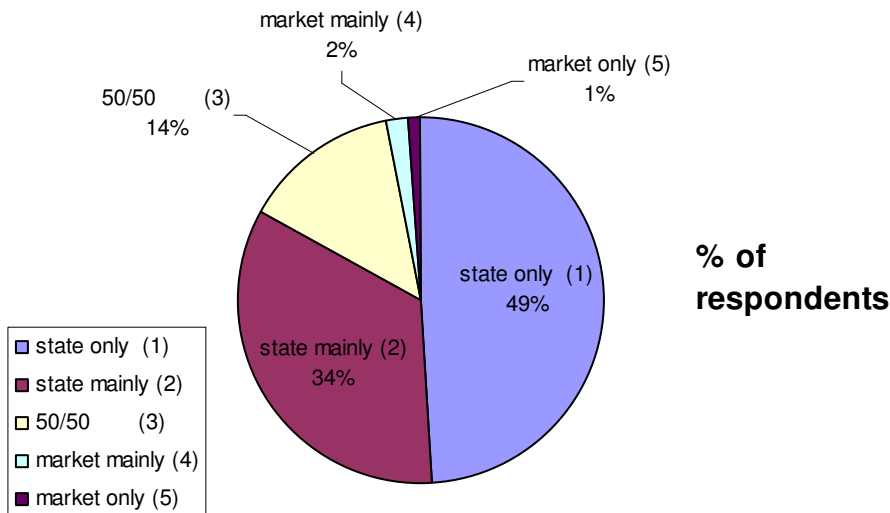
630 Ibid., 156.

631 Balzer, “The Putin Thesis,” 215.

**Figure 6-2 : Elite attitudes toward the role of the state vs. market in solving problems in the energy sector (1998)**



**Figure 6-3 : Elite attitudes toward the role of the state vs. market in solving problems in the energy sector (2000)**



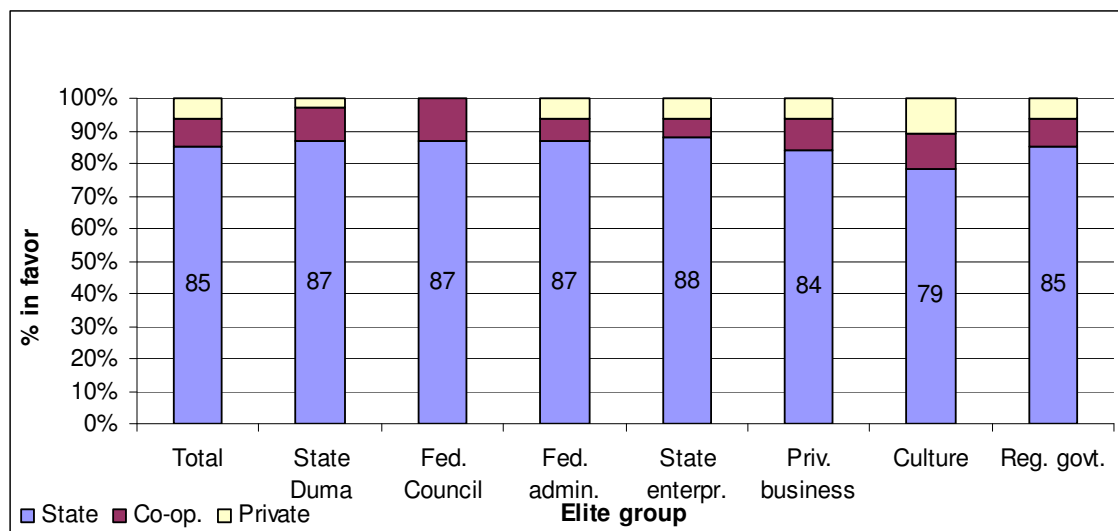
In both surveys, respondents were asked about what should be the role of the state and the market in solving the problems in the energy sector.

Steen’s findings suggest that by the time Putin came to power there was an overwhelming consensus among Russian elites that the state should play a leading role in the energy sector. Moreover, since the survey question asks about solving problems, it is implicitly accessing respondents’ causal beliefs about state action. In 1998, 86 percent of elites felt that the state

should be the only or main actor in solving problems within the energy sector. Just as overwhelming was the lack of support – at an astonishing 1 percent – for organizing the sector either entirely or mainly around the market to accomplish the same end. This level of support was stable going into 2000 with the corresponding figures largely unchanged (83 percent and 3 percent). A small minority also saw a shared role for the state and the market during both years the survey was conducted (12 percent and 14 percent). According to Steen, “In Russia, the elite is very positively disposed towards major state control in the energy sector.”<sup>632</sup>

Steen also surveyed elite attitudes about form of ownership in different sectors. Although he did not ask about energy specifically, his findings for heavy industry, found in Figure 6-4<sup>633</sup> and Figure 6-5,<sup>634</sup> are illuminating.

**Figure 6-4 : Elite attitudes toward form of ownership in heavy industry (1998)**



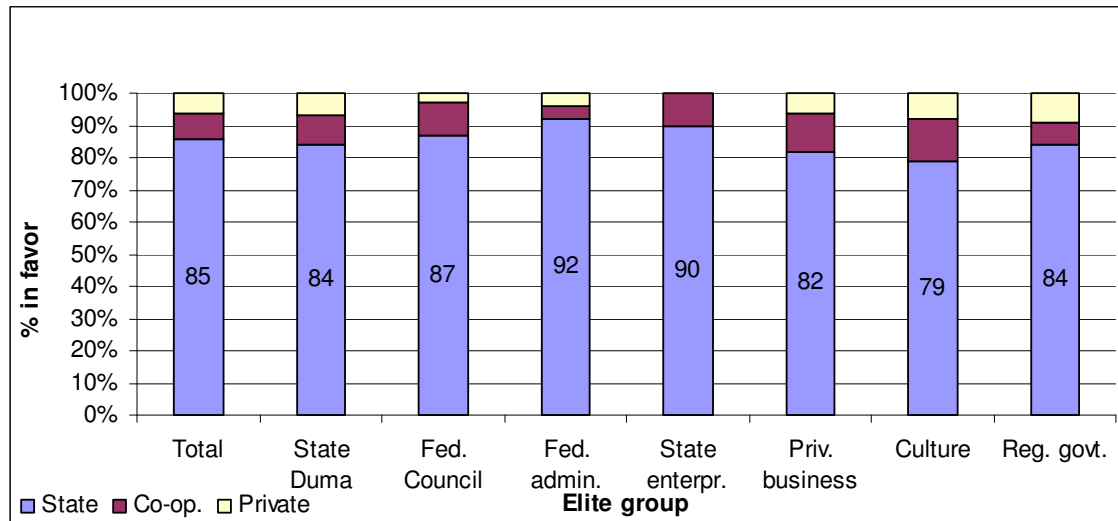
632 Ibid., 81.

633 Ibid., 78; 1998: n=980, response rate 95-98%.

634 Ibid.; 2000: n=605, response rate 98-99%.



**Figure 6-5 : Elite attitudes toward form of ownership in heavy industry (2000)**



In both surveys, respondents were asked to choose between three alternatives and asked which they thought was most suitable for heavy industry.

These data suggest that there was a strong preference for state ownership in heavy industry among Russian elites that was stable across 1998 and 2000. Moreover the consensus was broad; especially surprising is that the preferences of private business elites did not differ very much from the preferences of elites in the sample as a whole.

Also interesting is that respondents' attitudes about ownership varied significantly by sector. Heavy industry was the only part of the economy that elicited strong elite support for state ownership. By contrast, a large majority of respondents felt that private ownership was better in the retail sector, and a majority preferred private ownership in housing. Finally, cooperatives were preferred by a majority of respondents for agriculture and a plurality of respondents for light industry. This data can be found in

Table 6-1.<sup>635</sup>

635 Ibid., 78; 1998: n=980, response rate 95-98%; 2000: n=605, response rate 98-99%.

**Table 6-1 : Elite attitudes toward form of ownership in various sectors (1998 and 2000)**

	1998			1998			1998			1998			1998		
	State	Co-op.	Private	State	Co-op.	Private	State	Co-op.	Private	State	Co-op.	Private	State	Co-op.	Private
<b>Total</b>	<b>85</b>	<b>9</b>	<b>6</b>	<b>15</b>	<b>48</b>	<b>36</b>	<b>9</b>	<b>55</b>	<b>35</b>	<b>16</b>	<b>30</b>	<b>53</b>	<b>3</b>	<b>15</b>	<b>82</b>
State Duma	87	10	3	22	52	26	10	68	22	17	29	54	4	20	76
Fed. Council	87	13	0	10	59	31	3	73	23	7	23	70	0	7	93
Fed. admin.	87	7	6	16	49	35	12	54	34	20	36	44	3	29	68
State enterpr.	88	6	6	12	50	38	8	54	38	21	36	43	2	14	84
Priv. business	84	10	6	10	54	36	2	40	58	12	36	52	2	8	90
Culture	79	11	11	6	47	47	4	57	38	4	49	47	0	19	81
Reg. govt.	85	9	6	16	47	38	10	54	36	17	27	56	3	13	84

	2000			2000			2000			2000			2000		
	State	Co-op.	Private	State	Co-op.	Private	State	Co-op.	Private	State	Co-op.	Private	State	Co-op.	Private
<b>Total</b>	<b>85</b>	<b>8</b>	<b>6</b>	<b>15</b>	<b>44</b>	<b>41</b>	<b>11</b>	<b>51</b>	<b>38</b>	<b>17</b>	<b>27</b>	<b>55</b>	<b>2</b>	<b>12</b>	<b>86</b>
State Duma	84	9	7	10	61	29	9	59	32	16	27	57	0	17	83
Fed. Council	87	10	3	10	60	30	0	67	33	3	33	63	0	20	80
Fed. admin.	92	4	4	18	36	45	18	41	25	23	52	3	15	82	
State enterpr.	90	10	0	16	48	36	16	52	32	14	44	42	0	10	90
Priv. business	82	12	6	6	44	50	4	50	46	10	30	60	2	2	96
Culture	79	13	8	8	48	44	2	34	64	16	46	38	0	8	92
Reg. govt.	84	7	9	19	37	44	13	54	34	19	19	62	3	11	86

In both surveys, respondents were asked to choose between three alternatives and asked which they thought was most suitable for various industries.

So, elite attitudes toward ownership can hardly be described as ideological. In fact, overall preferences varied significantly depending on which sector of the economy was in question.

Putin's decision to embrace a greater role for the state in the energy sector upon coming to power was hardly surprising given what we know about Russian social preferences and particularly elite preferences at the time. The fact that his ideology reflected the aspirations of society also meant that state building in that direction would happen in a relatively more permissive context. Ultimately, however, a key factor was the Duma's acquiescence, which I explore in the next section.

### The Duma's acquiescence in Vakhirev's ouster

As we saw earlier, a key reason Vakhirev prevailed over the government in 1998 and retained his position at the gas monopoly was the uproar made in the Duma in his defense. Why was the Duma so complacent when the new administration removed him in 2001?

One possible reason was that the ideological composition of the State Duma had changed in a more liberal direction after the December 1999 election. The third Duma saw the party of power (the party loyal to the Kremlin), the non-communist, non-nationalist Unity (*Edinstvo*), do quite well, coming in second (with 73 seats) after the communists (with 113 seats). In fact, the KPRF (Communist Party of the Russian Federation) lost almost a third of the seats (44) that it held in the previous Duma.<sup>636</sup> However, there are three difficulties with this explanation.

First, the operation against Vakhirev began before the new Duma came into session. This means the same Duma that on the eve of the 1998 default threatened to shut down all legislative activity in the lower chamber if the government did not abandon its attack on Gazprom (even though a budget needed to be passed urgently to receive aid from the IMF) did

636 Results from the elections to the 3rd Duma, December 19, 1999 (data from Central Electoral Commission protocol on the outcome of the elections, signed December 29, 1999 with amendments from April 7, 2000), accessed December 6, 2011, at: <http://www.politika.su/fs/gd3rezv.html>.

not mobilize when a fifth state representative was added to the board in August 1999 against Vakhirev's wishes.

Second, despite its improved showing in the elections, the party of power still did not have a majority in the lower chamber. If we assume that Unity and the other liberal parties (Yabloko and Union of Right Forces) would have supported the president's aim to get rid of Vakhirev, that still constituted only 27 percent of the chamber. At the same time, a conservative estimate of the parties that would likely have opposed the initiative — KPRF, Fatherland All Russia (Primakov and Luzhkov), LDPR (Zhirinovskiy's bloc), Our Home Russia (Chernomyrdin's party) — represented 45 percent of the votes. Thus, the coalition against Vakhirev would have needed almost universal support from the remaining parties and deputies to form a majority. Very significantly, about 24 percent of the deputies were independents elected in single-mandate districts. Given these estimates, it would have been possible to form a coalition in favor of breaking up Gazprom, but it would have been difficult.

If the only factor that changed between 1998 and 2000 was an ideological shift in the Duma to a more liberal direction, a Unity coalition with liberals would not have had nearly enough votes, despite its favorable showing in the elections, to overcome the expected opposition to a "liberal" assault against Vakhirev.

Finally, to say that the Duma moved in a more liberal direction is slightly misleading. On the one hand, it is clear that the communists suffered a devastating loss in the 1999 parliamentary elections, and the main beneficiary was Unity. But Unity was elected on then prime minister (and presumptive president) Putin's platform, which, though more liberal than the communists and nationalists, still had an important statist message. At a minimum, in 1999 Putin and Unity were associated with the very popular second Chechen War.

Putin's initiative to replace Vakhirev did not encounter Duma opposition because Putin was not Yeltsin. Young and relatively unknown, the new president, despite his anointing by the outgoing president, did not have the same baggage as Yeltsin. As a result, he was able to bring many non-liberals into his governing coalition. He was able to do this because non-liberals did not see an attack on the state in his agenda, and this made them more likely to support him. Moreover his early policies were not hostile to the state and did not polarize the elite in the same way that Yeltsin's early policies had.

When Putin emerged as Yeltsin's successor, he was a relatively unknown figure in Russian politics. Moreover, his background suggested a mixed ideology, which meant that he could appeal to different constituencies. For liberals, his service and loyalty to former St. Petersburg Mayor Anatoly Sobchak, one of the liberal heroes during August 1991, was a good omen. Moreover, his nomination by Yeltsin and support from the leading oligarchs was a reassuring sign that he was not a communist or radical nationalist. Early on, many Westerners estimated that with Putin, Russia would continue to move on the liberal track promised by Yeltsin. When Putin went after Vakhirev, the West cheered because Vakhirev was seen as an impediment to reforming Gazprom. In fact, Vakhirev's departure precipitated a 5 percent rise in Gazprom shares and substantial growth in the price quotes for ADRs (American depository receipts).<sup>637</sup> In hindsight, we know that Putin's liberal intentions were overestimated.

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637 "Dismissal of Vyakhirev Spurs Gazprom Shares," *Russian Oil & Gas Report*, June 1, 2001.

By contrast, for statist, nationalists, and communists, his service in the KGB was a reassuring credential that suggested he was not a radical liberal. This was reinforced by the strong and very illiberal image he projected during the early phases of the second Chechen war, as well as by his early comments and policies in support of increasing state power, and national pride. As Sil and Chen have argued more generally about Putin's first term,

[I]t is Putin's approach to state rebuilding, and the renewed expectations associated with this approach, that explain why his popularity has been sustained even in the face of...catastrophes....

In contrast to the image Putin projects to the West as a serious partner in the promotion of a free market economy and the building of global democracy, at home his statements and actions suggest that a strong, unified and respected Russian state (that is, a state consistent with the ideal of *gosudarstvennost'*) has priority over the expansion of democratic contestation and local forms of civil society. This is evident in the case of a number of moves made by Putin to consolidate state power, moves that are recognised by the public as largely authoritarian in character and yet have been accepted and even welcomed, presumably on the hunch that a "firm hand" will lead to greater public order and economic security....

Putin's rhetoric is consistent with the public mood, with 48.3% (by far the highest percentage) declaring that the most important "unifying and mobilising idea" in Russia is the "revival of Russia as a mighty global power," compared with only 10.2% naming the "idea of individual freedom, priority of interests of the individual over interests of the state."...

[T]he favourable reaction to Putin's public pronouncements — in spite of public awareness that he has curtailed certain democratic freedoms and employed heavy-handed administrative methods to get his way — suggests a genuine receptiveness to an official discourse trumpeting a strong centralized state capable of bringing back public order, economic security and social justice, all linked to a stronger sense of national pride.<sup>638</sup>

This at least partly explains Unity's better showing and the decline of the communists during the 1999 Duma elections, as Putin coopted many of their positions. As Sil and Chen have noted,

[T]here is a great deal of overlap in the positions Putin has espoused and the positions that previously contributed to the appeal of the communists (KPRF) as the most serious challenger to El'tsin's rule.<sup>639</sup>

When the liberal government went after Vakhirev in 1997 and 1998, the CEO's claims that the assault aimed to dismember Gazprom, sell out to the IMF and international capitalists, and keep Russia on its knees found a receptive audience among nationalists, statist, and communists. They supported Vakhirev not so much because they wanted to see him continue at Gazprom – it was widely understood that Vakhirev dipped generously into Gazprom coffers, cheated the state of revenues, and generally ran his own show – but because he was very clearly not neo-liberal. He stole, but at least he kept Gazprom "strong" by keeping it intact. As a result, for the opposition he was seen as an effective and perhaps the only remaining bulwark to protect Russia's largest company from neo-liberal reforms they felt were illegitimate and deleterious to the state.

In other words, they supported Vakhirev not because they necessarily approved of the way he ran the company, but because he was less alien and odious than the neo-liberals Nemtsov

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638 Rudra Sil and Cheng Chen, "State Legitimacy and the (In)significance of Democracy in Post-Communist Russia," *Europe-Asia Studies* 56, 3 (May 2004): 359-61.

639 *Ibid.*, 362.

and Kirienko. Yes, he was a crooked oligarch, but at least Vakhirev was not one of “the little boys in pink shorts” (*Мальчики в розовых штанишках*), as Yeltsin’s first vice president Alexander Rutskoi infamously derided the architect of neo-liberal reforms, Yegor Gaidar. Vakhirev was the lesser of two evils.

### **Putin, ideas about the state, and coalitional choices**

Vakhirev’s appeal was also supported by the polarization characteristic of Yeltsin’s presidency. The liberal versus communist/nationalist cleavage was not unique to the battle over Gazprom but was a characteristic of Russian political life during the 1990s. Shortly after the August coup, a very strong majority in the Supreme Soviet supported the president and his intention to take “decisive measures” (liberalize prices and create private property). However, a year later, support for the president’s economic course dissipated within the same body as Yeltsin clashed with the legislature over Gaidar and his neo-liberal approach.

As I mentioned earlier, the polarization during the 1990s was very much a product of the president’s determination to pursue a particular economic policy that was illegitimate for large portions of the elite. The role this policy entailed for the state in the domestic economic sphere was a central factor that led to this polarization. During the October 1993 bombing of the Supreme Soviet, the conflict pivoted on the same axis. Finally, the 1996 election reinforced this cleavage as Yeltsin’s campaign strongly emphasized the same ideological divide. Domestic identities hardened, and politics was a never-ending series of confrontations leading to crisis. Ultimately, the polarized and crisis-ridden character of Russian politics during the 1990s was a product of Yeltsin’s choices. His determination to pursue a neo-liberal line was a central factor, and the polarization that resulted hampered his ability to govern. In this context, it is not surprising that Vakhirev could mobilize the support of nationalists and communists. His non-liberal credentials made him a natural ally in this all-out war, and this overshadowed the fact that he was a corrupt oligarch.

From historical perspective, we have to ask why Yeltsin chose this course. One possible explanation is related to the size of his coalition. Bueno de Mesquita and Smith have argued that: “As coalition size increases, incumbents rely more on public goods to reward supporters.... Small-coalition leaders rely more on private goods to retain office.”<sup>640</sup> From this perspective, neo-liberal reforms were a vehicle for compensating a small elite coalition of aspiring capitalists. These included the “liberal” oligarchs who did not manage enterprises in the Soviet Union but could leverage their favorable positioning vis-à-vis the state to accumulate wealth and eventually acquire property (for example, Khodorkovsky); the “red directors” who wanted to transform their management positions into ownership or at least autonomy from the state (such as Vakhirev); the regional leaders for whom collapse of central state power created local political autonomy and economic chaos (barter and non-payment) created rent extraction opportunities and political power.

By contrast, Putin created a broader coalition, which added groups that had been excluded under Yeltsin: the bureaucracy as a class, statist, moderate nationalists and leftists, and

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640 Bruce Bueno de Mesquita and Alastair Smith, “A Political Economy of Aid,” *International Organization* 63 (2009): 309-340.

the underprivileged (the poor and the elderly). The model proposed by Bueno de Mesquita and Smith is powerful in its ability to predict a great deal of the politics in Russia during the last two decades (with only one variable). However, to extend our understanding further, we need to ask why these leaders chose these coalitions. As the most powerful and legitimate figure in Russia during the late 1991 revolutionary moment, Yeltsin had many possible choices, yet he picked practically the narrowest coalition possible. As argued previously, this was related to his thinking about the state. In particular, his causal understanding of the state's role in the economy – which was part of a broader vision of building capitalism presented to him by the neo-liberal advisers he chose – narrowed the range of partners that were available to him in governing and pointed him toward the small group of elites who would benefit from the private goods that his policy allocated and therefore support his power.

Was this about making virtue of necessity? There are two senses in which this may have been true. First, it may refer to the fact that the reforms he chose were the only or best possible way. Yeltsin and his advisers certainly thought so, and many Westerners continue to think so today. However, we know that there were many other proposals for economic reform available, most of which would have enjoyed far greater support and generated a larger coalition.

Second, necessity may refer to the fact that the only approach that would have been supported financially by the West was a neo-liberal one. There are a number of problems with this explanation as well. It is clear that receiving financial aid from the West was important to Yeltsin. However, it was also important to Gorbachev, who, as discussed in chapter 3, did not implement Western economic advice wholesale, partly because he was trying desperately to keep together a governing coalition for whom this was not legitimate. In addition, international bargaining under Gorbachev revealed that different states had different views about aid to the USSR, and this could have been leveraged to make deals more suitable to Moscow.

An additional problem has to do with Yeltsin's continued commitment to the economic course he chose. As the decade progressed, two things became clear. First, the West was not planning to give Russia levels of aid on the order that Yeltsin thought he deserved and that would have been necessary to make a significant difference. Second, it was also clear that Russia could get away with breaking the rules and still receive aid. The political importance of supporting Yeltsin meant that Western leaders would overlook the fact that Russia was not quite keeping its end of the bargain. When push came to shove, Bill Clinton picked up the phone to tell the IMF and World Bank to extend credit even if all the conditionality had not been met. Under these circumstances, we might have expected a change, and yet Yeltsin stayed the course.

The 1996 election is telling in this respect. At the beginning of the year, Yeltsin's popularity was abysmally low, and the state had no money to pay civil servants and pensions. To raise money, Yeltsin consented to the loans for shares scheme in which the state borrowed money from the oligarchs (money they got through their ties with the state), putting up some of Russia's most valuable companies as collateral. Later, the state defaulted on the loan (this was a foregone conclusion), and the assets were given away in closed auctions at outrageously undervalued prices.

Under such circumstances, Yeltsin might have unleashed a small purge. There was no shortage of state officials who would have relished hauling in some obnoxiously flamboyant financial tycoons and confiscating their wealth and property. This would have allowed the

president to score political points with the population, steal the opposition's thunder, and it might have been a prelude to better tax collection.

In fact, around the time of the Treaty of Social Accord (April 1994), which was supposed to restore his legitimacy after the October 1993 crisis, there was an episode when Yeltsin ordered the arrest and harassment of a few of the newly rich in his circle. According to Tsygankov, Yeltsin's bodyguard and former KGB general Alexander Korzhakov organized a raid on several oligarchs who were dragged out into the cold and thrown face down in the snow with guns to their heads.<sup>641</sup> The point was to send a signal. Yeltsin would also convene the oligarchs and bang his fist on the table for them to be more cooperative. But when they called his bluff, there was no stick to punish them. The 1996 election demonstrates that, rather than change course, Yeltsin intensified his policy of privatizing and creating a wealthy oligarchy.

Similarly, in 1998 he might have sacked Vakhirev at Gazprom and put in someone more trustworthy but also acceptable to the opposition (not a neo-liberal). He did not because Vakhirev was his ally who supported his re-election and was prepared to use Gazprom's resources to achieve the president's narrow aims.

Putin's approach to coalition building was different. As an example, in 2000 Unity created a majority coalition with the communists, and the communist G. Seleznev became speaker of the Duma. This was partially the result of Putin's interest in consensus, but the reason he was able to create consensus was because he shared with a large segment of Russian society and the elites a commitment to an important value: the central importance of the state in Russian life. Against this backdrop, his understanding of economic policy was different. Moreover, he was willing to take extreme (and non-liberal) measures – send an oligarch to Siberia, confiscate an oil company, or crack down on the media – to promote state interests. Finally, his commitment to cultivating the state's power internationally also resonated with the public, as the data cited by Sil and Chen above suggest. The final section examines Putin's ideological line with respect to international relations.

### **Putin's approach to international relations**

Putin expressed early on that the role of the Russian state in international relations needed to be modified. In his first address to the Federal Assembly in July 2000, he stated:

For a long time we chose: rely on foreign advice, help, and credits or to develop based on our distinctiveness, on our own strength. Very many countries were faced with such a choice.

If Russia stays weak, then we will effectively have to make such a choice. And this will be the choice of a weak state. It will be a choice of the weak. The only realistic choice for Russia can be the choice of a strong country. Strong and confident in itself. Strong, not in opposition to the world community, not against other strong states, but together with them.<sup>642</sup>

For Putin, the previous decade had seen a significant increase in the dependence of the Russian state on international actors and other states. This was a characteristic of a weak state and unacceptable for Russia. More broadly, Putin was suggesting that the way Russia's role in the

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641 Discussion with Professor Andrei Tsyganov, UC Berkeley conference, "20 Years After the Revolution," spring 2011.

642 Putin, "Address to the Federal Assembly on July 8, 2000."

international system had been understood during the previous decade – to depend on external actors or to retreat into isolation – was mistaken and problematic.

In fact, this was a choice faced by weak states, but one inappropriate for Russia, which for Putin by definition was a strong state. In other words, whether Russia was weak or strong was not exogenous to Russia; state strength was intrinsic to Russia itself. Furthermore, Russia's recognition of this with confidence would create additional options. As a result, Russia did not have to choose between dependency and autarchy. Furthermore, Putin was explicitly not calling for confrontation. In fact, there was another alternative: to work with other strong states. He does not say so explicitly, but these remarks strongly suggest that among powerful states, Russia had agency. It could work to shape the terms of its integration and the structure of the international system.

Overall, Putin was clearly rejecting isolation and confrontation. However, he also did not accept Russia's previous role under Yeltsin, which in the theoretical language of this dissertation I am calling a regime taker. As a state in an exceptional category (of strong states), Russia had a more attractive option: to contribute to the terms of its own integration by cooperating with other powerful states.

However, cooperation did not mean taking advice, help, and money. Rather it meant asserting itself as a powerful state that was prepared to bargain to shape its own destiny and at the same time make a contribution to the structure of the international system. Russia could be a regime maker, and this was not a hostile or uncooperative posture, but it did mean that Russia would behave as a strong state among other strong states. As we shall see in the following chapters, this vision would be reflected in Russian policy toward the ECH regime.

### **Sources of state strength: the primacy of the domestic, social consensus, and economic stability**

In Putin's estimation, for Russia to be strong there were two preconditions, both of which were largely internal to Russia. The first concerned the relationship between domestic politics and international relations. For Putin, domestic goals had to come prior to foreign policy goals. This was a strategic imperative for Russia to be strong:

We cannot and must not lose strategically. That is specifically why recently the conception for foreign policy, a revamped conception for foreign policy, was approved. In it, the supremacy of *domestic goals over external ones* is acknowledged.

The autonomy of our foreign policy does not illicit doubt. The foundation for this policy is constituted by pragmatism, economic effectiveness, and the priority of national goals. But we still have work to do for these principles to become the norms of state life.<sup>643</sup> (emphasis added)

These remarks need to be understood within the context of what came prior to his accession to power and how this was understood by many Russian elites.

Under Gorbachev, one of the foundational principles of Soviet foreign policy was to create a benevolent international environment that was conducive to economic development and the renaissance of socialism in the USSR. The idea that internal development depended on the

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643 Ibid.



external environment was an important principle in this model. At the same time, Soviet domestic policy was not completely subordinated to international imperatives. The USSR withdrew from Eastern Europe and Afghanistan and did not veto the first Gulf War in 1991. Through these actions the USSR was signaling its benign intentions toward its neighbors and also that it was a responsible member of the international community willing to cooperate with other states.

Nevertheless, as we saw in chapter 3 domestic interests retained significant autonomy from foreign goals. Under Gorbachev, liberal economic measures were watered down through compromise made necessary by political opposition from conservative elites and also the incomplete legitimacy of such measures in society (for example, private property). For liberals and Yeltsin, what was essentially an attempt to generate consensus through motley policies (that were admittedly not very effective) was a mark of Gorbachev's "indecisiveness" and a political weakness.

Moreover, we saw that in some areas the USSR was actually exporting domestic norms (Gorbachev's vision for a synthesis of socialism and capitalism). Therefore, although the late Soviet model recognized that foreign imperatives played a significant role in domestic developments, we cannot say that domestic goals were subordinated to foreign ones.

From the perspective of the president and many Russians, under Yeltsin, domestic goals were very much subordinated to foreign ones. In particular, cooperation with the West and promoting an inflow of finances (whether economic aid for development from Western states and Western-dominated institutions or FDI (foreign direct investment) by private investors) took priority over domestic goals.

From the perspectives of the liberals who promoted those policies, there was a harmony of interest between domestic and foreign policy goals. For example, shock therapy was supposed to be the fastest and most effective way to build capitalism, heal the economy, and make Russia strong and prosperous. We also saw in the ECH sphere that for Konoplyanik, the fastest and most effective way to rebuild the Russian energy sector and broader economy was by importing Western legal norms to promote foreign investment. Furthermore, as we saw in chapter 4 a quick resolution to ECT negotiations was supposed to bolster Yeltsin's standing in domestic politics by showing the fruits of international economic cooperation. This was a symptom of Russia's role identity as a regime taker.

Of course, this approach had political consequences; the polarization that emerged under Yeltsin was very much related to his choice to pursue a neo-liberal economic line and what was perceived as pandering to the West at the expense of domestic interests. At a minimum, the social consensus behind this approach was quite thin.

It needs to be added that the liberal governments simply did not have enough political support to fully implement their policies. Hence the claim by those sympathetic to the neo-liberal project that Russia never implemented shock therapy. This is certainly true in a very literal sense: for a variety of reasons, liberal governments did not have the capacity to fully follow the neo-liberal model, but it was not for lack of trying. As a result, those critical of the liberal agenda – who did not accept the harmony of interests thesis – saw the pursuit of external goals (such as attracting foreign investment) at the expense of domestic ones very much as the modus operandi under Yeltsin, even though he did not fully succeed in these efforts.

By 2000 (indeed even earlier), many Russians including the new president were disabused of the merits of that approach. Thus the Foreign Policy Concept from 2000 states in the first section (general principles) that:

The international situation that unfolded by the beginning of the XXI century has demanded a reconsideration of the general situation around the Russian Federation, the priorities of Russian foreign policy and the opportunities for supporting it with resources. Alongside a certain fortification of the Russian Federation's international position, negative tendencies have also revealed themselves.

Some expectations connected with the formation of new, equal, mutually advantageous partnerships between Russia and the surrounding world, as this was proposed in the General principles of the foreign policy concept ....from 23 April 1993, did not prove true.<sup>644</sup>

So far I have argued that for Putin, international goals had to be subordinated to domestic ones for Russia to be strong. But what did this mean concretely? Putin's remarks in his July 2000 address give us a glimpse of how he thought this might work in practice:

At the same time, the Russian Federation has the real potential to secure a worthy place in the world. In this respect, the long term strengthening of the Russian state, consolidation of civil society, and the fastest possible transition to sustainable economic growth will have a decisive significance.<sup>645</sup>

Not surprisingly, a strong state will help Russia secure a worthy place in international relations, but more revealing is the reference to social consolidation. From this perspective, state strength resulted from putting domestic goals ahead of foreign imperatives to create domestic consensus. This contrasts with Yeltsin's approach, which, by putting foreign goals ahead of domestic ones, led to polarization, which contributed to the weakness of the state.

In summary, according to this interpretation, for Putin one of the pre-conditions for state strength was social consensus based on prioritizing domestic goals ahead of foreign ones. For realists, this is not a novel insight. One of the sources of state strength is the character of domestic politics; for a state to be strong externally, first it had to be able to line up its own troops and have its own house in order.

The second pre-condition for a strong state was economic strength. In his July 2000 address he claimed that:

Today's economic indicators look optimistic only against the backdrop of yesterday's....But they are very modest compared to other countries, which are developing both much faster and in a much more sustainable manner than us. The current growth is only connected to a small degree with the renewal of the economic mechanism. In many respects, it is a product of a favorable foreign economic situation.

We cannot be at peace with such a state of affairs. And it is not just a matter of our national pride, although that too is important. The issue is much more acute and dramatic. Will we be able to preserve ourselves as a nation, as a civilization, if our wellbeing will time and again depend on the disbursement of international credits or the benevolence of the leaders of the world economy?

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644 Conception of the Foreign Policy of the Russian Federation, Document, *Nezavisimaya Gazeta*, July 11, 2000, accessed December 6, 2011, at: <http://www.ng.ru/printed/9244>.

645 Putin, "Address to the Federal Assembly on July 8, 2000."

Russia needs an economic system which is competitive, effective, socially just, and which will facilitate political development. A stable economy is the main guarantee of both a democratic society and a basic foundation for a strong and respected state in the world.<sup>646</sup>

A strong state, as well as a strong nation, civilization, and democratic society, depends on a sound economic system with an effective mechanism. As argued earlier in this chapter, for Putin, the state would play a key role in developing an effective mechanism and Russia's economic power, particularly in energy.

## Summary

This chapter has examined how the president's view of the state changed when Vladimir Putin succeeded Boris Yeltsin in 2000. The president did not reject the neo-liberal line, but he did have a more benevolent view of the legitimacy of state power and its role in society, the economy, and the energy sector specifically. This different view of the state and the fact that it reflected a broad consensus in society (unlike Yeltsin's) were a prelude for a different kind of state-building project and new coalitional choices and ultimately led to higher sovereignty overall, particularly with respect to Gazprom. The president also articulated a different view of the state's relations to other states internationally. The next chapter continues to explore this question, which is connected to the shift in Russia's role identity and early changes in ECH policy.

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646 Ibid.

## CHAPTER SEVEN: CONSTRUCTING THE STATE INTEREST – THE SECOND RATIFICATION DEBATE (2000 TO 2003)

### Overview

This chapter continues our examination of how the ideological line changed when Putin came to power. The previous chapter examined the ideological line as articulated publicly by the new president. This chapter focuses on its institutionalization into the official roles of the state. The second part of the discussion looks at the consequences for ECH policy. Empirically, we examine the second debate on ratification, which lasted roughly from 2000 to 2003. The data come largely from the ratification hearings in January 2001 as well as public statements by key officials. The debate was not restricted to the hearings, but they are a valuable window onto the process and discussion.

To understand what happened, we first have to recall the ideological line as articulated by Putin. President Putin's views on the state's role in the economy differed from those of his predecessor. As we saw in the last chapter, he did not reject the neo-liberal approach. However, because of his different and more positive understanding of the state and its causal effects in certain strategic sectors, the president also accepted that the state could play an important role in those parts of the economy. Thus, the new ideological line as articulated by Putin combined an interest in the neo-liberal approach with an interest in state action in strategic sectors. Both were legitimate. The second main idea related to Russia's special external capacity, characteristic of great states, to shape the international economy.

Third, Putin also made clear that for Russia, the domestic realm took precedence over the international one. This meant that the external function of the ideological line – to signal that Russia was a particular type of state by virtue of its acceptance of the ECH regime and adherence to neo-liberal principles – was no longer applicable. Moving forward, Russian ECH policy would be an expression of its interests only, and these interests depended on domestic factors. Implicit in this claim was a rejection of the idea of a general harmony of economic interests between Russia and other states. Whether such a harmony actually existed would be decided domestically and not learned from external actors (for example, through seminars).

Social consensus was a source of state power and a primary goal, underlining the importance of putting the domestic before the international; Russia would not pursue policy that was polarizing domestically, no matter how attractive the international consequences. It also pointed to a particular type of politics and decision making that was less confrontational. Combined, these ideas constituted the SS approach<sup>647</sup>, which made up the new ideological line under Putin.

As we shall see, these ideas were expressed both discursively and behaviorally by state officials during the ratification hearings in January 2001, an indicator that they were becoming institutionalized into the official roles of the state. The clearest voice in articulating the SS perspective was Valery Yazev, deputy chair of the Duma Committee on Energy, Transport, and Communications, which oversaw the hearings.

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647 The strategic sector approach overlapped with some parts of the neo-liberal approach, but not all.

The renewed importance of the state meant that a new set of ideas became available during the policy debate. To begin with, the state was a legitimate actor, and its interests could be the center of attention. In fact, the focal point for the discussion became the state interest. Gazprom in particular invoked the interest of the state and highlighted the company's importance from this perspective due to its export revenues and fiscal contributions, both the largest of any company in Russia. Duma deputies and other participants also underlined the importance of understanding the state's interest and noted with consternation that the debate revealed that the state's interest was unclear. In addition, it was possible to critique the neo-liberal line from the perspective of state goals. Here, too, Gazprom and its allies played a leading role in beginning this discussion.

Participants in the debate also recommended that Russia should be more assertive in promoting its interests within the regime. This was consistent with the idea of being a great power that shaped the international system through bargaining with other great powers. It also reflected the emergence of Russia's new role identity as a regime maker.

The one idea that was not mentioned explicitly was the importance of social consensus. However, the idea of consensus was expressed behaviorally, in that the discussion was characterized by serious deliberation, and a consensus actually emerged. There was no loyal or disloyal opposition. Everyone was interested in understanding the interests of the state. In this respect, participants were expressing their servant identities. The fact that state-oriented thinking and an interest in markets were now legitimate no doubt played a role by expanding the conceptual terrain on which consensus could emerge. In any case, the ideological line was also becoming institutionalized in the sense that it was shaping the dynamics of policy making, which would be characterized by deliberation and consensus building.

Of particular interest is the collaborative role played by Duma deputies. Previously, the opposition-dominated parliament had rejected the neo-liberal line articulated by Yeltsin, which only became institutionalized into official roles within the government. Opposition deputies who made up the majority were masters by virtue of opposing Yeltsin's course. The schism between the Duma and government over the neo-liberal approach led to polarization, which created a toxic environment for policy making. By contrast, the new ideological line generated cooperative relations among policy makers in the government and the Duma.

Also noteworthy is that supporters of the ECH regime who articulated important aspects of the neo-liberal line during their arguments nevertheless acknowledged that parts of Gazprom's critique were legitimate and needed to be considered carefully. They also agreed that the question of structural reform in the gas sector – a domestic question – should be decided before determining Russia's position on ratification. Again, the domestic came before the international, even for supporters. Here the testimony of Deputy Minister of Foreign Affairs Igor Ivanov in particular was revealing. The ability to acknowledge the legitimacy of arguments made by adversaries was an important development and reflected how both the substance of the ideological line and the character of politics were changing.

Finally, perhaps the most important development from a policy perspective was the emergence of a statewide consensus on ECH policy. Especially important was that Gazprom, the president, the government, and the Duma could finally see eye to eye concerning the ECH and Russia's interests. Specifically, participants agreed that the agreement portended potential difficulties for Gazprom, and Russia postponed ratification on that basis.

Before this consensus could emerge, it was necessary to persuade the president that these ideas were not just a state-oriented façade for promoting the interests of Gazprom’s managers, of whom Putin was very skeptical. Here the new CEO of Gazprom, Alexei Miller, played a key role in persuading the president to embrace Gazprom’s perspective. Of course Miller’s appointment itself was a product of the president’s state building in the gas sector, which implied a more active state role in creating policy. With the key decision maker on board, the cognitive agreement extended to the Duma, the president, the government, and Gazprom. For the first time, there was a statewide consensus concerning Russian ECH policy.

This chapter also sheds light on our theoretical questions concerning state identity change and the relationship between state identity and policy. The focus of attention is on role identity. As mentioned above, the period from 2001 to 2003 saw subtle changes in Russian policy that indicated it was becoming a regime maker. The main finding from this analysis is that the president articulated a new ideological line pointing to Russia’s external capacity as a great power to fundamentally shape the international economy and a new relationship between domestic and international goals. This directly constituted Russia’s regime maker role identity. However, the effects of this new ideological line and role identity on policy were indirect. In fact, the idea of external capacity was an environmental factor during the debate that made new policy solutions available. Ultimately, this solution would be translated into actual policy: the unprecedented linkage between ECT ratification and TP negotiations and the suspension of negotiations on the draft TP due to disagreements with the EU related to the WTO.

## **Organization of chapter**

The remainder of this chapter examines these issues in greater detail. The first section demonstrates the position of the early Putin government to show both the continuities (largely favorable attitude and intent to ratify) and the change (lack of haste, focus on deliberation) in Russian ECH policy at the time. The following sections examine the debate on ratification that began with the 2001 hearings. My focus will be on the arguments made by opponents of ratification (Gazprom and its allies) and how supporters of the ECH reacted to these arguments. The section that follows examines the role of Alexei Miller in persuading the president. We then examine the changes in Russian policy that occurred as a result of the debate. The last section summarizes the main findings.

## **Early ECH policy under Putin**

### *Continuities*

This section examines the position of the Russian government concerning the ECH and Treaty during the early Putin period. Just like the Yeltsin government that preceded it, the government under Putin had a favorable view of the ECH regime and Treaty.

When the question of ratification came up for the second time in 2000, the Ministry of Energy held a meeting on the question. A majority of participants were in favor of ratification. According to Komarov,

...[A]t the Ministry of Energy, this question was discussed with the participation of all interested parties – oil, energy and gas producers, and the industry ministries. There were different points of view, and I will not conceal that the majority of the participants in these discussions supported the idea of ratification of the ECT.<sup>648</sup>

This was also confirmed in interviews with participants in the process.

Top government officials also underscored the importance that Russia attached to the ECH. For example, on the occasion of his visit in late September 2000 to the Secretariat in Brussels, Deputy Prime Minister Viktor Khristenko described it as “an organisation that promotes the common interests of Russia and its EU partners in ensuring Europe's energy security on the basis of commonly-accepted and transparent legal norms.”<sup>649</sup> Thus, not only did the government have a favorable view of the ECH, the discourse of the Russian government was very similar to what it had been under the previous president.

Moreover, the government intended to make a second attempt at ratification. During the visit, Khristenko reaffirmed “the intention of the Russian Government to facilitate actively ratification of the [ECT] by the State Duma.”<sup>650</sup> At the end of the visit, it was also announced that the Russian Ministry of Energy had invited “ECT high-level officials [to] visit Moscow in late October or early November for talks with the Russian Government and Parliament aimed at developing further co-operation between Russia and the Energy Charter.”<sup>651</sup> Like previous governments, Russia was again inviting Charter officials to Russia to help promote ratification.

During an October meeting of the Cooperation Committee,<sup>652</sup> Deputy Economic Development and Trade Minister and head of Russia's delegation Maxim Medvedkov commented that, “Russia's energy sector is also badly in need of new technology and fresh investment....This is key in creating an 'energy space' with Europe... The ‘energy space’ and the so-called ‘energy charter’ will formalize trade in this sector.”<sup>653</sup> In the context of calls by the EU to “improve legal and commercial security in Russia to attract more private EU investment to the Russian energy sector,” Medvedkov declared that, “the Russian Parliament, could ratify the Energy Charter Treaty (ECT) in December, which would naturally contribute to the security much desired by potential foreign investors.”<sup>654</sup> Again, the Russian government was signaling its favorable view of the ECH and Treaty and its commitment to the basic principles at the heart of the regime: the neo-liberal priority of attracting private investment through legal guarantees. Together with the “energy space,” the ECT was part of a larger project to integrate Russia with Europe according to the neo-liberal model.

The government's support is also confirmed by repeated claims by the Secretariat to that effect. Secretariat officials stressed that the Putin government, like its predecessors, was interested in getting the Duma to ratify the document. Prior to a trip to Moscow in the spring of 2000, Secretary General of the Secretariat Dr. Ria Kemper stated that:

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648 “System of Long Term Contracts is disintegrating,” *Kommersant Daily*, July 10, 2001, 6.

649 Ibid.

650 “Russia Supports Accession to Energy Charter Treaty,” *European Report*, September 30, 2000.

651 Ibid.

652 The Cooperation Committee was a technical body responsible for managing the EU/Russia Partnership and Cooperation Agreement that governs trade relations between the two parties.

653 Anna Raff, “EU, Russian Officials Prep for Summit,” *The Moscow Times*, October 13, 2000.

654 “EU/Russia/Energy—Creation of Joint Group of Experts for Studying ‘Prodi Plan,’” *Agence Europe*, October 24, 2000.

[M]ore constructive relations of cooperation than earlier formed between the present Duma and executive authorities in Russia. Therefore [I am] certain that the matter of ratifying the Treaty to the Energy Charter will get off the ground this year.... It is, certainly, for the Duma to decide on the schedule....As to the Russian government, it was and remains strongly in favour of the ratification...the process will [also] be lobbied by Russia's major partners, above all, the European Union."<sup>655</sup>

Throughout the year, officials at the Secretariat emphasized that the Putin government supported the ECT and that ratification was on the way. For example, in May 2000, Kemper expressed confidence that the Duma would ratify the ECT the same year.<sup>656</sup> The press reported that:

Kemper reiterated that she was confident that the Russian parliament will ratify the Energy Charter Treaty this year, which would send an "an important positive signal to the outside world concerning Russia's openness for equal and nondiscriminatory cooperation in the energy sector."<sup>657</sup>

Kemper's statement also reflected the fact that Russia's cooperation in the ECH sphere was supposed to send a signal internationally to investors and other states that it accepted neo-liberal principles; as argued previously, this was the external function of the ideological line.

After her October trip to Moscow, Kemper was quoted as saying, "There are clear signals that Russia is moving [towards ratification]."<sup>658</sup> The article also stated that "Problems, though, are located at the ratification process in the Duma...Ratification might not take place before the end of the year, but one can expect that a determining impulse will be given soon."<sup>659</sup>

In early December, Kemper was quoted as being "convinced that Russia wants to move ahead with ratification of the Energy Charter Treaty,"<sup>660</sup> and the following day an article appeared saying that she "was relatively optimistic about the possibility of Russia ratifying, in 2001" and that she and Conference Chairman Christophersen felt "that there is, within the new Duma, a determination to continue ratification work."<sup>661</sup>

Therefore, clearly the new Russian administration had a favorable view of the regime and Treaty and was sending signals that it intended to promote ratification. The official Russian discourse concerning the treaty was very similar. This is consistent with the argument made earlier that Russia's approach to the ECH had become institutionalized into the apparatus of the state through the ideological line. Despite the fact that the new president had different personal views on both the state's role in the energy economy and Russia's relations with other states and approach to foreign policy, in the early stages of his tenure the government had a generally positive assessment of the agreement, was sending signals similar to those under Yeltsin, and had

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655 Alexander Mineyev, "Russia expected to ratify Treaty to Energy Charter," *ITAR Tass*, April 19, 2000.

656 "China Interested in Joining Energy Charter Conference," *Dow Jones International News*, May 17, 2000.

657 Ibid.

658 "Energy Charter—Transit Talks Continue as Russia Asked To Ratify Treaty," *European Report*, November 1, 2000; "East-West pipeline talks seen complete by mid-2001," *Reuters News*, October 26, 2000.

659 Ibid.

660 "Energy Charter Sees Transit Protocol in May 2001," *Dow Jones International News*, December 7, 2000.

661 "EU/Energy—Conference on Energy Charter Aims To Conclude Transit Agreement in May 2001 and Trusts Russia Will Ratify Treaty in the Spring—No Rivalry with EU/Russia Energy Partnership," *Agence Europe*, December 8, 2000.



the same policy as before: Russia was quickly moving forward (already in 2000) with its second attempt at ratification.

*Change: reflecting on every decision*

Further insights concerning the new government's approach to the ECH can be gleaned from public discussions that occurred in the fall of 2000.<sup>662</sup> At the end of October 2000, President Putin met with French President Jacques Chirac during the sixth EU-Russia summit in Paris. During the meeting, the Russian president directly stated that Russia needed to make "important efforts" to stabilize the legislative environment and provide "all possible guarantees to European investors." A statement released by both parties after the summit said that "ratification of the Energy Charter Treaty and the improvement of the investment climate are 'important elements' [of EU-Russia cooperation in the energy sphere]." But Putin also added that Russia was not ready to give in to every demand and that progress will not be "artificially accelerated" with Russia "reflect[ing] on each decision."<sup>663</sup> Like the other members of his government, the president expressed a favorable view of the ECH and Treaty, and his public discourse was informed by neo-liberal principles. Furthermore, he endorsed the importance of ratification through a joint statement. The president was also influenced by the ideological line that he inherited, both discursively and in terms of the political signals he saw it sending internationally.

However, his comments also reveal a subtle shift in thinking. The idea of "artificial acceleration" and "reflection on decisions" suggested that Russia's commitment to the ECT had changed. Previously, there had been no need for the government to reflect on the virtues of the ECT, which were never in doubt. At the same time, ratification had been urgent. By contrast, under Putin the government would deliberate on these questions more carefully and without haste. Therefore, while signaling a favorable attitude and intention to move ahead with ratification, the president was also suggesting that Russia was prepared to re-examine the merits (and liabilities) of the Treaty.

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662 Energy became the focus of even greater attention due to events in the EU. The early fall of 2000 saw a mini-energy crisis in the EU during which protests over high energy prices (due to a spike in oil prices) led to transport blockades and the near shutdown of several European countries. At the end of September 2000, European Commission President Romano Prodi called Putin to discuss dramatically increasing EU energy imports from Russia. This became known as the "Prodi plan." According to Commission spokesman Jonathan Faull, during the telephone conversation, Prodi suggested that the two parties "transform what is currently an important commercial relationship into a long-term strategic partnership from which both parties stand to gain considerably." Following Prodi's phone call, German Chancellor Gerhard Schroeder also raised the same topic during a meeting in Moscow with Putin. Several weeks later, the EC and the Russian government created a joint expert group to "identify by what concrete means the EU and Russia could strengthen their energy cooperation and how the EU could help Russia to increase its deliveries of gas and oil to Europe." "EU to discuss long-term energy tie with Russia," *Reuters News*, October 2, 2000; "EU/Russia/Energy—Creation of Joint Group."

663 "EU/Russia—A Summit Hailed for Maturity Leaves Some Gaps," *European Report*, November 1, 2000.

## The 2001 ratification hearings

### *The role of ECH officials and the EU*

In addition to being a major participant in Russian debates about the ECT and an authoritative source of information on what it represented, ECH officials played a visible role in putting the question of ratification on the immediate political agenda. In October 2000, a delegation of officials from the Secretariat and the ECH conference visited Moscow. A major goal of the trip was to impress on Russian representatives the necessity to ratify the ECT.<sup>664</sup> During the trip, Secretary General Kemper and Conference Chairman Christophersen held talks with Deputy Speaker of the Russian State Duma Vladimir Lukin, representatives of the Duma's Energy Committee, Russian Deputy Prime Minister Viktor Khristenko, Energy Minister Alexander Gavrin, and senior officials from the Ministry for Economic Development and Trade. Meetings were also held to discuss the ECH's role in regulating interstate energy transit issues with the management of Lukoil, Transneft, Gazprom, and Itera.<sup>665</sup>

Charter calls for ratification were reinforced by European calls for ratification, the most important of which were made by Jacques Chirac and Romano Prodi during the EU-Russia summit with President Putin at the end of October 2000.<sup>666</sup> In early November 2000, it was announced that the Duma would hold hearings the following January. The article also stated that, “The announcement follows a visit to Moscow this week by a high-level delegation of the Energy Charter... Russian leaders have in the past supported the ECT, but the Duma hasn't ratified the treaty yet.”<sup>667</sup> In response to the announcement, the EU “hailed the news that the Russian Duma would begin consideration of ratification of the Energy Charter Treaty early next year.”<sup>668</sup>

The government renewed its request for Duma ratification on November 17, 2000.<sup>669</sup> The order was signed by Prime Minister Kasyanov.<sup>670</sup> It appointed the Minister of Energy, Alexander Gavrin, to represent the government during the Duma hearings. The Council of the State Duma scheduled ratification hearings to be held by the State Duma Committee on Energy, Transportation, and Communications in January 2001.<sup>671</sup> In December, the Duma Energy

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664 “EU/Energy—The 5th Energy Charter Conference Notes That Negotiations on the Transit Protocol Will Not Be Completed Before June 2001—Russia Has Still Not Ratified,” *Agence Europe*, June 30, 2000; “Charter Call—Russia Should Ratify Energy Charter Treaty,” *NEFTE Compass*, October 26, 2000; “Energy Charter Delegation To Consider Ratification of Energy Charter Treaty by Moscow,” *Daily Petroleum Report*, October 31, 2000.

665 “EU/Russia—Where Are the Next Steps?” *European Report*, November 4, 2000; “Charter Call.”

666 “Russia soon to ratify energy charter—secretariat,” *Reuters News*, November 3, 2000.

667 “Russia's Duma To Discuss Energy Charter Treaty in Jan 01,” *Dow Jones Energy Service*, November 3, 2000.

668 Ann MacLachlan, “ESA Committee To Meet To Discuss Whether To Change U Import Quotas,” *Nuclear Fuel*, 3, 25, 23 (2000).

669 Government of the Russian Federation, “On the Approval and Introduction for Ratification into the State Duma of the Federal Assembly of the Russian Federation the Energy Charter Treaty,” Decree from August 26, 1996.

670 “The Head of MinErgo Assigned To Be the Representative of the Government of the RF during Consideration of the Question of Ratifying the Treaty,” *Interfax News on the Fuel and Energy Complex*, November 22, 2000.

671 V.C. Katrenko, remarks by chairman in “Energy Policy—Parliamentary Hearings, ‘On the Ratification of the Energy Charter Treaty (ECT),’” *Ecology XXI, International Scientific Journal*, Energy Policy, Ecological Policy, Demographic Policy—Parliamentary Hearings, 2 (2001).

Committee met and, among other items, “confirmed the make-up of a working group to prepare for parliamentary ratification” of the ECT.<sup>672</sup> The article also made clear that, “the deputies supported the idea of holding hearings in January of the following year regarding the question of ratification of the ECT with the participation of all interested parties.”<sup>673</sup>

### *The ideological poles*

As I will argue shortly, the 2001 hearings represented a genuine policy debate that influenced government thinking. However, the hearings also saw elements of the political polarization characteristic of the 1990s. The most aggressive, indeed menacing,<sup>674</sup> opponent was the bombastic nationalist Deputy Vladimir W. Zhirinovskiy, who argued that the agreement was the latest in a series of traps designed by the West to steal Russia’s wealth. According to Zhirinovskiy, energy resources would be vital in the 21<sup>st</sup> century and determine which states survived into the 22<sup>nd</sup> century.<sup>675</sup> Since the resources belonged to Russia, and Western states badly needed them, the onus was on Russia to design the institutional structure of energy markets.<sup>676</sup>

Among the most spirited defenses of the agreement came from Deputy Maxim L. Korobov, who was explicitly responding to Zhirinovskiy. Korobov argued that the centrality of energy resources was a thing of the past; the future depended on information resources. Russia should avoid self-isolation even if this went against the immediate, “egotistical” interests of the national economy and individual Russian companies. This would only lead the West to intensify its technological development in search of cleaner alternative energy. At the same time, neighboring states would find alternative transit routes to European and Asian markets, and Russia would end up “squeezed off” from international markets.

Korobov also argued that the reason the debate was so acrimonious was that the ECT portended the end of Russian monopolies. Here he singled out Gazprom, which had become “a national relic...[a source of] national pride.” While the traditional monopolies wanted to maintain the status quo, it was necessary to break them up according to their “sub-systems” (production, transit) to create competition and generate efficiency. He stated that:

Objectively, you need to break up the two components. And then, it is possible that the subsystem producing the good, into which falls exploration, extraction of gas, will become more competitive. It will feel pressure from cheaper Turkmen or Uzbek, or even Kazakh gas. Inevitably, the market will force our large companies to shake a leg, to lower costs, and raise the efficiency of production.<sup>677</sup>

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672 “Russian Duma committee looks into Iraq sanctions and Energy Charter Treaty,” *BBC Monitoring Former Soviet Union – Political*, December 21, 2000.

673 Ibid.

674 Zhirinovskiy focused his wrath on expert advisers to politicians, who he claimed would be called to account for facilitating the plunder of Russia. He specifically mentioned Professor Yershov, who had been an expert during ECH negotiations since the Soviet period.

675 He also claimed provocatively that energy resources would be a weapon in the coming century.

676 He also claimed that, like OPEC, Russia should dictate prices.

677 M.L. Korobov, in “Energy Policy—Parliamentary Hearings, ‘On the Ratification of the Energy Charter Treaty (ECT).’”

He also claimed that if “we believed in markets,” domestic subsidies should be eliminated and the market should determine prices (something to which the monopoly producers certainly did not object).

Korobov concluded that there was no consensus on the agreement because the short term interests of different actors diverged, and thus Russia needed to be more forward thinking. However, if one looked 20 to 30 years forward, Russia needed to become more attractive to the outside world and “demobilize domestically.” Finally, Russia needed to become more intellectually prepared if it was to open up to the world rather than retreat into isolation.

Zhirinovskiy and Korobov very much represented the two extremes in the debate. One represented the belligerent, radical nationalist; the other, the utopian, neo-liberal idealist. Both sides presented their arguments in apocalyptic terms: ratifying the Treaty would lead to the loss of all Russia’s wealth and power and threaten its survival into the next century; not ratifying it would mean Russia would stagnate socially and economically, lose in global economic competition, and become isolated. Everything was linked to everything else. The decision was one of life or death. With their arguments, the pair was reproducing the ideological cleavages, identities, and political battles of the Yeltsin period. However, by 2001, these two views were exceptional. The next section develops this idea further.

#### *Deliberation as a prelude to changes in the ideological line in the ECH sphere*

In between these two poles, the ECT received various levels of support from different actors and agencies. Generally in favor were the Ministry of Energy, the Ministry of Foreign Affairs (MID), the Ministry of Economic Development and Trade (MERT), and the Federal Energy Commission (FEK, which regulates Russian natural monopolies at the Federal level).<sup>678</sup> The ECT was also supported by RAO UES (the former electricity monopoly then under A. Chubais) and the oil pipeline monopoly Transneft (under then President Semyon Vaynshtok).<sup>679</sup> Generally against the agreement were the Ministry of Atomic Energy and the Ministry of Industry and Science. Gazprom was adamantly against ratification and led the opposition. Deputies and experts testified in favor and against the agreement.

Rather than review all the arguments, the following sections focus on the testimony of key actors: the “gas lobby” (Gazprom and its allies), the Ministry of Energy (the central government agency dealing with ECH policy), and the Ministry of Foreign Affairs. The main goal is to understand how the ideological line was shifting. By analyzing this discussion,<sup>680</sup> we can observe a change in the ideological line at the micro-level.

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678 “Russia is not satisfied with the Energy Charter,” *Nezavisimaya Gazeta*, January 27, 2001; see also K. V. Yankov, testimony in “Energy Policy—Parliamentary Hearings, ‘On the Ratification of the Energy Charter Treaty (ECT).’”

679 “1.7 Mln Tons of Oil To Be Pumped By Baku-Novorossiysk Pipeline in 2001,” *Turan News Agency*, January 10, 2001.

680 A methodological note: the hearings were the main event during what I am calling the second ratification debate. They were both the catalyst of this debate and saw the most extended public discussion between supporters and opponents. The debate extended before and after the hearings. In some cases, I combine arguments by the same person from different sources. I do so both for convenience and to draw as comprehensive a picture as possible of the logic that underpinned arguments concerning this question. In putting together texts from different sources, I

To preview the key points, with the exception of the two poles identified above, and in contrast to the political battles in the 1990s, this was a true policy debate, not a clash of ideologies. This was pointed out by Konoplyanik during his testimony at the hearings:

It seems to me, today's parliamentary hearings showed ...a very positive reality. In comparison to previous discussions on this question or on similar questions, I confirm with pleasure that the discussion has moved from a context characterized primarily by political accusations between opponents to a context...characterized by a discussion primarily about concrete economic questions.<sup>681</sup>

That the discussion reflected a real policy debate was also noted by the chair of the committee that held the hearings, Deputy Vladimir S. Katrenko, in his introduction to the journal that published the transcripts:

In the present issue of the journal, the public has the opportunity to become familiar with the “kitchen” in which the opinion of the deputies on the Energy Charter Treaty – a recent international document of the greatest importance – is formed.<sup>682</sup>

The hearings were an opportunity to “reflect” on the consequences of ratification as the president had promised a few months earlier. This was a genuine moment for deliberation within the Russian state. The fact that this was an inquiry into what the ECT meant for Russia was significant because it created a context conducive to influencing government thinking and changing the ideological line in the ECH sphere.

Second, opponents' (Gazprom and its allies) critique of the ECT challenged key causal and analytical principles that previously underpinned Russian support for the ECH and Treaty. This changed how the government understood the ECT and what outcomes it expected from the agreement. As a result, this debate was a prelude to the emergence of a new cognitive consensus – one that included both the Duma and the Russian government – concerning the fact that the ECT posed a risk to Gazprom's business. The hearings were thus a significant moment when thinking about ECH policy began to change.

Finally, the debate saw many supporters contribute to the discussion as well. We will examine their arguments after analyzing the position of opponents. Proponents repeated many of the neo-liberal arguments we have seen previously. At the same time, they acknowledged the legitimacy of the points made by their opponent, Gazprom. As a result, their arguments were not always coherent or elegant, and this was associated with the fact that the ideological line was changing.

## **The gas lobby: critique of the ECT and the neo-liberal ideological line**

### *Transit and export revenues*

This section examines arguments against ratification made by Gazprom and its allies, what I am calling the “gas lobby.” The public assault against ratification actually began with a

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have paid special attention to not misconstrue what actors were saying. The extent to which I succeeded or failed can be judged by examining the original sources, which are publicly available.

681 Katrenko, “Energy Policy—Parliamentary Hearings, ‘On the Ratification of the Energy Charter Treaty (ECT).’”

682 Ibid.

press conference two days before the hearings when Gazprom board member and director of foreign economic ties, Yuri A. Komarov, suggested that Russia should, “consider a number of revisions to the agreement.”<sup>683</sup> Komarov also testified during the hearings.

With respect to energy exports, Komarov made an important critique of neo-liberal thinking. Whereas supporters had argued that the ECT would improve access to European markets, which would increase both quantity sold and export revenues, Komarov argued that the ECT would have the opposite effect in natural gas; in fact, Gazprom’s export revenues would fall. This was because the transit provisions of the agreement would open access to Russia’s gas pipeline network to Gazprom’s competitors, the natural gas producers in Central Asia. This would lead to a significant increase in the overall supply of gas to Europe and result in a collapse of prices. Furthermore, he added that because Russian gas was more difficult to extract than Central Asian gas and its deposits were farther from consumer markets (and thus more expensive to transport), Russian gas would be less competitive. The overall effect would be that Gazprom’s exports to Europe would be hurt and this would significantly impact not only Gazprom’s earnings but also the state budget, to which Gazprom was the most important contributor.

According to the Treaty, Russia will undertake the responsibility to transport foreign gas using national tariffs...

Under such circumstances for transit, we will open our route for Turkmen and Kazakh gas. I don’t want to upset you but our gas will come out uncompetitive....

The laws of the market are such that a few extra billion cubic meters of gas thrown onto the market will lead to...a collapse in prices.<sup>684</sup>

[Such terms for transit might] lead to a significant worsening of market conditions and to increased competition, reduced gas prices and export revenue.<sup>685</sup>

I would like to conclude by saying that revenues from the export of gas to Europe comprise roughly a quarter of state budget revenues. We plan to increase this share.<sup>686</sup>

Consequently...this would have an extremely negative effect on the budget.<sup>687</sup>

Komarov was challenging a key principle in the ideological line: that the Treaty would lead to greater energy exports and revenues for Russia. According to Komarov, the Treaty would have the opposite effect: lower export revenues. During the hearings, for the first time, he publicly cited specific figures concerning losses that the ECT would cause the company:

We estimate that our yearly losses will be many billions of dollars. Realistically, rather than increasing to \$15-17 billion, we will receive a maximum of \$6-7 million.<sup>688</sup>

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683 “Gazprom proposes during consideration of Russian ratification of the Energy Charter Treaty,” *Prime Tass*, January 24, 2001. The hearings were held on January 26, 1991.

684 Y.A. Komarov, testimony in “Energy Policy—Parliamentary Hearings, ‘On the Ratification of the Energy Charter Treaty (ECT).’”

685 “Russia Not Yet Ready To Ratify the Energy Charter Treaty—Gazprom Board Member, *Daily Petroleum Report*, January 25, 2001.

686 Komarov, “Energy Policy—Parliamentary Hearings, ‘On the Ratification of the Energy Charter Treaty (ECT).’”

687 “Russia Not Yet Ready To Ratify the Energy Charter Treaty.”

688 Komarov, “Energy Policy—Parliamentary Hearings, ‘On the Ratification of the Energy Charter Treaty (ECT).’”

Duma deputy and committee member, former prime minister, and “father of Gazprom” Viktor Chernomyrdin – during whose tenure Russia negotiated and signed the agreement – also testified against ratification:

Yuri Aleksandrovich Komarov made a brilliant and well-founded presentation today. Let’s say that we said today that now we have to make a decision... and we voted in favor of ascending, I could only add to what Komarov has said that today we would have to put a cross on the gas industry.

That is why today I would probably formulate the question differently. The question is not whether we need or don’t need the Energy Charter. We need it! We need it! If we want to be civilized people. If we want to cooperate and live in a normal civilized world. We need it! But for this we have to prepare.

...[Y]ou can destroy a market in the blink of an eye – simple. You have to approach all this very carefully, very carefully.

...We need the Treaty! I join the young man from FEK [Federal Energy Commission]; he said it right: “I agree with the MID [Ministry of Foreign Affairs] proposal.” I also agree with the MID proposal, in which Ivan Dmitrievich said: “I am for it, but not today!”<sup>689</sup>

Chernomyrdin supported Komarov’s argument that the ECT posed a threat to the gas industry and validated the causal principles Komarov proposed. However, his overall comments concerning the ECH and Treaty were very positive; it was a vehicle for becoming “civilized” and for cooperating in a “civilized” world. To ask whether to ratify or not was the wrong question at that time. Russia was simply not ready to take that step. Rather, Russia needed to ask how to become ready for ratification in the future. Therefore, the argument against immediate ratification was not a blanket condemnation of the regime or Treaty. This suggests that even for opponents of ratification, the neo-liberal line was still important.

### *The ECT as a threat to Gazprom’s investments: long term contracts*

Komarov also challenged the idea that the ECT would improve the investment climate in Russia, which was a key principle in the neo-liberal ideological line and the strongest argument in favor of the agreement.

They say that the investment climate will be improved.<sup>690</sup>

The opening of the gas pipelines will not lead to the increase of the investment rating of Russian companies and will not create access for them to international financial resources. The promises of European bureaucrats about the necessity to improve the investment climate in Russia and the important role of the ECT in this respect have nothing to do with the healthy pragmatism of western bankers, who believe only in reliable loan repayment.<sup>691</sup>

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689 V.S. Chernomyrdin, testimony in “Energy Policy—Parliamentary Hearings, ‘On the Ratification of the Energy Charter Treaty (ECT).’”

690 Komarov, “Energy Policy—Parliamentary Hearings, ‘On the Ratification of the Energy Charter Treaty (ECT).’”

691 “System of Long Term Contracts is disintegrating.”

Banks...evaluate financial attractiveness using concrete indicators. First and foremost, this is the profitability of projects. And again, I assure you, that from this point of view, our projects are not the most attractive.<sup>692</sup>

From a neo-liberal perspective, investment was promoted by reducing political risk. Komarov was arguing that investment depended on profitability. Because the ECT would damage Gazprom's profitability, it would hurt the company's ability to invest.

More specifically, the gas lobby argued that the ECT would threaten long term contracts (LTCs), which underpinned the company's ability to raise finances:

We will practically destroy the market. We will destroy the system of long term contracts. This means that we will also destroy the source for attracting resources into our projects. And then we will not be able to realize a single project, no matter how good the Energy Charter is.<sup>693</sup>

In the gas business, the only instrument for the provision of finance worthy of Russia is the cash flow from Gazprom's export contracts whence gas is supplied to reliable western partners. To the contrary, I am convinced that ratification of the ECT today will significantly worsen the investment opportunities of Russian energy companies. Moreover, this could lead to the increase of risk for Russian energy security and I think as a consequence, this would also be a threat to the energy security of Europe.<sup>694</sup>

To finance its projects, Gazprom relies on bank loans. To get these loans, it uses LTCs that it concludes with consumers (wholesale purchasers) as collateral. In this way, lenders have a reasonable assurance that Gazprom's projects will generate revenue and that the company will be able to repay its debt. Since the transformation in markets that would result from the scenario Komarov was describing would undermine LTCs, from the perspective of Gazprom the ECT would not improve its investment climate. To the contrary, its ability to raise finance would be significantly constrained. Komarov also argued that this would threaten energy security in the EU; I will return to this issue later in this chapter.

### *Linking the ECT and EU liberalization*

Komarov elaborated the jeopardy to LTCs later that summer. However, in an interview with *Kommersant*, the focus of his concern was the ongoing liberalization of the EU market:

[T]he actions of the European Union to force liberalization of the European gas market and create new rules of the game based on short term and spot deals, will inevitably lead to the demise of long term contracts, which are the primary source of financing for highly capital intensive new projects for extracting and transporting gas.<sup>695</sup>

What exactly was the threat from EU liberalization to LTCs? The price in Gazprom's LTCs is from a formula based on numerous factors including the price of alternative fuels.<sup>696</sup> The

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692 Komarov, "Energy Policy—Parliamentary Hearings, 'On the Ratification of the Energy Charter Treaty (ECT).'"

693 Ibid.

694 "System of Long Term Contracts is disintegrating."

695 Ibid.

696 The index includes other parameters, but since I am interested in showing Gazprom's thinking about why competition will undermine LTCs (and to keep things simple), here I am only focusing on the alternative fuel component. For more on the structure of LTCs, see Energy Charter Secretariat in co-authorship with R. Dickel, G. Gunul, T. Gould, J. Jensen, M. Kanai and Y. Selivanova, *Putting a Price on Energy: International Pricing Mechanisms for Oil and Gas* (Brussels: Energy Charter Secretariat, 2007), Ch. 4, especially 154.



formula is designed in a way that consumers prefer buying the contracted volumes of gas rather than alternative fuels (such as oil fuels and coal).<sup>697</sup> If the price of oil goes down, the contract price of gas also falls so that gas remains competitive. Historically, this is how the European gas market developed. The underlying principle was inter-fuel competition; gas had to be cheaper than its alternatives so that a gas market could be created.

The explicit goal of EU liberalization is to create a competitive market in gas; this implies gas-on-gas competition and spot markets. To understand why the two are in tension, we can look at what happened to Gazprom's long term business during the recent gas glut in Europe. This extra gas (which came largely from Qatar) was sold on the spot market, not according to LTCs. Moreover, the spot price was significantly lower than the price for gas under the LTCs. As a result, Gazprom's partners preferred to buy gas on the spot market instead of taking pre-contracted volumes according to the LTCs. Spot gas was competing with long term gas, and this was eroding the traditional basis for LTCs.<sup>698</sup>

The pressure that spot gas creates for LTCs was also described by Alexei Miller, who replaced Vakhirev as Gazprom CEO in 2001.

In a host of EU countries, we have noticed the first practical symptoms of the innovation: individual consumers are suddenly turning down traditional suppliers, yesterday's partners are secretly taking away each other's clients, one-time, in some cases speculative, deals are being made. Well, that is the specificity of markets in general.<sup>699</sup>

Like Komarov, Miller was arguing that spot markets undermined LTCs. In so doing, spot markets also eroded the cooperative foundation on which the long term gas business had been traditionally premised. For Miller, this was a natural product of competitive markets. In fact, Miller began promoting the Gazprom perspective very soon after becoming CEO in May 2001. We will return to the role Miller played later in this chapter.

How exactly was EU gas liberalization related to the ECT? Earlier we saw that Komarov was against ratification because he believed the ECT would ease access to transit for Central Asian gas producers. This would mean that Russian (Gazprom) gas would have to compete with cheaper gas from Turkmenistan, Kazakhstan, and Uzbekistan. With the direct marketing of large volumes of Central Asian gas in Europe, inter-fuel competition according to LTCs would give way to gas-on-gas competition based on spot prices. Therefore, for Komarov, the ECT was related to EU liberalization because both led to gas-on-gas competition and threatened LTCs, which were based on an entirely different pricing principle (inter-fuel competition).

Why was this a problem? Komarov identified several reasons. The first had to do with the nature of financing in the gas industry:

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<sup>697</sup> The alternative fuel depends on the contract.

<sup>698</sup> The LTCs provide for periodic renegotiations in which the price formula can be adjusted (for example should market fundamentals change). When the pricing question was reopened, Gazprom was compelled to agree to change the formula in its LTCs to include a spot gas price component in the price index. This was a compromise that emerged during bargaining between Gazprom and its long term partners. With the inclusion of the natural gas spot market component in the formula, the trade between Gazprom and its wholesale consumers was beginning to converge with the logic of spot markets. The key point is that gas on gas competition creates pressure for significant modifications to the traditional system of LTCs.

<sup>699</sup> "Gazprom' Is Obviously Undervalued," *Kommersant Daily*, August 24, 2001, 1.

[T]oday, there is still not one single mechanism that would provide for large investments in the context of short-term business.

...Furthermore, market liberalization suggests a fall in prices which in turn leads to investment outflow.<sup>700</sup>

Because of the capital intensity of projects, a minimal assurance was necessary that investors would be able to recoup their investments. Historically, this assurance had come from long term contracts. Liberalization was threatening this form of finance without addressing the question of how new, capital intensive, long term projects would be financed in their absence. In addition, competition puts downward pressure on price, and this made investment less attractive in general. This was consistent with the explanations we saw earlier.

There was also a second, related reason:

Without any question, this is one of the major elements of the change in rules on the gas market – transition from the European model of long-term contracts to American short-term business.

In my opinion, the period of long-term contracts has not yet passed in Europe. You cannot exclude that in the future, the share of short term business will increase significantly. But this is not even in the next ten years. At the least, you have to wait for the main investments to be made and for *the old capital investments to receive their return*.<sup>701</sup> (emphasis added)

The gas Gazprom was selling in Europe came from projects that had been designed and financed many years earlier. By promoting competition and lower prices, the rules of the game were being changed before the investors who had financed these projects had been remunerated.

In the context of opening access to Central Asian producers, this meant that Gazprom's competitors could take advantage of enormous capital investments in the pipeline system for free:

The logic of the EU directive and the ECT shows that all players on the gas market will receive equal access to investments that someone has made, someone has assumed the risks for. Furthermore, these investments still have not received their return, like for example in the case of the expansion project Yamal-Europe. We assumed colossal risks. Now, we are being told to forget about this, everyone will get equal access. The logic is great. The EU did not invest anything in this system. Well, first compensate our losses, make an adequate investment, and set up new rules of the game. I am convinced that until this balance is found, there is no sense for us to open our system.<sup>702</sup>

For Komarov, "equal access" to pipelines essentially created a situation where other market players could free ride on Gazprom's previous investments. These other firms had not participated in the large capital investment or assumed the risk related to provision of the good in question. Finally, Komarov was underlining that "equal access" was emerging before the large capital investments had produced a return for their investors.

The question of LTCs emerged in discussions with Kemper in the fall of 2001, since journalists, responding to statements from Gazprom, asked questions about them:

Journalist: Gazprom is also very concerned about the threat of the demise of the system of long-term contracts.

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700 "We will not Increase Supply of Gas to Europe," *Nezavisimaia gazeta*, August 10, 2001.

701 Ibid.

702 Ibid.

Kemper: I have explained to Mr. Miller that there is nothing in the treaty that would constitute a threat to the system of long-term contracts. The EU is seriously looking at the problem of Gazprom's long-term contracts, but exclusively in the context of the liberalization of Europe's internal gas markets....The threat to long-term contracts does not originate from ratification of the ECT, but from liberalization of the European gas market. Negotiations between Gazprom and the EU are aimed at finding a compromise: not to undermine the contract system and at the same time not to destroy the principle of creating competition on the European market.<sup>703</sup>

Kemper's reply is revealing. From her perspective, EU reforms – which she confirmed threatened LTCs – were unrelated to the ECT. As a representative of the Secretariat, it was natural for her to understand the question from a legal/organizational perspective; indeed, this was her job. However, this perspective was decidedly different from those of Gazprom, which was looking at the gas market as a whole, and Russian politicians, who were not looking at the problem through a strictly legal lens. Kemper made similar counter-arguments again one week later in an interview that was called in Russian, “We Will Make You Happy.”<sup>704</sup>

This section has shown that, in highlighting the dangers of ECT ratification, the Gazprom lobby was creating a linkage between the ECT and EU liberalization. Both threatened Gazprom's business in Europe. Both would transform the EU gas market by creating gas-on-gas competition, which threatened the company's business and state revenues and would hurt the company's ability to raise financing by undermining LTCs.

Previously, Russia had been integrating into Europe by accepting the rules of the game proposed by the EU. This meant accepting the ECH and Treaty and also implementing neo-liberal structural reforms domestically. At the same time, the EC was also promoting neo-liberal structural reforms as it embarked on the creation of a single EU market. At the heart of this model for integration was the idea that both Russia and the EU would converge on a single neo-liberal model. The ECT was one component of this. The ECT and EU liberalization were always implicitly linked. However, during the 1990s the valence of this linkage was positive. During the second ratification debate, Gazprom pointed to EU liberalization and highlighted the risks it posed for its business. It also connected EU liberalization to the ECT by arguing that the ECT was part of a broader project to create market structures in gas that favored EU consumers over Russia. At this point the linkage became explicit, was at the center of Russia's attention, and had a negative valence.

### *Sectoral characteristics, energy security, and ideological hegemony*

One of the key participants in the second ratification debate was Committee Deputy Chair Valery Yazev, who was a former head engineer at Tyumentranzgas. Unofficially, Yazev came to be known as the chief lobbyist of Gazprom in the State Duma. Yazev testified at the hearings and repeated many of the arguments we have already seen. He also played an important role in promoting Gazprom's perspective during the public debate that ensued after the hearings.

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703 “Alexei Miller Gave Me Hope.”

704 “We will make you happy.” The same discussion appeared at the end of the month in an interview with the prestigious energy trade journal *Neftegazovaia vertical*, (“The Charter does not Infringe on Russian Economic Interests,” September 30, 2001) and again on the ten-year anniversary of the Energy Charter (“Ten Years Since,” December 20, 2001).

In an article in early 2002 entitled, “We will not give away our pipeline one little bit,” Yazev expounded on the problems with the ECT. Like other opponents, he tied the ECT to liberalization in the EU and highlighted the importance of LTCs, which he said were threatened.<sup>705</sup> Here, we examine his arguments to understand how the threat to LTCs was connected to energy security:

There are areas where it is worth conducting experiments with extreme caution. One such area is mutual international energy security. You cannot lightheartedly throw away those foundations on which to this day the reliable energy supply of Europe rests. In this connection, I would especially like to emphasize that it is essential to maintain long term gas contracts - a time tested means of providing energy security.

The strengthening of international energy security must take into account the changing conditions of the energy cycle, and first of all, the increasing complexity and expense of new sources of energy. Liberalizing energy markets in Europe fundamentally changes the nature of this business.<sup>706</sup>

For Yazev, LTCs were essential because they allowed Gazprom to raise financing for capital intensive, long term projects. Without them, new investments would not be made in future projects. The problem was all the more acute moving forward since the next generation of Russian gas (and energy worldwide) would have to be developed under more expensive conditions, both due to the complexity of the deposits (further north, offshore, more complicated geological formations) and the greater distances to markets (requiring longer pipelines).

Given the growing demand for gas in Europe and Russia, the erosion of LTCs and underinvestment in new resources would lead to insufficient supplies down the road. In the context of markets, this meant that prices would go up. Therefore, for Yazev the threat to LTCs was really a threat to energy security both in Russia and Europe.

For Yazev, the natural gas market was not just any old market. It had special characteristics related to the conditions of its production. First and foremost, it differed due to its capital intensive nature, which necessitated special forms of financing (LTCs).

The liberalization of the European gas market supposedly gives all of its participants the right to trade gas, leaving the owner of the network responsible for keeping it well maintained. Furthermore, whether you like it or not, the network has to be further developed. Who is most concerned about this? Of course, by definition the owner of the gas network is. Thus, he has to attract resources - but these are enormous capital investments the return on investment for which takes 10-12 years - look for credits, and insure risk. Given this, the best guarantee for attracting credit are long-term contracts. However, liberalization of the gas market and energy markets in general, puts long term contracts in the grave. With liberalization, spot - that is to say short term contracts, gas stock markets, etc... - are at the heart of the business. In other words, the system of “buy – sell” like, forgive me, panty hose, underwear or any other everyday good.

However, we are talking about a strategic resource, which nature does not replenish. You cannot act like you can with a mass consumer good here. The energy market, due to its capital intensity, labor intensity, resource intensity and long period of return on investment presumes long-term business.<sup>707</sup>

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705 V.A. Yazev, “We will not give away our pipeline one little bit,” *Trud*, February 1, 2002.

706 V.A. Yazev, testimony in “Energy Policy—Parliamentary Hearings, ‘On the Ratification of the Energy Charter Treaty (ECT).’”

707 “Ten Years Ago the European Energy Charter was Signed,” *Business Oil*, April 17, 2002.

From this perspective, liberalization in the EU and the ECT were misguided because they both took a general approach to markets as essentially all the same. From Yazev's perspective, markets had important sectoral characteristics. Natural gas was not the same as any other.

A similar argument was made by Miller in an interview with *Kommersant* several months after he became CEO of Gazprom. The context was a discussion about the importance of LTCs:

[T]he gas market has its own specificities in terms of the product and the geography, in the same way that produce, telecommunications, and American and Asian gas markets have their own laws. Ignoring the particularities of the gas business, and moreover attempting to drastically break a fragile balance - the parity of interests between producers and consumers - is fraught with the danger of serious negative consequences for the energy security of our continent.<sup>708</sup>

These arguments linking investments, LTCs, and energy security were very similar to the logic put forward by the Soviet economist Abalkin. At the same time, this logic was very different from the arguments Konoplyanik made in favor of competitive markets in energy (with many small firms) during the 1990s.

Gazprom and Russia also promoted this perspective in discussions with the EU. Kemper alluded to this in the statement discussed above. In an interview with the German newspaper *Handelsblatt* two months after his appointment, Miller stated that he was against EU plans to liberalize gas markets at the expense of producers<sup>709</sup> and that liberalization “would lead to a breakdown in companies' abilities to sign long-term deals.”<sup>710</sup> Miller repeated his comments to EU representatives ten days later.<sup>711</sup>

Later in August, Miller discussed the ECT in an interview and again linked it to the dangers of EU gas liberalization. In his statements he underlined the great risks involved and again noted the importance of LTCs for investment:

Spot markets can only be a supplemental layer. Only long term contracts under the condition take or pay corresponds to a just division of the enormous risks and multi-billion dollar investments that have already been made into the reliability and security of the gas transport system...The demise of this ... scheme will quickly lead to problems in the investment mechanism, and as a result to the reduction of extraction and to the growth of prices. Given the famous inertia in the gas industry, restoring the previous level of extraction and supply will require no less than five-seven years. It is unlikely that reliable suppliers and serious consumers are interested in this kind of scenario.<sup>712</sup>

Miller was expressing concern about “boom/bust” cycles. With the support of the Russian state, Gazprom insisted on the unique characteristics of natural gas, the significance of LTCs, and the threat to energy security for the entire continent in its discussions with the EU. In this debate, they found allies in key European national energy companies. For example, Miller's position on

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708 “‘Gazprom’ Is Obviously Undervalued.”

709 According to the gas directive of May 1998, EU gas liberalization was supposed to be completed by 2005. “Gazprom Goes on a Diet,” *Kommersant Daily*, July 25, 2001, 4.

710 “Gazprom Speaks Out Against the Liberalization of the European Gas Market,” *Reuters-Russian Language News*, July 10, 2001; “Gazprom expressed concern to EU representatives in Connection with Market Liberalization,” *Prime-TASS*, July 20, 2001; “Gazprom Goes on a Diet.”

711 “‘Gazprom’ Will Not Conclude New Contracts on Gas Supply to Europe in the Near Future,” *Interfax News Fuel and Energy Complex*, July 20, 2001.

712 “‘Gazprom’ is Obviously Undervalued,” *Kommersant Daily*.

LTCs received support from Burckhard Bergmann, the president of what was then the German natural gas company Ruhrgas and one of Gazprom's key partners in Europe.<sup>713</sup>

These efforts were successful to the extent that the EC acknowledged the importance of LTCs for the reasons Gazprom was putting forward. However, the cognitive tension between LTCs/energy security and competitive spot markets/efficiency would continue to persist in EU policy. As we shall see, the arguments that Russia made later about security of demand (the logic that underpins LTCs) were rejected by the EU.

This section has focused on the arguments made by ECT opponents related to liberalization in the EU and the threat it posed to LTCs, smooth investment, and energy security. The same arguments applied to the ECT, since it was seen as an instrument for creating competition that would undermine LTCs. This discussion reveals that an important shift was taking place in the ideological line. In terms of analytical principles, opponents were arguing that not all markets were the same. Markets varied significantly depending on sectoral considerations and particularly on the conditions of production. From this perspective, if markets were to function properly this needed to be addressed when designing policy. In natural gas, market reforms had to take into account the capital intensity of the industry and the complex conditions of production that were anticipated in the future. The gas market needed special forms of finance to support investment; "free markets" by themselves did not address investors' concerns about commercial risk and would lead to underinvestment, scarcity, and energy crises.

Finally, Russia and Gazprom consistently made the energy security argument to EU officials within the context of the ongoing project to create a single, competitive market in gas. Insofar as Russia and Gazprom were arguing that their own interests were universal, this was a bid for ideological hegemony. The effort yielded some success in that the importance of LTCs was acknowledged for the reasons the gas lobby was suggesting. However, the hegemony was very limited; despite Russia's arguments, the intellectual conflict between energy security (understood in this way) and competitive markets was not resolved in the EU, and concerns for competition would prevail.

### *Market positioning, state interests, and regime making*

Implicit in the gas lobby critique of the ECT (and EU policy) was the idea that Russian and EU interests diverged. The crux of the matter was that producers and consumers had different preferences related to price. In discussing EU policy to lower prices, Komarov further elaborated how EU and Russian interests differed:

Europe has already destroyed the electricity market and produced a collapse in electricity prices. Now they need cheap gas....Europe does not plan to lower its taxes, its colossal taxes on energy.

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713 Ruhrgas was acquired by the electricity company E.ON in 2002-3. E.ON History, accessed on July 27, 2011, [http://www.eon.com/en/corporate/2066\\_2596.jsp](http://www.eon.com/en/corporate/2066_2596.jsp). After many years of gas-on-gas competition, Ruhrgas began cooperating with Gazprom in 1998, and the company acquired a minor share in the Russian monopoly. Bergmann became a member of Gazprom's board in 2000. In June 2011, Miller appointed him International Affairs Advisor. "Alexey Miller Appoints Burckhard Bergmann as His Advisor," *Press Center, Gazprom News*, June 30, 2011. These developments are indicative of the depth of the alliance between Gazprom and the German energy industry.

Europe is waiting for cheap gas, in other words, this decrease in price will have to be paid for by gas producers, and that is first and foremost, Russia.<sup>714</sup>

From this perspective, a state's interests depended on its positioning in a market. In terms of price, suppliers and consumers simply wanted different things. This translated into different preferences over market structure (competitive or monopolistic). However, the question was more complex than just high or low prices; it also concerned tax policy and state revenues.

From this vantage point, the EU wanted to have its cake and eat it, too: lower energy prices to make the economy more competitive (meaning lower costs of production for firms) and decreased consumer prices (if the savings are passed on to consumers), but also unchanged taxes to maintain state revenues at the same level. According to this argument, creating competitive markets to lower price would lead to a significant transfer of wealth from the Russian state and Gazprom (through lower tax and export receipts) to European states, producers, and consumers (through unchanged tax revenues, lower costs of production, and potentially lower consumer prices).

The conventional wisdom is that there is a conflict between high taxes and lower production costs/consumer prices. However, through a particular type of industrial policy (creating competitive markets), the EU was trying to have both. Gazprom was pointing out the consequences of this policy for the international distribution of wealth and in particular the harm producers would suffer. Komarov also argued that, “[i]f you look at the ECT in the context of EU initiatives, it is completely unbalanced from the point of view of producers’ interests.”<sup>715</sup>

The idea that consumers want lower prices while producers want higher prices is hardly an original insight. However, conflicts of interest related to price and the idea that interests depended on your positioning in a market were not a politically salient part of the Russian government's vocabulary in the ECH sphere. This was an important change in analytical principles that the Russian government adopted after this debate.

This conflict of interest concerning price and the role of state policy in shaping price to promote state interests was an important idea in the statements of V. Yazev. Several interview subjects suggested to me that Yazev positioned himself in policy battles to advance his political career. In other words, he sensed what the key issues were, in what direction the ideological current was moving, and placed himself in the vanguard to show his value as a politician.<sup>716</sup> He may also have actually believed in these ideas. In any case, as the hearings made clear, he was the defender *par excellence* of Gazprom, the state, and by corollary the emerging ideological line. His arguments provide a valuable lens for understanding how the ideological line was changing.

Yazev highlighted the active role that Western states played in shaping international energy markets to influence price, which was important for their domestic economies:

The new elected US President George Bush already today announced that the American economy and the standard of living of all American citizens depends first and foremost on the global position of the USA. And the head of...Morgan Stanley, Steven Roach unambiguously predicts

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714 Komarov, “Energy Policy—Parliamentary Hearings, ‘On the Ratification of the Energy Charter Treaty (ECT).’”

715 “We Will Not Increase Supply of Gas to Europe.”

716 Interviews in Moscow, 2008-2009.

the stagnation of the American economy should oil prices go above \$18 a barrel. And today, the entire policy of unified Europe and America is aimed at lowering prices for energy....

The Energy Charter is a unique instrument in the battle for lowering prices for global energy.

What do we need? Coordination with those countries that are the primary producers of energy... I am not saying that we should create a new OPEC, but everyone understands the analogy. We need to work out our own position and dictate terms in a pragmatic, tough, and cynical manner. And not be under the thumb of those who need our resources....the idea that we should trade our resources according to their rules – that is the epitome of cynicism!<sup>717</sup>

Like Komarov, Yazev argued that whether you were an energy supplier or a consumer was important in determining state interests. There was no harmony of interests between Russia and Europe because one exported energy, while the other imported it. By the same token, the former wanted higher prices, while the latter wanted lower ones.<sup>718</sup>

Furthermore, it was natural for states to intervene in the international economy to promote their interests. The United States and EU both had an aggressive policy to shape energy markets and prices to their advantage. From this perspective, the ECT – which was proposed by the EU, deeply influenced by the United States (which did not even sign it), and based on principles developed in the West – was an instrument that promoted the interests of consumers rather than suppliers.

Obviously, government liberals in the 1990s did not think they were promoting the interests of the West at the expense of Russia. The key difference is that they saw a harmony of interests, whereas Yazev did not. The idea that the ECT favored importers of energy over exporters was entirely absent in Russian ECH policy during the 1990s. Nevertheless, it would become a recurring theme within the Russian state; here, too, the ideological line was changing.

Finally, rather than assume the interests of consumer countries, Yazev was arguing that Russia had to develop its own interests. Furthermore, Russia should work aggressively, but pragmatically, to craft “rules of the game” that promoted its own interests rather than accept the rules proposed by the West (whose interests were different). Among other things, Russia might coordinate with other energy producers.<sup>719</sup>

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717 Yazev, “Energy Policy—Parliamentary Hearings, ‘On the Ratification of the Energy Charter Treaty (ECT).’”

718 In many respects, these arguments—as well as those of Komarov and Chernomyrdin—are similar to those made by Zhirinovsky, whom I have characterized as ideological. Is this not simply xenophobia? There are several differences. First, these arguments were based on economic reasoning. Saying that an international agreement or a particular market structure favors consumers over suppliers is not the same as saying, “Remember Mr. Boiko? He simultaneously had two citizenships. People are working for the other side.” Second, the Gazprom lobby did not condemn the agreement wholesale but focused on particular problems, which they argued could be corrected through (difficult) negotiations. Zhirinovsky argued that “all these charters are dangerous.” Finally, no one besides Zhirinovsky stated that “in the Ministry of Property there was an agent X...who confirmed the list [stating] who gets what: which industry, which asset. The time will come when he will have to answer.” This was the context for his final remarks at the hearings: “I ask doctor of economics Yershov [who had testified earlier] to think about responsibility.” There is a difference between being a radical nationalist making not too subtle threats of violence and not seeing an economic harmony of interests between Russia and Western consumers of its resources.

719 Yazev, who is the head of the Russian Gas Society, would become somewhat famous internationally for working to create the “International Alliance of National Non-governmental Gas Organizations” or “MANNGO” (Международного альянса национальных неправительственных газовых организаций), which is a rudimentary



In this connection, Yazev also supported previous arguments that Russia should not allow equal transit tariffs for its competitors but rather leverage its transit monopoly to shape the gas market. Therefore, ratification would mean that:

Russia will have to set a single gas transit tariff for all transitors on its pipeline. But this is not advantageous, since Gazprom's unique network allows [us] to maintain a monopoly on all transit across Russia territory. Why not use this?<sup>720</sup>

We can see that market positioning referred not just to consumers versus suppliers. It also had consequences for how Russia related to its competitors. In particular, as a firm (state) that had a monopoly on transit, it could exercise market power to shape energy flows, market volumes, and ultimately price. This thinking would also shape Russian policy toward its Central Asian competitors.

Overall, critics were arguing that Russia needed a more sober assessment of its interests, which did not overlap with those of consumer states, the EU included. This kind of understanding could only emerge with a more sophisticated economic analysis that acknowledged that states had different positioning on markets. Finally, clearly the idea of making rules, using its monopoly to influence the market, and coordinating with other producers reflected the kind of thinking that underpins a regime maker role identity. On all of these issues, the ideological line shifted after the ratification debate. Furthermore, as we shall see, Russia began to translate these insights into its policy in the ECH sphere.

### *Domestic vs. international in energy*

The second ratification debate also raised the question of the relationship between the ECT and domestic structural reforms in energy. Creating competitive markets was a central part of the ideological line during the 1990s and an important policy goal for Russian governments. However, especially in the energy sphere, successes were limited.<sup>721</sup> As a result, structural reform in energy – particularly in electricity and gas – was still on the agenda by the time Putin came to power.

During this debate, Yazev argued that since work on developing the structure of Russian domestic energy markets was still in progress, Russia should abstain from ratification on that basis alone.

The country is on the threshold of reforming its natural monopolies. As of today, the concept for reforming Gazprom and RAO UES has not been chosen. And we, having signed the Energy Charter Treaty, are limiting ourselves in our choice for reforming natural monopolies with an international-legal framework. Has anyone thought about this or not?

Today we should probably first figure out: in which direction will our electricity go? How will the development of Gazprom proceed? How will processes in atomic energy develop? In the oil

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natural gas cartel. "A Gassy Opposition," *Kommersant*, October 31, 2006, accessed on July 23, 2011, <http://www.kommersant.ru/Doc/717833/Print>.

<sup>720</sup> "Yesterday at the Duma Hearings About the Problem of Ratification of the Energy Charter Treaty," *Oil Digest*, January 27, 2001.

<sup>721</sup> The oil industry saw the creation of numerous private firms. A number of interview respondents suggested that at the regional level, however, competition was still limited. Electricity and natural gas remained national monopolies. Interviews in Moscow, 2008-2009.

sector? And without tying ourselves down with any international legal commitments, decide our domestic questions, and then, based on this, decide: to join or not to join whatever constraining – for us too – international legal agreements?<sup>722</sup>

For Yazev, it did not make sense to undertake international commitments before Russia had decided on the structure of its domestic energy markets. Otherwise, it would be constrained internationally in terms of what kind of domestic policy it could develop. Of course, it is implicit that Russia should decide the structure of its internal markets on its own.

In fact, the debate over ratification overlapped with a major political battle concerning the structure of the natural gas market. Government liberals proposed yet again to break up the gas monopoly. Not surprisingly, Gazprom objected. This high stakes battle lasted until late 2003, when it was decided that Gazprom would be reformed but not broken up. For Yazev, it was premature to ratify the ECT in 2001 while this question was still unresolved.

In highlighting the primacy of domestic questions over international ones, Yazev was invoking an important point that President Putin made in his July 2000 address: Russia should not subordinate domestic goals to international ones. In this particular context this meant that, as Yazev suggested, Russia's international commitments should not constrain the development of its domestic gas industry. The latter, on which Russia had to decide autonomously, came first. Only after the domestic structure had been chosen could Russia negotiate legally binding terms internationally. Moreover, international rules could not impinge on what had been decided in the domestic sphere.

As we shall see in the next chapter, the fact that a single concept for the domestic gas market was finally chosen had an important effect on Gazprom's behavior in the ECH sphere; beginning in the fall of 2004, for the first time since the ECH was created, the company would play an active role in promoting its interests within the ECH context and specifically in shaping the terms of transit during negotiations on the draft protocol on transit.

Before moving on to arguments made by proponents, we can summarize this section to understand the main contours of opponents' criticism of the neo-liberal ideological line. The gas lobby challenged two important causal principles behind the prevailing thinking that the ECT was in Russia's interests. Opponents argued that the ECT would have the opposite effect of what was promised in terms of: 1) decreasing export revenues for Gazprom; and 2) severely damaging its investment climate. The key point was that the transit provisions undermined its transit monopoly with respect to Central Asian competitors, and this would transform the EU market, leading to lower prices and eroding LTCs on which Gazprom relied to finance its projects. The discussion of LTCs also saw opponents link the ECT to EU liberalization; the goal of both was to transform the Eurasian natural gas market to create competition, which was detrimental to Gazprom's business.

The gas lobby also challenged two analytical principles that characterized the ECH ideological line up to that point. First, it criticized the understanding of markets that emerged from a neo-liberal perspective. In fact, a stylized approach to markets in general was misleading because markets varied significantly by sector. The "one size fits all" analysis missed the variation in financing and investment according to the characteristics of production; in this respect, natural gas was not just any old market. Ignoring this promised uneven production,

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722 Yazev, "Energy Policy—Parliamentary Hearings, 'On the Ratification of the Energy Charter Treaty (ECT).'"

future scarcity, and high prices, and this threatened energy security not just in Russia but in Europe as well. Essentially, this was an argument against boom/bust cycles. Russia and Gazprom also made this argument to its EU counterparts. In this respect, they were trying to create ideological hegemony in Europe. However, although Russian/Gazprom arguments did have some effect, in the end the attempt at ideological hegemony had only limited success.

Second, opponents argued that in evaluating the Treaty, Russia needed to have a more sophisticated understanding of its positioning on the international natural gas market and develop its own interests on that basis. Until now, Russia had adopted the EU interest as its own. An implicit attack on the harmony of interests premise (all states had an interest in competitive markets and efficiency) that shaped the ECH ideological line in the 1990s, this view emphasized that Russia was a producer/exporter to Europe, which was a consumer/importer. This alone meant that the two had different interests concerning competitive markets and price levels. From this perspective, the ECT and EU structural policy both aimed to transform the Eurasian natural gas market to create competition that would lower prices and transfer wealth from Russia and Gazprom to Europe and its firms for whom gas was an important input (while leaving EU taxes unchanged). In short, the ECT and liberalization were in the interests of consumer, not producer, states. Both were instruments to make the EU economy more efficient (through lower energy prices from competition), but this would only erode Russia's natural gas rents.

The political insight here was that powerful states played an active role in shaping international markets to their advantage. This was a natural state of affairs and most evident in US and EU foreign policy. Russia's foreign policy should aim for the same. In particular, Russia needed to come to terms with its market positioning as a Eurasian transit monopolist and leverage this to shape the gas market to its advantage.<sup>723</sup> Ratifying the ECT was indeed a grave mistake since it would have the opposite effect by undermining the market power (to control transit and shape volumes and prices) that this positioning conferred on Russia. In addition, Russia could also coordinate with other producers to shape the market; in other words, creating a cartel was an attractive option that was available to Russia. This thinking was very consistent with a regime maker role identity and would affect Russian ECH policy.

Finally, opponents argued that it was premature to discuss ECT policy, let alone ratification, since Russia was still in the process of reforming its domestic markets. ECT policy could not come before domestic reform because it would limit the kind of domestic structure Russia could create. By making commitments internationally that could impinge on domestic policy choices, Russia was giving up its autonomy. Supporters had the process exactly wrong; first Russia needed to settle the domestic questions and then on that basis promote its interests internationally. This hearkened back to the vision of great powers – which do not subordinate domestic goals to international ones – that Putin proposed in July 2000.

In short, this critique led to a major shift in the ECH ideological line in Russia. It also informed its changing state identity. The next section examines the arguments made by

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723 From the neo-liberal perspective, monopolies were unambiguously harmful because they were inefficient and could exercise market power to extract surplus from consumers through higher (monopoly) prices. As a result, monopolies needed to be broken up as much as possible; natural monopolies had to be regulated to prevent such abuses. The fact that internationally Russia was not a consumer but a supplier and might have different interests was not salient in ECH discussions. Again, the idea of market positioning in this sense was not really a part of Russia's political vocabulary in the ECH setting.

supporters to have a full view of the second ratification debate. This will be a prelude to understanding how the ideological line and state identities change theoretically, which I examine at the end of this chapter.

## **Arguments in favor of the ECT**

### *The Ministry of Energy*

The Ministry of Energy was the lead government actor in charge of Russian ECH policy. During the 1990s, it played a coordinating role (among relevant Russian agencies and firms) in developing Russia's position for negotiations. It also represented the government during ratification hearings in 1997 and 2001.

Testifying in support of ratification, First Deputy Energy Minister Gurami Avalishvili invoked many of the neo-liberal principles that underpinned the agreement and repeated many of the arguments advanced by supporters in the 1990s. The ECT, by creating an attractive climate for private investors, would promote investment into Russia. It would also legally protect Russia's investments abroad and increase trade. The latter implied an increase in Russian exports. In addition, Avalishvili argued that the agreement advanced key goals in the most recent energy strategy (2000): the increase in the efficiency of the energy sector, the globalization of energy markets and Russia's entry into the global economic system, and the expansion of mutually advantageous international cooperation in energy. According to Avalishvili, the successful development of the energy sector, Russian economic growth, and the country's economic and energy security depended on fulfilling these goals, and the ECT was valuable because it promoted these objectives. By now these arguments should be familiar; this was the neo-liberal ideological line.

Additionally, he argued that the ECT trade regime was similar to the WTO regime and so would allow Russian exporters to take advantage of the WTO regime in the energy sector in advance of Russia's accession. He also noted that the ECT would alleviate Russia's transit difficulties with neighboring states.

Interestingly, Avalishvili argued that Russia could raise its revenues by increasing the transit of energy materials from neighboring states. Here he specifically mentioned transit of natural gas from Central Asia as a source of revenues (the more gas Russia transited, the greater the revenues). At the same time, he noted that Russia, as a state that both provided and required transit services to and from other states, needed to approach these questions in a way that admitted reciprocity. In other words, Russia should accord the same terms to all other states as it wanted for itself. In short, the ministry was focusing on the revenue-earning side of transit. This was exactly the opposite of what the gas lobby argued should be Russia's strategy (not maximizing transit to increase revenues, but controlling/limiting transit volumes to support prices). As we shall see shortly, these arguments about Russia's role as a transit state were elaborated by the MID.

More generally, Avalishvili argued that ECT ratification was key to the development of strategic relations in energy between Russia and the EU, as "underlined in the joint Putin-Prodi statement" from the previous year (discussed above). Thus, ratification of the ECT was important because of its consequences for Russia's relations with the EU. This was consistent

with the idea of sending a signal to Western governments about the kind of state that Russia had become: one that accepted the neo-liberal rules of the game and was law abiding and committed to international institutions as the primary form of interstate cooperation.

Finally, Avalishvili also noted how the agreement related to Russia's integration into the international economy:

The increasingly active participation of Russian in the processes of economic and energy integration that are occurring in Europe demands the convergence of rules of interaction in order to realize cooperation. The ratification of the Treaty will give Russia the opportunity to speak with its partners using the same legal language.<sup>724</sup>

Two points are noteworthy here. First, cooperation and integration depended on convergence of rules, which was based on the neo-liberal model. As Russia became increasingly active in the international energy economy, it had to accept those rules. The ECT was important for Russia to move in that direction. Second, we can see the importance of law in interstate relations. When Russia spoke to its partners, the language was legal. However, non-ratification of the ECT meant that Russia had a speech impediment that hindered cooperation. ECT ratification would eliminate this problem.

### *The Ministry of Foreign Affairs*

The Ministry of Foreign Affairs also played a key role in articulating the advantages of ratification. Representing the ministry was Deputy Minister Dr. Igor D. Ivanov,<sup>725</sup> who also discussed the ratification question in an article and book he published at the time. Below I will refer to his arguments from all three sources.

Overall, the ministry was in favor of ratification. According to Ivanov,

[T]he delay [in ratification] is due to the fact that previously it was not entirely certain that the document could garner a solid and convincing majority given the makeup of the previous Duma. However, from the point of view of the state interests of the country, such a delay appears unjustified.<sup>726</sup>

During his testimony, Ivanov made many of the same neo-liberal arguments that we have seen previously, namely that the ECT would attract investments to Russia by improving its investment climate in legal terms:

We have talked a lot about foreign investment in the energy complex. Here too the Treaty equalizes the attractiveness of Russia with other countries interested in such investments.

...In other words, ratification will allow us to build in the energy complex an investment climate corresponding to international law.<sup>727</sup>

In this way, we are bringing our investment climate closer to the standards of international law....This in fact was the primary [issue] when the Treaty was being concluded.<sup>728</sup>

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724 G. D. Avalishvili, testimony in "Energy Policy—Parliamentary Hearings, 'On the Ratification of the Energy Charter Treaty (ECT).'"

725 Ivanov was an academic economist and a corresponding member of the Russian Academy of Sciences.

726 Ivanov, "The Energy Charter Treaty and the Interests of Russia."

727 Ibid.

Here Ivanov was highlighting the neo-liberal causal principle that had been part of the ideological line under Yeltsin: laws modeled on international norms were necessary to attract private foreign investment. The main reasoning had been that such laws reduced political risk, making private investors more comfortable about investing in Russia. Here Ivanov mentions a different but complementary logic: Russia had to adopt these laws to catch up with other states that, due to their better legal framework, were more competitive in attracting foreign investment. From this perspective, the international financial system was a legal competition between states for financing; whichever state was most successful in emulating “international standards” would win the race to bring in private investment. Ratification was necessary to support Russian efforts in this competition. Furthermore, he stated very clearly that attracting investment through this kind of (neo-liberal) strategy had been the goal when Russia negotiated the ECT.

Ivanov also argued that the trade regime would promote Russian exports in a wide variety of goods including value-added processed goods.<sup>729</sup> At the same time, Russia could take advantage of the benefits of a trade regime close to GATT prior to actually joining. Thus the ECT was a way to enjoy the GATT’s benefits with only “minor blood shedding”<sup>730</sup> compared to what most countries experience when joining the organization.

In terms of transit, Ivanov argued that the agreement would promote the interests of Russian exporters that experienced difficulty transiting resources to the EU market. He also addressed Gazprom’s critique of the transit provisions head on:

There remains one question – the disagreement concerning transit. The substance of the matter is that Gazprom is fully satisfied with article 7 when it applies to its transit operations in foreign states. But it has been opposing its application...on Russian territory.

...The selective application of international treaties according to the principle “one thing for them, something different for us” just does not happen.<sup>731</sup>

Ivanov was pointing out the inconsistency, indeed hypocrisy, of Gazprom’s position on the ECT. The company had an instrumental view of the agreement based on its interests. For Ivanov, this was not possible in international relations. It is consistent with the neo-liberal view of state sovereignty as legal sovereignty: states make laws and sign treaties, but then they are bound by them irrespective of power or interests.

For Ivanov, international law was central to international relations, and he focused on how international law was necessary to promote Russia’s interests:

As a major energy superpower, Russia naturally has to defend its interests in this sphere everywhere in the world. Among other things, this is done through a system of international agreements. One of these is the Treaty which we are examining today.<sup>732</sup>

Any treaty is a balance. We believe that this balance falls in favor of Russia. Moreover, we are already using this Treaty.

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728 I. D. Ivanov, testimony in “Energy Policy—Parliamentary Hearings, ‘On the Ratification of the Energy Charter Treaty (ECT).’”

729 This was a response to critics who argued that Western states were only interested in raw materials.

730 Ivanov, “The Energy Charter Treaty and the Interests of Russia.”

731 Ibid.

732 Ivanov, testimony in “Energy Policy—Parliamentary Hearings, ‘On the Ratification of the Energy Charter Treaty (ECT).’”

...90% of our gas is supplied to foreign consumers through the territory of third countries. I repeat, the Ministry of Foreign Affairs is doing everything possible...to provide the political conditions for this transit. But we can't guarantee success in this respect every time.

Fine, through Brussels, with a reference to the energy dialogue we were able to neutralize Poland this time, and were able to see "Blue stream"<sup>733</sup> to its conclusion. But we cannot guarantee, that tomorrow or the day after we will be able to do the same thing with respect to some other country, *if only because we do not have the law to count on. We have political, moral, technological, all sorts of arguments, but for the time being they are not legal arguments.*<sup>734</sup> (emphasis added)

Ivanov acknowledged that law was only one of the instruments available to Russia to promote its interests, but from his perspective, law was the most reliable and effective. As an instrument of diplomacy, law was superior to politics, which made for an ad hoc and unreliable foreign policy. Finally, Russia was already using the ECT in international affairs to advance its interests. Ratification would make its use of the Treaty more effective.

Ivanov also discussed the importance of international laws and multilateral institutions in a book he published in 2001:

Russian economic diplomacy, under conditions of globalization, must transform itself from being primarily bilateral to being mostly multilateral, defending the interests of the country through multilateral agreements (for example, the RF-EU PCA, UN convention for maritime rights, etc...) and within the framework of international organizations (WTO, IMF, APEC, etc...) which at present set the tone for forming world trade policy.<sup>735</sup>

These remarks are indicative of a regime taker role identity: to be economically successful, Russia needed to accept what was out there. This was the ideological line under Yeltsin and the vision for integration that prevailed in Russia during the 1990s. The idea of promoting Russia's interests through multilateral international institutions – and the diplomatic value of the legal regime provided by the ECT in particular – was still a central idea.

Ivanov's remarks also show that the neo-liberal approach influenced the ideological line in the area of transit and Russia's relations in this sphere with other energy producers of the former Soviet Union (FSU):

Our geopolitics consists of attracting onto Russian territory a maximum of transit of Caspian and Central Asian energy resources, and not allow them to bypass Russia under the control of the US. This is what is written in the Russian Strategy for the Caspian, approved by the country's President, and in the decisions of the Russian Security Council, and if we do not do this, we will lose both the Caspian and Central Asia. That is why we are investing, particularly from our budget billions of rubles and dollars, urgently building new ports and gas and oil pipelines. And this too demands ratification of the Treaty, because in its absence *we remain uncompetitive in the legal sense* for our partners in the CIS.<sup>736</sup>

We are...investing significant amounts of money into infrastructure...But you must understand, if we are trying to channel all the transit through Russia, *we have to be competitive as a transit country in the legal sense.* If our transit regime remains uncertain, then, naturally, it will be sufficiently difficult to promote this goal, and then the producers, who under different circumstances would agree to transport their exports through Russian territory, will look for

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733 Blue stream is a natural gas pipeline from Russia to Turkey that passes under the Black Sea.

734 Ivanov, testimony in "Energy Policy—Parliamentary Hearings, 'On the Ratification of the Energy Charter Treaty (ECT).'"

735 Ivanov, *Economic Interests of Russia*, 22.

736 Ivanov, "The Energy Charter Treaty and the Interests of Russia."

alternative outlets onto the world market. This concerns the very same Turkmenistan.<sup>737</sup>  
(emphasis added)

We saw earlier that Avalishvili made the argument that the ECT would increase Russia's revenues from transit by attracting more energy transit from Central Asian producers. Ivanov was making a political argument: maximize transit to keep Russian control over resources coveted by the United States. Nevertheless, the same logic that applied to investment was operative for transit. To attract it, Russia had to be legally competitive.

This is very different from the approach the gas lobby was promoting: to exercise monopoly power to shape the market. For Ivanov, Russia's (meaning Gazprom's) abuse of its monopoly was precisely what created legal uncertainty and would result in closer relations between the Central Asian states and Russia's geopolitical competitor, the United States. This difference is interesting because it shows two different views of the relationship between economics and power. For Ivanov, the economy (a neo-liberal transit policy) was an instrument of power (Russia would prevail over the United States). For Gazprom and its allies, power (Russia's monopoly) would lead to greater wealth. This contrast is also indicative of how the ideological line was changing under Putin.<sup>738</sup>

Finally, Ivanov's statements revealed that Russian ECT policy was not just about achieving international goals, but it had an important domestic political and economic component as well. This can be seen in his explanations of why Gazprom opposed ratification:

[Gazprom argues that ratification] will introduce disorder onto the energy market of the CIS, in particular, opening a path for Turkmen gas to Europe. It would be more accurate to say that ratification will make this market and transit operation more predictable and transparent....<sup>739</sup>

Gazprom... is protesting resolutely against the ECT, and in particular its article 7 on transit, because the transparency of transit would complicate the company's transfer pricing along the entire length of its gas pipelines.<sup>740</sup>

From this perspective, the ECT was partly a vehicle to create order in Russia's gas markets by creating transparency, imposing rules, and perhaps most importantly eliminating the informal extraction at the expense of the state that was characteristic under Vakhirev.<sup>741</sup> The idea of using international commitments to promote and lock in domestic goals is familiar to IR scholars. However, what this suggests in the battle over the ECT was really several political battles simultaneously. First, it was a contest over how to organize international energy markets. Second, it was a conflict over the relationship and balance of power between the state and

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737 Ivanov, testimony in "Energy Policy—Parliamentary Hearings, 'On the Ratification of the Energy Charter Treaty (ECT).'"

738 Many interview respondents noted this when discussing Russia's increase of energy prices to former Soviet republics. Under Yeltsin, low energy prices were an inducement to keep FSU states in Russia's sphere of influence. Under Putin, this policy was considered a failure (the FSU states "freelanced" and "fed at many troughs" anyway). Thus, prices were raised to increase revenues (so the argument goes). Interviews in Moscow, fall 2007, 2008-2009. For a good discussion of the emergence of "geo-economics" under Putin, see Andre P. Tsygankov, *Russia's foreign policy: change and continuity in national identity*, (Lanham, Md.: Rowman & Littlefield, 2006).

739 Ivanov, "The Energy Charter Treaty and the Interests of Russia."

740 Ivanov, *Economic Interests of Russia*, 119.

741 Transfer pricing was one of the ways companies avoided officially showing a profit and paying taxes. For a good example see, All In The Family - Audit Chamber Probe Into Itera Alleges Transfer Pricing. NEFTE Compass. 24 August 2000.



domestic actors (the state could invoke its commitments under the ECT to change business practices in the gas sector).

*The response to the gas critique*

Many government actors, indeed a majority, supported ratification in 2001. From their perspective, the ECT broadly promoted Russia's interests in the energy sphere. This assessment was based on the neo-liberal ideological line, which saw competitive markets governed by a robust legal framework that protected the interests of private market actors as the most effective form of economic organization. At the international level, this thinking was based on a belief in a harmony of interests across states that would all benefit from free markets, competition, and efficiency. For Russian liberals, this vision promised increasing wealth and economic development, and they argued that this would restore Russian state power. Finally, it also construed sovereignty as legal sovereignty whereby the most important interaction between states was multilateral treaty making. From this perspective, states were subject to the laws they made and thus were all equal and behaved consistently irrespective of power or interests.

However, everyone was aware of Gazprom's objections. First, Gazprom identified the same transit problems at the time of the previous ratification attempt.<sup>742</sup> Second, Komarov's press conference before the hearings attracted considerable attention. As it turned out, supporters of ratification conceded that Gazprom's arguments about the deficiencies of the transit regime in the ECT were legitimate and needed to be addressed. This was related specifically to the question of Gazprom's relations with its competitors in Central Asia, how this would affect its business in Europe, and the consequences for the state budget and Russian economy. For example, although he made a strong case concerning the advantages ratification would bring to Russia, Avalishvili did not reject Gazprom's arguments entirely:

We know about the concerns of Gazprom concerning ratification of the treaty. And we think that a discussion will be dedicated to this question.

In conclusion, I would like to note that the importance of the Treaty as an international investment and trade agreement for the development of the energy complex, requires a very serious attitude and the resolution of a series of questions. In particular, conducting a detailed analysis of the economic and political consequences for Russia of ratification of the Treaty.<sup>743</sup>

As we can see, Avalishvili himself did not address Gazprom's concerns during his testimony. However, he did promise a discussion and suggested that analysis of the consequences of the agreement was necessary. This was partly a response to Gazprom's claims that its business would suffer disastrous consequences and also to the repeated claims by opponents that arguments in favor of ratification were based on attractive theories, not economic analysis or concrete numbers (such as economic models forecasting how revenues and investments would change).<sup>744</sup>

A more specific reply came from Ivanov, who, as we just saw, was skeptical of Gazprom's opposition:

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742 Interviews in Moscow 2008-9.

743 Ivanov, "The Energy Charter Treaty and the Interests of Russia."

744 For examples of this kind of critique, see Yazev, "Energy Policy—Parliamentary Hearings, 'On the Ratification of the Energy Charter Treaty (ECT).'"

Overall our opinion is as follows: of course, the Treaty needs to be ratified, but there are things that need to be finalized beforehand. *In particular, I think that our gas sector is right, that ratification of the Treaty today, without settling our relations with Turkmenistan might create specific threats to our interests on export markets.* That is why, probably, first it is necessary to settle on an intergovernmental basis our relations with Turkmenistan. They are also right in another of their objections, specifically, that it is *necessary to conduct an expert study.* ... That is why in short, our position is the following: Definitely in favor of ratification, but not tomorrow.<sup>745</sup>

While supporting ratification, Ivanov was also acknowledging that Gazprom's critique of open pipeline access for its Central Asian competitors was legitimate. As a result, Russia could not ratify the ECT right away but first needed to settle its relations with Turkmenistan (the largest gas producer in Central Asia) at the intergovernmental level. In other words, the Russian state had to address the problem of competitors' gas flooding the EU market.<sup>746</sup> From a broader political perspective, Ivanov also understood that Russia would need to rehabilitate its relations with Turkmenistan after Gazprom's extended gas embargo cut off an important source of revenues for that country.

With supporters' acknowledgment of the legitimacy of Gazprom's arguments, the old neo-liberal ideological line was becoming adulterated with competing ideas. On the one hand, Ivanov argued that Russia needed to ratify the ECT to create a predictable legal framework and thus be legally competitive and able to attract maximum transit from its Central Asian competitors. From this perspective, foreign policy through law and multilateral institutions was the most reliable and effective form of diplomacy and a good economic strategy. At the same time, he admitted that due to the possible negative economic consequences of that very policy, Russia needed to settle its relations with Turkmenistan on a bilateral, interstate basis.

In short, his thinking was not quite coherent. He was accepting some of the principles proposed by Gazprom, but these did not quite fit with the neo-liberal principles on which his arguments in support of the ECT were based. In Kuhnian terms, the export market problem was an anomaly for neo-liberal thinking, and so his response was ad hoc.

Additionally, his arguments presented two different visions of the state. One perspective – the neo-liberal vision – saw the state as the promulgator of international laws (treaties) in a multilateral setting to create a predictable framework for economic activity within the context of competitive markets. According to the other vision, the state is an international actor that has bilateral political relations with other states and an eye toward specific interests (protecting Gazprom's export market and locking in gas supplies for domestic consumers) and substantive economic outcomes (signing LTCs and supporting gas prices in the EU). This was the beginning of the SS perspective. Moreover, the SS vision was becoming primary; the Russian state had to settle the Turkmenistan question before ratification. Previously, there had been no need for

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745 Ivanov, "Energy Policy—Parliamentary Hearings, 'On the Ratification of the Energy Charter Treaty (ECT).'"

746 Settling relations also refers to a related goal: signing LTCs to purchase Turkmen gas to supplement dwindling domestic gas in Russia's fuel balance. Demand for gas in Russia was growing now that the economy was recovering. At the same time, the giant fields that were Gazprom's main source of gas production were past their peak. As a result, imports were needed to make up future shortfalls. In his testimony, Avalishvili's mention of "analysis of bilateral relations connected to the development of future fuel and energy balances of the CIS" also refers to this issue. In fact, Russia's recent strategy for limiting gas volumes on export markets (EU and Turkey) has been to sign long term purchase contracts at "EU prices" with its competitors in the FSU (Azerbaijan, Central Asia) for domestic consumption. This will be discussed in greater detail in the next chapter.

sequencing since the ECT was supposed to be the basis for energy relations between Russia and other FSU (indeed, all other ECH) states.

In addition, Ivanov also agreed with Yazev that Russia needed to finish reforming its domestic markets before making a decision on the Treaty. This is very different from the original concept behind the ECT in which there was no conflict between Russia's international commitments in energy through the ECT and the structure of its domestic markets. The reason they were previously compatible was that, in principle, both ECH policy and domestic structural reform followed the same blueprint: creating competitive markets according to the neo-liberal model.

### **The emergence of the SS ideological line in the ECH sphere**

#### *Discovering the interest of the state*

During the 1990s, Russian thinking about the interests of the state was informed by the neo-liberal perspective. This approach posited that the state's primary interest was to attract investment to create competitive markets that would lead to greater economic efficiency, increased foreign trade revenues, and economic growth. In short, neo-liberal reforms would lead to the wellbeing of the whole of Russia and even to increased tax revenues for the state. Viewed in this light, all good things went together. However, during the hearings, it became clear that no one really knew what the state interest was. This "red flag" was an important new theme raised by several participants during the ratification debate.

The concern about the interest of the state was first publicly raised before the hearings took place. Two days before the hearings, Yuri Lipatov, the deputy chair of the Duma Committee on Energy, Transport and Communications – the committee holding the upcoming hearings – stated that the goal of the hearings was to "figure out" the consequences of the ECT, which was a "complicated legal document." He also added that while the electricity and oil sectors supported that ECT, the agreement gave Gazprom serious pause. According to Lipatov, "the committee's goal is to figure out the position of the government. Different ministries have their own approaches to this document, but the government does not have a single position overall."<sup>747</sup>

During the hearings, Lipatov raised the same concern in his concluding remarks, which he addressed specifically to Chernomyrdin:

But Viktor Stepanovich, I would like one more time to say to you – an authoritative person as the former prime minister: as of today, for all intents and purposes, the Government does not have a single opinion on this document, and in my view, this is the biggest problem.

That is why the State Duma is prepared to work with the government to solve questions in a serious way, in a state oriented way (*по государственному*)...I officially declare to you, that kind of understanding of this document does not exist today. Thank you.

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747 "Y. Lipatov: At the Parliamentary Hearings a Discussion of the Energy Charter Treaty Will Take Place," *InfoCom-State Duma Press Service*, January 24, 2001.

For the deputy chairman, the greatest problem was the lack of a consolidated position within the government. This was not the right way to proceed with policy; effective policy required a single position, and the Duma was prepared to work with the government toward this end. Revealingly, Lipatov equated being “serious” with a statist orientation. This was indicative of how the ideological line was changing: statist thinking was becoming more prominent and valuable.

Not surprisingly, Yazev made the same point, also at the end of his testimony:

That is why, in consideration of what I have said, I would like to underline one more time, that Russia must for the time being refrain from ratification of the Energy Charter Treaty. Until a single state approach to this question – that takes into account first and foremost, [our] interest in providing for our energy security, reforming our natural monopolies, and the development of the country’s energy strategy until the year 2020 – is formulated.<sup>748</sup>

Yazev’s concern about developing a single-state approach was very clear. Moreover, yet again he was subordinating Russia’s ECH policy to domestic questions. He had already pointed out that domestic reforms came before the ECT. Here he was also suggesting that ECH policy needed to be seen through the lens of Russia’s energy security. As we shall see in subsequent chapters, the question of energy security became an important concern for Russia in the ECH sphere. Finally, ECH policy needed to be understood from a long term perspective and thus needed to await the release of the new, 20-year energy strategy.

During his testimony Chernomyrdin, who, as mentioned already, was now a deputy, also noted the lack of a clear position concerning the agreement: “I regret very much that...the government does not have a lucid position. After all, we are not going to decide the fate of the country through the method of voting. Perhaps, after all, we should think a little?”<sup>749</sup> The former prime minister was making the same point as the other speakers about the lack of an obvious, single position. These remarks are particularly interesting because they reveal how he thought about policy decision making. The reference to voting suggests that the state interest is not just an aggregation of separate, sub-state preferences in which the interests of the majority prevail. Policy has to be developed by thinking about the whole.

Duma Deputy Vasilii N. Teterin, the deputy chair of the Duma Committee on Property, also noted that the hearings revealed a contradiction between different societal groups. Like Chernomyrdin, he concluded that this was not the right context within which to make a decision:

[F]rom what position are we supposed to consider this problem? If we consider it from the position of electricity, then it is one question. If from the position of the oil men, another. If from the position of the gas men, a third question. From the position of academics – a fourth. Who after all should define from what position to act? Probably, the state! It should act from the position of Russia’s energy security.

I think that this question is so important that we today as legislators do not have the right to let the opportunity to analyze the ECT slip.<sup>750</sup>

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748 Yazev, “Energy Policy—Parliamentary Hearings, ‘On the Ratification of the Energy Charter Treaty (ECT).’”

749 Chernomyrdin, “Energy Policy—Parliamentary Hearings, ‘On the Ratification of the Energy Charter Treaty (ECT).’”

750 V.N. Teterin, testimony in “Energy Policy—Parliamentary Hearings, ‘On the Ratification of the Energy Charter Treaty (ECT).’”

For Teterin, how to decide the ratification question depended on the onlooker's perspective. All the sectoral groups and even academics saw the problem in different terms and came to different conclusions. The hearings were showing that there was no single way to understand the agreement; the problem was more fundamental than the state not having its own interest. Without a state perspective, Russia could not even begin to think about what the ECT represented. As a result, it was the state's role to define the framework within which an assessment of the ECT could take place. Furthermore, the primary consideration had to be the energy security of Russia as a whole. In theoretical language, the state had to impose a cognitive consensus based on the energy security interests of the whole, and only then would it be possible to understand what Russia's ECT interest was. More generally, the ECH discussion was moving in a statist direction.

### *Further study*

By the time the hearings were over, there was universal consensus that Russia was not prepared to ratify the ECT. Even supporters adopted Ivanov's formula: ratify, but not tomorrow. Almost everyone also agreed that the ECT merited additional study. According to chairman Katrenko, "[e]veryone agreed with postponing ratification for a period that would allow the ECT to be studied."<sup>751</sup> The lack of a clear, unified position on what the ECT represented for Russia led the deputies to recommend further study. Moreover, the consensus was that the question needed to be analyzed from the perspective of the state.

Again, Yazev was a key figure, recommending a study of the consequences of ratification for Russia as a whole before the question could be decided:

[I]t is necessary to receive an official government report and a financial-economic substantiation of the law "On the ratification of the Treaty..." before its discussion in the State Duma. No one has brought forth these figures.

...Taking into consideration the strategic significance of this question, it would be sensible to discuss it at the Security Council. And it would be appropriate, and this will be in our recommendation, for the State Duma to request that the President have the Security Council review the question of Russia's participation in the ratification of the Energy Charter Treaty.<sup>752</sup>

As Yazev had predicted, the Duma recommended that the president ask the Security Council to evaluate the agreement from both an economic and geopolitical perspective. Implicit was the idea that the Security Council would examine the document from the perspective of the state. According to one interview subject who was a member of the Security Council and participated in these deliberations, the Council examined the document and there was very little support for ratification.<sup>753</sup> The overwhelming consensus was that it did not promote Russia's interests in its current form.

The overall point here is not that previous governments were unconcerned about state interests, energy security, and long term strategy. These concerns were not new. The difference was that under the old, neo-liberal ideological line, none of these issues conflicted with the agreement. Viewed through the prism of the old ideological line, by creating legal certainty for

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751 Katrenko, "Energy Policy—Parliamentary Hearings, 'On the Ratification of the Energy Charter Treaty (ECT).'"

752 Yazev, "Energy Policy—Parliamentary Hearings, 'On the Ratification of the Energy Charter Treaty (ECT).'"

753 Interview in Moscow, fall 2007.

private firms the ECT would lead to investment, competitive markets, efficiency, exports, economic growth, and taxes, all of which were consistent with state interests. By the same token, investment and competition would generate both energy savings through efficiency and new resources at the lowest possible prices; this would promote security of supply.<sup>754</sup> Finally, creating competitive markets *was* the long term strategy. Again, all good things went together.

Furthermore, suggestions to the contrary were previously a sign of being “anti-reform” and led to polarizing ideological battles about whether the country was moving forward with global integration or reverting into the isolationism of the Soviet past. Under the new president, however, there was more room for debate, so critical views could be seriously considered, debated, and studied. Furthermore, a state-oriented analysis was not only legitimate but entirely obvious and appropriate. By 2001, it was the lack of a state perspective up to that point that seemed anomalous.

### *The counterproposal and international leadership*

We saw previously that in his address to the Federal Assembly, Putin deplored Russia’s dependency on other states. Moreover, as an inherently powerful state, Russia did not have to choose between dependency and confrontation/isolation. As a great power, the Russian state had another option: it could integrate into the international economy by shaping the terms of this integration (through tough bargaining with other great powers) to promote its own indigenous interests. Translated into the language of state identity, this thinking implied that Russia did not have to be a regime taker. It could be a regime maker. In practical terms, this meant it could also bargain to promote its own goals even if this meant creating rules, norms, and principles that were outside the framework proposed by other great states. Russia could even take the lead internationally, but ultimately how it behaved would depend on its own interests as decided by domestic groups only.

As discussed in the previous section, this thinking was expressed in policy when Russia linked ratification to a satisfactory outcome in the negotiations on the TP for Gazprom. This meant that Russia was willing to subordinate accession to the ECT to the goals of an important domestic actor even when this defied international expectations. In other words, Russia was prepared to promote domestic interests even if this sent the wrong signal internationally.

This section examines two examples of the regime maker logic as articulated during the debate. This regime maker attitude was evident in the statements made by Duma Deputy Yazev. His concluding remark was a recommendation that:

[t]he Government of the Russian Federation develop a *Russian* version of the Treaty and a proposal concerning the conclusion of the multilateral framework agreement on transit, addressing [our] national interests with the goal of subsequently entering into negotiations with the European Community on these questions.<sup>755</sup> (emphasis added)

Three points merit our attention. First, Yazev was suggesting that Russia go back to the drawing board and create its own version of the Treaty. The reader will recall that this was the policy of

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754 As we shall see in chapter 9, the understanding of energy security had also changed. During the 1990s, energy security was security of supply, or availability of resources. In 2006, Russia would propose a more complex understanding of energy security.

755 Yazev, “Energy Policy—Parliamentary Hearings, ‘On the Ratification of the Energy Charter Treaty (ECT).’”

the USSR when negotiations began in 1991. However, ten years later, submitting a new proposal for the Treaty implied restarting negotiations. Within the ECH context, this was a very provocative proposition since the ECT was concluded in 1994 after three difficult years of multilateral negotiations. The agreement had already been signed and ratified by many states that would be reluctant to reopen negotiations. (We will see in chapter 9 that the idea of changing the Treaty – proposed by Russia in the fall of 2006 – elicited a very skeptical reaction from all of the other states).

Second, for Yazev the Russian proposal had to reflect Russian interests. Contrary to neo-liberal thinking, the deputy did not necessarily see a harmony of interests between Russia and other states. Moreover, domestic interests and goals were primary. In the same vein, the reactions of other states were secondary to promoting Russian interests.

Finally, Yazev was not proposing multilateral negotiations but rather bilateral bargaining with the EU. As obnoxious as this seems to a liberal sensibility, from this perspective not all states were equal, and Russia, as a great power, needed to focus on relations with other powerful states. In other words, the key issues that concerned Russia could be solved among the great powers. Once Russia and the EU had worked out a deal, with their combined power they could bring the small states in line. In fact, this is precisely the scenario that emerged during negotiations on the draft TP at the end of 2002. Since all of the outstanding disagreements concerned Russia and the EU above all, the Conference decided to suspend multilateral negotiations and begin bilateral consultations between the two parties. The idea was that once the pair came to an agreement, multilateral negotiations could be reopened to accommodate the other states.

The idea that Russia should behave as a regime maker was also mentioned during the hearings by the director of the Institute of Theoretical Problems, the famous scholar Erast I. Andriankin:

To ratify this Charter is impossible....all the more since the energy sectors of Russian industry are its foundation. They should be state run....

However, this does not mean that we should now slam the door shut...that would be the wrong approach. We should put forward our own plan, what we used to call before a counter proposal. And this counter proposal should reflect the interests of Russia specifically, of our state. This proposal should have advantages over the other proposals...it is high time that Russia took into its hands problems that concern all mankind...moreover, in doing so we would learn to be at the head of leadership. That is very important too.

...This counter proposal should reflect not only our immediate affairs, which only interest us alone. Let them reject it rather than our rejecting the Charter.<sup>756</sup>

Andriankin's assertion that the energy industry should be state run was the most explicit rejection of the neo-liberal model during the hearings. Like Yazev, Andriankin was also proposing to renegotiate the agreement. However, his language is particularly illuminating; "what we used to call before a counter proposal" is of course a reference to the Soviet approach to foreign policy. This approach was characterized by an interest in leadership, agenda setting, and the projection of Soviet interests as global interests. Andriankin was suggesting that this

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756 Erast I. Andriankin, testimony in "Energy Policy—Parliamentary Hearings, 'On the Ratification of the Energy Charter Treaty (ECT).'"

approach was lacking in the new Russia. Like the USSR, Russia needed to take the lead. Moreover, leadership was a goal in and of itself.

In summary, the second ratification hearings saw not just substantive critiques of the ECT, but also the articulation of a different role for Russia in the ECH sphere. This role implied making its own proposals based on domestic interests and taking a leadership role, even though it might defy the expectations and preferences of other states. Furthermore, leadership was an end in itself. We will see in subsequent chapters that Russian ECH policy would come to reflect most of these ideas. Finally, these ideas were consistent with the view of foreign policy that Putin had already elaborated in the early stages of his presidency. Before concluding with a discussion of how Putin's vision was connected to these micro-level changes in the ideological line, the next section looks at another policy (rather than discursive) indicator of Russia's new role identity: the unlinking of the ECT from the WTO.

### **The emergence of a state-wide consensus concerning ECH policy**

#### *Convergence of state and Gazprom thinking on the ECH*

The most important political outcome of the debate was that the position of the president changed. Putin had called for reflecting on the agreement, and it was ultimately the arguments that emerged from this debate that moved him. As a result, he went from cautiously supportive of ratification to skeptical. His position on the ECH and Treaty converged with that of Gazprom. How did this happen?

Putin's thinking about the ECT did not change because the Duma had considerable political influence over the president. If a majority coalesced in committee or in the chamber at large, the Duma could certainly block ratification against the wish of the president and government; it did this in 1997. However, this did not change the thinking of the president and the government or prevent them from staying the course at the time. In fact, the ECT was resubmitted for ratification again in 2000.

I am not arguing that the hearings themselves or the deputies changed government thinking directly. The hearings were a key moment because they precipitated this debate, but the debate lasted an extended period of time and took place in many different settings. We can observe the public debate that took place during the hearings and in the press. However, the most important debates were the ones that took place behind closed doors within the government and specifically with Putin, who had a personal interest in all things related to Gazprom. In this respect, Miller's role as a trusted associate and direct lobbyist of Gazprom's interests vis-à-vis the president was critical. Why did Miller adopt Gazprom's approach? Moreover, why was Miller so important?

#### *Going native: the new ideological line and Miller's embrace of Gazprom's approach to the ECH*

At the time of his appointment, Alexei Miller had been an acquaintance of Putin for ten years. Miller was from St. Petersburg, where he was trained as an economist; he was not a specialist in gas. From 1991 to 1996, Miller worked in the St. Petersburg Foreign Economic



Committee of Mayor Sobchak’s administration. During that time, Putin was the head of the committee. From 1996 to 1999, Miller worked at the St. Petersburg port. In 1999, he became head of the Baltic Pipeline System. Before being appointed as head of Gazprom, he was a deputy minister of energy in the government and was involved in the crafting of the Russian Energy Strategy and the Conception of RF Energy Security.

In February 2001, when Energy Minister Gavrin was fired after a crisis that left tens of thousands of people freezing in unlit homes during a record cold spell, it was rumored that Miller might take his place.<sup>757</sup> At the time, an article in *Nezavisimaya Gazeta* described him as being independent from various financial and political cliques within the establishment and totally neutral and politically untainted with respect to the energy sector. It was noted that this type of independence was rare.

Miller had also been described as having an ideological affinity with Economic Development and Trade Minister German Gref and Alexei Kudrin, the more “principled and consistent economic reformers” within the government.<sup>758</sup> Liberal sympathies notwithstanding, Miller began defending Gazprom very quickly after becoming CEO, using many of the same arguments as his predecessor. In the words of one interview participant, Miller quickly “went native.”<sup>759</sup>

How do we explain Miller’s embrace of the Gazprom line? In a 2001 interview shortly after Miller’s appointment, Komarov gave one possible explanation. Discussing why ECT ratification had been postponed, Komarov shed light on the role of individuals in making policy:

[T]his decision was based on serious risks for the position of Russian gas in Europe. This is a question of national scale, since the revenues from the export of gas comprise 20% of all the hard currency inflows and one quarter of the revenues of the Russian budget. The gas export strategy is first and foremost dictated by *the interests of the state*, and it is my deep conviction that this cannot change in connection with a change of management at Gazprom.<sup>96</sup>

For Komarov, Miller’s approach was a product of the objective threat posed to Gazprom by ECT ratification and the consequences this entailed for the Russian state. From a constructivist viewpoint however, to be convinced, the new manager would have to accept the causal principles underlying Gazprom’s revenue forecasts and also harbor sympathy for a perspective focused on the interests of the state (as opposed for example to arguments focused on the macro-economy and the need for competition to create efficiency in production).

Upon becoming CEO, Miller’s education by Gazprom experts most certainly involved the “threat from Central Asian competitors” argument voiced during the 2001 debate. This argument was based on a particular economic logic that had been developed at Gazprom much earlier. Although these arguments dictated anti-competitive policies, they were based on causal principles that emerge from liberal economic thought. The very basic idea that an increase in the number of suppliers or greater quantity of supply leads to lower prices (*ceteris paribus*) is familiar to any economist. This logic would have resonated with Miller, who was a trained, liberal economist. In short, due to his training, Miller would not have found these principles particularly controversial.

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757 “Who Will Defeat the Energy Crisis,” *Nezavisimaya gazeta*, February 13, 2001.

758 Ibid.

759 Interview in Paris, fall 2006.

In addition, Miller would also have been open to arguments pointing toward the interest of the state. As we saw previously, this was very much the ideological line emerging under Putin. As Putin's subordinate, Miller would have had to take these arguments seriously simply by virtue of his position as the newly anointed czar for Russian gas policy. Moreover, one of the main factors behind this choice was that Miller was loyal to the president and could be trusted to approach policy making in a way that was consistent with the president's own thinking.

In short, Miller's embrace of the Gazprom perspective was by no means pre-ordained by objective factors that jeopardized state interests, as Komarov argued. Rather, they were contingent on the ideological priors, both causal and normative, that the new manager brought to the table, which made him sympathetic to these constructed arguments. Moreover, these priors were pre-determined by the emerging ideological line (in this respect, Miller's education was an extension of the ratification debate) and also by the intentional choice of Miller (as someone who would follow this ideological line) by the president.

### *Miller as the trusted lobbyist*

Miller's appointment was a key factor in shaping the president's thinking. All of my interview participants who answered this question suggested that Miller played a very important role in persuading the president that the ECT in its present form posed a threat to Gazprom.<sup>760</sup> To understand Miller's significance, we have to consider the president's relationship to his predecessor as Gazprom CEO, Rem Vakhirev.

As we saw in chapter 6 the president was very skeptical of Vakhirev, his overblown managerial autonomy, and the shenanigans at Gazprom (at the expense of the state) that this autonomy facilitated. We might say that the debate prior to Vakhirev's departure focused the president's attention on Gazprom's concerns, to which he may have been sympathetic. However, he probably was not fully sold, since he had no way of knowing if Gazprom's vociferous attack on ratification was another one of Vakhirev's stunts in the Duma.

After the change in management, which occurred in the middle of the debate (May 2001), Alexei Miller quickly adopted the Gazprom line on the ECT and began to play a prominent role in the debate. The fact that he was a close and trusted associate of Putin meant that with Miller, Gazprom now had an effective conduit for lobbying its perspective at the highest level of the Russian state.

Vakhirev's removal and Miller's appointment as the new CEO in May 2001 were significant because they eliminated an important source of conflict between the president and Gazprom. This conflict prevented the company from shaping the new president's thinking about gas policy. Specifically, because of the way Vakhirev ran Gazprom under Yeltsin, the new president could not easily distinguish between the interests of the company and those of its top management. With this conflict over, Putin could focus on understanding Gazprom's business and the consequences that ECT posed for Russia's largest company.

In terms of ECH policy, with Miller's endorsement of the Gazprom line, the new president and the gas monopolist finally began to see eye to eye. Moreover, since the president controlled the government and foreign policy specifically, this meant that a statewide consensus

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760 Interviews in Moscow, fall 2006, fall 2007, 2008-9.

– which included the president, the government, and Gazprom – emerged within the ECH policy sphere for the first time.

## Early changes in Russian ECH policy

### *Linking ratification and the protocol on transit*

Aside from recommending further study, the Duma also noted in its summary of the hearings that the consequences of the ECT transit regime for the Russian economy had not been sufficiently examined. In this connection, the committee suggested continuing negotiations on the Protocol on Transit (TP) with the goal of defending the interests of the gas sector. Specifically, the Duma focused on the question of free access to the national pipeline network for foreign states and the consequences for Gazprom's business in Europe. In short, Gazprom's perspective, embedded within a SS approach, prevailed over the old neo-liberal ideological line.

Moreover, protecting Gazprom's interests through the TP became a pre-condition for ratification by Russia. The link between ratification and satisfying Gazprom's demands through the TP persisted. Valery Yazev played an important role here as well. During the ratification hearings, he recommended that Russia develop a proposal for the draft TP that "corresponded to its national interests" and begin negotiations on this question with the EU. A year later he reinforced the link between ratification and the TP when he declared that the Duma would return to the question of ratification "only after a Transit Protocol that is advantageous to Russia appears."<sup>761</sup> The linkage between the ECT and the TP was also reinforced by Miller, as is demonstrated by the following comments from Kemper:

I feel that the appointment of ...Miller...suggests that...Gazprom will respond to the political interests of Russia. And this is first and foremost to attract investment, although I have to admit that in discussing the treaty, the point of departure for Gazprom is still its own commercial interests and its wish to remain a transit monopoly.....Happily, Alexei Miller understands the importance of the ECT for attracting foreign investment....The new head of Gazprom let me know that...if a satisfactory Transit Protocol is enacted, then the ECT might be ratified.<sup>762</sup>

In addressing the linkage of the two documents specifically, Kemper noted that the ECT and the TP were legally different documents. The Secretariat also consistently said that they needed to be considered "separately and independently." This was very much the norm in the ECH setting: the ECT stood alone and took precedence over other agreements within the regime. There were no political linkages to other documents or issues, and states did not stipulate conditions for ratification. However, she also noted that certain "political circles in Russia" spoke of the tremendous link between completion of the protocol and the "fate of the ECT" and that this could not be ignored.<sup>763</sup> Thus, the ratification debate precipitated an important change in Russian foreign policy.

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761 "The Transit Dead End of the Energy Charter," *Neftegazovaia vertical*, March 15, 2002.

762 "Alexei Miller Gave Me Hope."

763 R. Kemper, "The Charter and Russia: Path to Agreement?" *Neftegazovaia vertical*, 1, January 30, 2002, 7-9.

### *Unlinking the WTO and the ECT*

Proponents of the ECT had argued that ratification of the agreement would allow Russia to enjoy the benefits of the WTO without going through the difficult process of entry into the organization. As early as 2001, Komarov attempted to separate discussions of the ECT from the WTO. In response to the question of WTO accession and liberalization of the gas market, Komarov replied, “I think that these are different processes. The WTO establishes economic, customs, and fiscal rules. But the ECT is a special instrument created to get access to resources. In my opinion, there is no way to link these questions.”<sup>764</sup>

However, the proximate cause for the separation of the two questions was the EU’s insistence during WTO negotiations that Russia liberalize its gas sector. During bilateral negotiations in October 2003, the then European Commissioner for Trade Pascal Lamy included demands related to Russia’s internal gas policy.<sup>765</sup> In Russia this came to be known as the Lamy Package. It included six items, many of which were directly related to the question of gas transit.<sup>766</sup> However, by the end of 2003, the Russian government had fully embraced Gazprom’s approach to transit, and this was a key consideration in the disagreement with the EU. Thus in explaining the dispute, the press reported that: “Part of the problem derives from the importance of Russian gas monopoly Gazprom within the Russian state. The monopolist’s stance on transit is stalling Russia’s ratification.”<sup>767</sup>

The Lamy proposal elicited a “very sharp public response” from Putin,<sup>768</sup> who stated that “unjustifiably strict conditions” were blocking Russia’s entry into the WTO:

We constantly hear assertions that the EU supports Russia’s entry into the WTO. But in fact, unfortunately, in our opinion, time after time we are confronted with unjustifiably strict conditions, that in practice block Russia’s entry into the WTO....We do not have principled disagreements with the EU concerning the introduction of market principles into Russia’s energy sector...[the disagreement] is related only to tempos and the concrete forms that reforms will take.<sup>769</sup>

The president was not against liberal reforms in principle; however, Russia reserved the right to decide the rate at which such reforms would be introduced. Moreover, these comments suggest that for the president, there was no single blueprint to create a market. There were different types of market reforms, and ultimately Russia would decide which ones worked best.

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764 “We Will Not Increase Supply of Gas to Europe.”

765 Andrei A. Konoplyanik, “Russia-EU Summit: WTO, the Energy Charter Treaty and the Issue of Energy Transit,” *International Energy Law & Taxation Review* 2 (2005): 32; “Russia Announces Again That It Does Not Aim To Join the WTO,” *Interfax Financial Economic News*, December 2, 2003.

766 The six points in the Lamy Package were: 1. Raise internal prices for natural gas; 2. End Gazprom’s monopoly on gas exports; 3. Lift restrictions on gas transit (‘free transit’); 4. Allow foreign investors to build pipelines in Russia; 5. Introduce equal prices for transit of gas for domestic users and for exports; 6. Cancel gas export tariffs. Andrei Konoplyanik, “Gas Transit in Eurasia: Transit Issues Between Russia and the European Union and the Role of the Energy Charter,” *Journal of Energy & Natural Resources Law* 27, 3 (2009): 472.

767 “Russia’s gas dilemma focuses WTO membership aspirations,” *Platt’s Commodity News*, December 19, 2002.

768 Konoplyanik, “Gas Transit in Eurasia.”

769 “Russia Announces Again That It Does Not Aim To Join the WTO.”

His economic adviser at the time, Dr. Andrei Illarionov, an avowed neo-liberal, also stated that, “joining the WTO is one of Russia’s priorities, and we would like to do it, but this does not mean that we will accept any conditions.”<sup>770</sup> Illarionov also argued that lower gas tariffs reflected Russia’s natural competitive advantage, and the government did not think it was necessary to reject this.<sup>771</sup> German Gref, the former minister of economic development and trade and also a respected liberal, stated that Russia would raise its prices, taking into account what was best for its domestic economy: “[w]e will be able to move only according to those tempos (raise gas prices – interfax) that the situation in the economy allows.”<sup>772</sup> Responding to the EU demands in energy, Maxim Medvedkov, deputy minister of economic development and trade and in charge of negotiations for Russia’s accession to the WTO, argued that:

...no country in the world ever agreed for its reforms in such important sectors as energy to be potentially contested or put under the control of international courts.

...Together with the EU we have an opportunity in the near future to find a common approach, although this will not be simple.<sup>773</sup>

Russia was very clearly signaling that it was not going to subordinate its domestic policy to international constraints through legal commitments. In addition, in rejecting the neo-liberal policy proposed by the EU, Russia was also proposing a common approach, which suggested that it intended to make its own contribution. This foreshadowed later arguments Russia would have about how the EU should organize its own markets. This type of policy is very consistent with the thinking of a regime maker.

How were the EU demands related to the ECH? The EU had already begun pressuring Russia to create TPA for gas produced in Central Asia when negotiations opened on the TP in 2000.<sup>774</sup> TP negotiations also touched on other issues related to transit, some of which were being raised by the EU in the WTO setting.

At the same time, representatives from the Secretariat also tried to put pressure on Russia by linking ratification of the ECT to making progress with the WTO. The Charter was supposed to be a “litmus test” of Russia’s ability to make the sacrifices necessary for joining the WTO. According to a spokesman for the Secretariat,

Russia wants to become a member of the World Trade Organization but its attitude towards energy shows that it is still not ready for it....The World Trade Organization is based on the principles of non-discrimination. The Russian parliament's ratification of the Energy Charter Treaty will be in many ways a litmus test of how ready it is to join the WTO....The principles are exactly the same.<sup>775</sup>

This was indicative of the expectations that the international community had for Russia at the turn of the century. Meeting international demands was essentially a test that showed Russia’s readiness to further integrate into the international economy. To be included, Russia had to show that it accepted neo-liberal principles and also a neo-liberal approach to sovereignty which meant constraining itself through treaties. In other words, the ECH was an arena for the EU to use

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770 Ibid.

771 Ibid.

772 Ibid.

773 Ibid.

774 Interviews in Moscow, fall 2006, 2008-9.

775 “Russia's gas dilemma focuses WTO membership aspirations.”

sticks and carrots to shape Russia's behavior to comply with the neo-liberal model; this also extended to demands related to domestic gas policy.

However, by 2003, Russia no longer accepted the premise that underpinned this strategy (that Russia was a regime taker). At the beginning of December, Russia took action. On the eve of the 13<sup>th</sup> meeting of the ECH, the Deputy Prime Minister Viktor Khristenko, who would shortly become acting prime minister of Russia and later minister of industry and energy, publicly stated that:

[I]n no way does the WTO solve the problem of transit; this question is not covered by the norms and rules of the organization.

...In principle, this is an impossible situation since a special structure has been created to solve this [transit] problem, ...and the theme is unexpectedly thrown into WTO negotiations....You cannot simultaneously discuss this topic everywhere; first you have to decide in which forum you will make decisions; this is much too serious a topic.<sup>776</sup>

With the EU making demands for liberalization of the Russian gas transit regime in two different forums, Russia decided to suspend bilateral consultations with the EU on the draft TP.

The timing was significant; earlier that year, the secretary general had proposed a compromise text of the draft TP with the expectation that all parties could sign it at the year-end conference. The Secretariat and many states were eager to move forward, and this would presumably also have opened the way for Russian ratification of the ECT since the latter was contingent on a successful outcome related to the transit regime. Thus Russia's suspension of consultations was a double blow. It sent a signal that Russia would have a say in deciding which issues were discussed in what setting. In addition, it meant that the TP would not be finalized according to the timeline set by the secretary general. More generally, it demonstrated that Russia was not willing to sacrifice its perceived interests to get a speedy resolution to the ECH question.

Russian neo-liberals attributed great significance to the fact that Russia did not accept the compromise text. In an op-ed entitled, "The Energy Dialogue: the Lost Charter," which appeared in the prominent business daily *Vedomosti* at the end of the year, Vladimir Milov, a former deputy minister of energy, argued that:

The Session of the Energy Conference on December 10 is supposed to accept the final text on the Transit protocol to the Energy Charter. It appears that this will happen without the participation of Russia. Many years of negotiations have not brought us to an agreement of positions on the protocol; the unsettled disputes have not been removed. *Russia put itself before the choice of either ratifying the protocol together with the Energy Charter Treaty (ECT), or remaining outside the charter process. By all appearances, the Transit protocol will be signed without agreement with Russia....The reasons – the invention on the Russian side of a link between the Energy Charter Treaty and the Transit Protocol....Why did this happen?... It is possible that the reason lies in the wish of those who stand behind the backs of the Russian negotiators to not ratify at all either the Energy Charter Treaty or the Transit Protocol....To save the situation, it might be*

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776 "Khristenko Is Against Signing the Transit Protocol on Supply of Gas Between the RF and EU in the WTO Framework," *Interfax Financial Economic News*, December 1, 2003.

necessary for Prime Minister Kasyanov to become personally involved. Although it seems that we have already lost this round.<sup>777</sup> (emphasis added)

The former deputy minister still subscribed to the old neo-liberal ideological line.<sup>778</sup> From this perspective, Russia should have agreed to the compromise TP and ratified the Treaty, despite the (implicitly illegitimate) concerns of an important domestic actor who was in opposition (Gazprom). Russia needed to keep integrating and send a signal that it was a reliable state that accepted the neo-liberal approach. Viewed in this light, Russia was letting an important opportunity pass by and retreating into self-imposed isolation (outside the Charter process). We can understand Milov's disapproval of the linkage Russia created between the TP and ECT ratification. His attitude on this question was the counterpoint to expectations among Western actors and the Secretariat that they were separate documents, and linkages were out of line, even if they were a "political reality." Overall, from the neo-liberal perspective, the linkage was controversial.

However, suspending TP negotiations was not a fundamental change in Russian policy toward the ECH. Nor did it signal that Russia was ending its participation in the regime or retreating into isolation. In fact, the conference did not adopt the TP without Russia, a testament to how important Russia's transit position was within the regime. Suspending consultations was a tactical response to EU pressure to liberalize gas.

The press reported that Khristenko expressed confidence that once the transit question was closed in the context of the WTO, the sides would return to negotiations in the context of the transit protocol.<sup>779</sup> More generally, however, it showed that Russia was not prepared to make concessions related to its domestic gas policy or subordinate the interests of Gazprom to make progress in the ECH regime. In short, Russia's regime maker identity, as articulated by the president in 2000 and the participants during the January 2001 hearings, was slowly becoming evident in its policy; it was beginning to call some of the shots.

In any case, the EU and Russia came to an agreement on the WTO in 2004 which did not include any concessions by Russia related to its domestic gas policy or the gas transit regime. Russia had prevailed on these points. Once the WTO question was settled, Russia indeed started consultations on the TP anew. However, its approach was very different because, for the first time, Gazprom was the major driving force behind TP negotiations. We will examine this development in the next chapter.

### **Summary (policy making under the new ideological line)**

The articulation of a new ideological line by the president introduced as legitimate a new set of state-oriented ideas as well as the notion that social consensus was important. These ideas became institutionalized into the official roles of the Russian state and supported a genuine

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<sup>777</sup> Vladimir Milov, "Energodiologue: The Lost Charter," *Vedomosti*, December 4, 2003. Two months later, Kasyanov was dismissed.

<sup>778</sup> For example, Milov was an important driving force behind the failed attempt to break up Gazprom. Interviews in Moscow, fall 2007, 2008-9; in Paris, fall 2006. His tenure as deputy minister was very short. According to several interview respondents, later he would become "persona non grata" with the Kremlin, and his refusal to accept the new ideological line played a role. Interviews in Moscow, fall 2006, 2008-2009.

<sup>779</sup> "Khristenko is Against Signing the Transit Protocol."

policy debate about the substance of the Treaty and the consequences of ratification for Gazprom.

Before these ideas could be put into practice, however, the key decision maker (Putin) had to be assured that Gazprom's arguments represented genuine state interests rather than the particular interests of those making the arguments (the managers). It was critical that the conduit for these arguments was a trusted associate to persuade the president. Moreover, the trusted messenger adopted the corporate line of his new company because he was open to its state-oriented logic, which was consistent with the new ideological line. With the president's embrace of the Gazprom line, the government adopted the same approach and policy. As a result, for the first time, a statewide consensus emerged in the ECH policy sphere, and a single state interest became clear: protecting Gazprom's business. Finally, policy ideas that emerged from the debate could be translated into concrete policy actions: the linking of ratification to negotiations on the draft TP.

How is the change of the ideological line related to state role identity and policy outcomes? The external function of the old ideological line was to send a signal that Russia accepted international norms and principles (that is, neo-liberalism). This idea was institutionalized into official roles of the state (government officials) and constituted Russia's role identity as a regime taker. It was then the backdrop against which policy decisions were made.

The new ideological line explicitly rejected this role. Russia would not accept neo-liberal principles or the ECH without first reflecting critically on whether and how they advanced Russian state interests. The new line also posited that the international would take a back seat to the domestic and that Russia would fundamentally shape the international system through bargaining with other states over regime fundamentals (to promote domestically formulated goals) rather than taking those fundamentals as given. All of these ideas became institutionalized into the official roles of the state as reflected by participants during the hearings. Therefore, the new ideological line constituted the role identity of regime maker.

After a productive debate, a consensus emerged that Gazprom's transit concerns were legitimate (and genuine) and should be addressed in the ongoing negotiations on the draft TP. The novel policy decision was to link the outcome of these negotiations to ratification. For the first time, Russia was making ratification subject to political conditions. Later, it also suspended negotiations on the draft protocol to clarify issues related to EU demands concerning the structure of Russia's domestic gas industry. Again, Russia had never suspended negotiations in the ECH setting pending another political outcome. In both these respects, Russia's agenda positioning was relatively controversial.

However, the role identity did not cause these policy outcomes directly.

The policies emerged in relation to particular policy problems: protecting Gazprom's monopoly on transit and deflecting EU pressure. The role identity – and the institutionalized ideas on which it was based – were background factors that enabled particular policy solutions to specific problems that emerged during debate. To put it very bluntly: the role identity had nothing specific to say about how to deal with the problem of protecting Gazprom's transit monopoly (for example). However, when this problem came up during debate, and policy makers had the idea to solve this problem through a linkage to the protocol, the idea was plausible because it was consistent with Russia's role identity (the self-conception of being a great power that drove a



hard bargain, which was institutionalized into the official roles of the state). Finally, since it was plausible, policy makers could decide in favor of the linkage becoming state foreign policy.

We can also ask counterfactually how the same problem might have been solved under the old ideological line. If the idea of linking ratification to the TP were voiced, it would have invited the question: “But what kind of signal will that send to investors and our Western partners?” A discussion about being reliable and discouraging foreign investors and other states would probably have ensued. Given the ideological line, this question and critique of the solution would be very compelling, and thus the decision to implement it as policy would be unlikely.

In short, the ideological line constituted the state’s role identity; however, this did not lead directly to changes in policy. Within the context of a genuine debate and a specific policy challenge, a policy solution emerged that was *possible as policy* since it was consistent with the ideological line. Finally, the policy solution turned into a policy outcome through the deliberate choice of decision makers. The next chapter examines Russian ECH policy from 2004 to 2006.

## **CHAPTER EIGHT: TURNING THE TABLES – RUSSIA AS MERCANTILIST AND THE ECH REGIME (2004 TO 2006)**

### **Overview**

This chapter examines Russian Energy Charter (ECH) regime policy during the period from 2004 to 2006, when it shifted significantly. In the run-up to the 2006 G8 summit in St. Petersburg, Russia began a complex policy maneuver to pressure the EU to conclude a favorable deal that linked the ability of Gazprom to invest in the EU to Russia's eventual ratification of the ECT. For the first time, Gazprom was a central actor driving Russian ECH policy forward, a *very* unexpected development given the company's previous opposition. These developments reflect changes in Russian behavior related to several of the phenomena in which we are interested: use of sticks and carrots, unitary actorhood, and the identities of domestic actors (Gazprom).

The goal of this chapter is to understand how ideas about the legitimacy of state power (internal with respect to domestic actors in strategic sectors and Gazprom specifically, and external with respect to other states) produced these policy outcomes. Briefly, ideas about legitimate state power to intervene in strategic sectors allowed the state to develop authority over Gazprom, and this transformed its identity (operational logic) from a fiefdom to a national champion. The state also established authority over the gas sector overall and the gas policy making process. This allowed the state to eliminate conflicts of interest and solve policy problems that prevented Gazprom from seeing the potential value of the ECH. Once these problems were addressed, Gazprom began for the first time to participate productively in the ECH process.

It took an external event to mobilize Russian diplomacy to propose a grand bargain that linked ECT ratification to a particular form of investment (asset swaps). Moreover, in advance of the G8, Russia began a diplomatic maneuver to pressure the EU, an unexpected development since it was previously the EU that was pressuring Russia to ratify the ECT. Russia had turned the tables and was using sticks and carrots to shape EU incentives and compel them to accept the proposal (which they did not). This also reflected that Russia could behave in complex ways as a unitary actor. Again, this was possible because a single state interest had emerged by then; the statewide consensus was that ECH policy was about promoting Gazprom's goals in Europe, which reflected the fiscal interests of the state. Finally, the idea that Russia was a great power was an important background factor that made using sticks and carrots possible.

### **Organization of chapter**

This chapter begins by specifying the outcomes to be explained. The section that follows presents the argument in greater detail. The section after examines why Gazprom went from destructive opposition to productive participation in the ECH process. The next section looks at why Russia's agenda positioning changed. Finally, we explore why Russia was able to use sticks and carrots and function as a unitary actor to support its proposal in 2006.

## Changes in outcomes

### *Use of sticks and carrots*

In advance of the 2006 G8 summit for heads of state, the Russian Federal assembly passed a law that would give Gazprom a monopoly on exports. It had been a long-standing goal of the EU to promote unconstrained access to Gazprom's pipeline so that multiple producers could export to Europe, thus stimulating competition on that market. If enacted, the law would "cost" the EU in the sense that a key goal would have been defeated. However, the law was left unsigned, and all indications were that it was meant to be a bargaining chip for the president at the summit. Thus, Russia was deploying sticks and carrots to compel the EU (unsuccessfully) to accept this new deal. Previously, it had always been the EU and members of the Secretariat that were pushing Russia to ratify the agreement. As we saw in Chapter 7, the EU and ECS played a very important role in putting ratification on the agenda for the second time in 2001. After the first gas war between Russia and Ukraine, the EU began aggressively lobbying Russia to ratify the ECT. By 2006, Russia was putting pressure on the EU to accept its deal linking ratification to investment. Essentially, by putting pressure on the EU, Russia was turning the tables in the relationship.

### *Unitary actorhood*

The law "On Exports" passed both houses of the Assembly quickly and with overwhelming support. This contrasted with recent history when the government and legislature worked against each other in the area of ECH policy. For the first time, the government and parliament were creating policy that allowed them to work with each other to pursue a common goal. The whole point of the initiative was to advance the interests of Gazprom, which was now a central actor driving the ECH process. Previously, the gas monopolist was the primary opponent of the regime, essentially killing ratification on two occasions. The policy convergence between the president, government, parliament, and Gazprom reflected that a state wide consensus on ECH policy had emerged and Russia had become a unitary actor in that policy area.

### *Changes in societal identities: Gazprom*

But why did Gazprom's ECH policy change? How did it go from obstructing government policy to being the primary force behind Russia's ECH initiatives? Gazprom opposed ratification due to the personal interests of the managers and its "defensive" interests related to the conditions of access to its pipeline system for its competitors, both domestic and in Central Asia. By the fall of 2004, however, the personal interests of the managers were no longer an obstacle, the defensive interests were less salient, and Gazprom had developed "offensive" interests in shaping the transit regime within the EU to its advantage.<sup>780</sup> As a result, for the first time it began actively participating in negotiations on the draft TP.

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780 I will discuss these interests in detail in the following chapter. For the discussion here, it is sufficient to understand that these concerned Gazprom's interests inside the EU, rather than its concerns about protecting its pipeline monopoly.

The discussion that follows examines these three outcomes: 1) Why did Gazprom's policy change, and how is this related to its corporate identity? 2) Why did Russia use sticks and carrots to promote its deal? and 3) Why was the Russian state able to act as a unitary actor in 2006?

## **The argument**

The heart of the story relates to Gazprom. Inspired by a different view of the state and having articulated the SS approach as the new ideological line, Putin implemented his state-building strategy to establish state authority over the gas monopolist. The main step was to reduce the autonomy of company management. This allowed the state to develop an understanding of the internal workings of the company, restore lost assets, and regain control over financial flows.

Crucially, state authority over the company eliminated one of the reasons Gazprom opposed the ECH: the rules established by the Treaty would interfere with management's personal interest in protecting its ability to extract rents informally. This represented a change in its corporate identity since the company's operational logic was no longer dictated by the personal interests of management but by the interests of the state.

However, the company still had "defensive interests" related to its pipeline monopoly that dictated against the ECH. These were addressed by the state's establishing authority over Russia's foreign gas policy and domestic gas market. The latter concerned not only Gazprom, but other gas producers as well. State authority over foreign gas policy meant that Gazprom changed the character of its relations with its Central Asian competitors to be more cooperative than they had been during the 1990s.

Authority over domestic gas markets (all Russian gas producers) meant that a final settlement for structural reform (and especially the domestic transport regime) favorable to Gazprom was definitively accepted by all relevant actors in Russia. Combined, the new relations with Central Asian gas producers and the final resolution of the structural reform question in the gas industry meant that Gazprom's defensive interests became less salient. As a result, managers could focus on its international strategy and in particular on its goals in the changing EU market. From this perspective, they began to see the ECH in a different light; no longer a threat, it was now a potential instrument for promoting Gazprom's interests in Europe. As a result, the company began actively participating in the ECH process (negotiations on the draft TP) for the first time, and this signaled a new level of engagement by Russia in the process.

Russia proposed the grand bargain after a series of external events made Gazprom's interests more urgent. In particular, after a media scandal the government of the United Kingdom thwarted Gazprom's acquisition of shares in Centrica, a major UK energy company. This brought the Russian authorities' attention to the difficulties the company experienced in trying to invest in EU markets. The Centrica affair came on the heels of the first Russo-Ukrainian gas war (January 2006), which changed EU perceptions about Russia's reliability as an energy supplier and raised concerns about EU energy security. In any case, Russia's response was to link ECT ratification to the question of investment, proposing the reciprocal exchange of assets, or "asset swaps," between Gazprom and its commercial partners in the EU.

The Centrica affair was clearly the proximate cause behind the initiative. Obviously, the fact that Gazprom no longer opposed the ECH and saw eye to eye with the government on this question was also an important factor. Combined, these two factors can explain why Russia raised the investment question. However, to understand why Russia deployed sticks and carrots to support its proposal we have to invoke an important background factor: Russia's new role identity as a regime maker. Using the bill to create sticks and carrots to shape the EU's incentive structure was merely the expression of the idea that in negotiating with other powerful states, Russia should drive a hard bargain. This was articulated by Putin when he first became president and invoked during the 2001 ratification by Yazev, one of the authors of the bill passed by the Federal Assembly.<sup>781</sup>

However, what was perhaps more unexpected was that all these actors of the state could come together to act in unison so effectively over such a short period of time. Under Yeltsin, Russia was known for its disunity and foreign policy freelancing<sup>782</sup> independent of the state. An obvious example of this was Russia's inability to ratify the ECT on two occasions despite government support and the fact that doing so was consistent with official state policy

Since the reasons for Gazprom's support have been covered, the key question is why the president, the government, and the parliament were all on the same page. The state was able to act in unison because different officials within the state converged on a single understanding of the state interest in the ECH sphere. Whereas previously the ECH meant different things to different actors and was a venue for different political battles, by 2006 the ECH meant one thing: the interests of Gazprom in the EU, which were related to the fiscal interests of the state. Moreover, the state had the authority to impose this view even on actors with competing interests. The remaining sections elaborate these arguments and bring forth evidence to support these claims.

### **Changes at Gazprom and the ECH: from destructive opposition to productive participation**

There were two basic problems that needed to be overcome before Russian ECH policy could change in these ways. The first problem related to the personal interests of Gazprom managers, who opposed the ECH because they feared it would interfere with their ability to extract rents from the gas business. The second issue related to Gazprom's defensive interest in protecting its transportation monopoly vis-à-vis its competitors in Central Asia and Russia. The following sections examine how these problems were solved through the lens of state authority.

#### *Authority over Gazprom and changes in societal identity: from fiefdom to national champion*

The starting points for our explanation are elite ideas about the state. In contrast to his predecessor, President Putin came to office with the belief that the state had an important economic role in certain sectors, among these energy, and natural gas was at the top of the list.

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781 Stephen Boykewich, "Gazprom's Monopoly on Exports Backed by Duma," *The St. Petersburg Times*, July 7, 2006.

782 Doug Blum and Carol Saivetz, "Fishing in Troubled Waters: Putin's Caspian Policy," transcript of presentation at Belfer Center for Science and International Affairs (BCSIA), Harvard University, May 2, 2001.

This led to a new state-building strategy in which state authority would extend to the gas business and gas policy making. As we saw in chapters 6 and 7, this became a central part of the ideological line under Putin – what I am calling the SS approach – and, as the Steen survey data in chapter 6 demonstrated, this was largely a legitimate idea for Russian elites at the time.

The logical corollary of these ideas and state-building strategy was to change the state's relationship to Gazprom. Upon becoming president of the Russian Federation in 2000, one of Vladimir Putin's first priorities was to reassert the rights of the Russian state, as the largest shareholder in the company, over its single most valuable economic asset and rein in the autonomy that management had enjoyed under Yeltsin. After over a year of political, legal, and corporate wrangling (discussed in chapter 6), CEO Rem Vakhirev was replaced in May 2001 by Alexei B. Miller, a close Putin associate and reliable in terms of implementing the new ideological line at the company.

Although Gazprom had always been a state-owned enterprise, under the old CEO the Russian central government had had only nominal control over the business. Gazprom was run almost exclusively at the discretion of company management, and gas policy often promoted the interests of management at the expense of the state. Indeed, the government had very little knowledge, let alone control, over how the gas sector worked or gas policy was developed. The battle over taxes and the collusion between company managers, regional governments, and other companies to informally extract rents at the expense of the central state were symptoms of the fact that during the 1990s the management had much more control over the gas business than did the state. Thus, we can say that based on the logic of Gazprom's operations, its identity as a corporation was a fiefdom.

Gazprom was not unique in this respect. Like the other oligarchs during Yeltsin's revolution who found themselves at the reins of valuable companies that previously had been controlled by the state, Vakhirev ran the organization largely at his own discretion. His authority in the gas business dwarfed the authority of government officials. This was consistent with the old neo-liberal ideological line that saw the state as an inefficient and oppressive actor in the economic sphere. What was unusual was that Vakhirev was not legally the company's owner; he had been entrusted with managing the company to promote the interests of its main shareholder, the state. However, de facto he had sufficient autonomy to promote the private interests of his management team instead.

The fate of the ECH in Russia is an important example of this. Early on, the management was not interested in the ECH because they did not think the company needed it.<sup>783</sup> It is also clear that personal motives at least partially drove Gazprom's opposition to ratification of the ECT. From the perspective of Gazprom's former managers, the Treaty regularized the rules of the Eurasian gas trade and promoted transparency. This would have interfered with their ability to continue informally extracting rents, which conflicted with their personal interests. As one interview respondent told me, "Vakhirev and his crew had a good thing going. But the Treaty would just shine a bright light on all the shady business that was going on and interfere with a lucrative personal business. Why would you let a goat in your garden?"<sup>784</sup>

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783 For details concerning Gazprom's early involvement with the ECT and management thinking related to the agreement, see Konoplyanik, eds. (Russian edition), "The Energy Charter Treaty," 37, fn 2.

784 Interview in Moscow, spring 2009.

This was also suggested in a January 2001 article about ratification by then Deputy Foreign Minister I.D. Ivanov. He also directly connected these practices to the problem of missing state authority during the economic transition and used this to explain the difficulty of developing an efficient, coherent, and successful foreign policy, particularly in the ECH sphere.

Thus, although the agreement might have been useful to the company from the perspective of its international business – and as we saw in chapter 5, Vakhirev did not hesitate to refer to the goals of the agreement when it was expedient to do so – the peculiar relationship that emerged between the state and its most important economic agent after the collapse of the Soviet Union led to Gazprom's resisting the agreement and kept the Russian state from committing to it even though cooperation through the ECH was an important state priority. In simple terms, private interests prevailed over state interests. Specifically, the personal interests of the managers of a state-owned company interfered with state foreign policy.

Vakhirev's departure and the arrival of Miller was a turning point for Gazprom's corporate identity. To put Gazprom's house in order was a daunting challenge, and at first it looked like Miller would not last very long in his position as CEO. However, during the next three years the new CEO oversaw a personnel revolution within the company, established control over its financial flows, and regained valuable assets that had been transferred out of the holding by the previous team of managers.

Replacing the old management and cleaning house at Gazprom eliminated these conflicts of interests; the interests of management would no longer interfere with state policy. As a result, the company began to operate according to a new logic that promoted the interests of the state rather than those of its managers. This represented a transformation in the company's identity: Gazprom went from being a fiefdom to a national champion. According to one account in the business press,

The Kremlin wasn't always so concerned about policing its shareholdings--let alone the rest of Russia Inc. Over the past decade it let Gazprom Chief Executive Rem Vyakhirev run the company as his fiefdom. That changed last year when Putin ousted Vyakhirev and replaced him with an aide, Alexei Miller, with a mandate to clean up Gazprom.<sup>785</sup>

With this change in identity, one of the impediments to Russian ECH policy – the conflict of interests between the state and Gazprom managers – was eliminated.

In summary, we can say that a different view of the state motivated Putin to embrace a state-building strategy to create relations between the state and its largest company that were not only closer but also characterized by a hierarchy of authority and the primacy of state over private interests. As a result, he appointed his protégé Miller, who faithfully implemented this policy, which changed the operational logic of the company or what I am calling its corporate identity. This eliminated the conflict of interest between the state and management and one of the obstacles to Gazprom's cooperation in the ECH sphere. However, this alone was not sufficient to produce an interest in the ECH at the company. The state also had to address Gazprom's defensive interests. I discuss this in the next two sections.

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785 Paul Starobin and Catherine Belton, "Gazprom: Russia's Enron? Gazprom and PricewaterhouseCoopers are under fire," *BusinessWeek*, February 18, 2002.

*Authority over foreign gas policy: Turkmenistan and Gazprom's defensive interests*

What were Gazprom's defensive interests, and how did they conflict with the ECH? As we saw during the 2001 ratification debate, Gazprom's strategy in the EU was to influence the overall supply of gas in Europe by controlling Central Asian exports to that market. By controlling the level of competition, Gazprom could shape the terms of trade (price, type of contract) with EU customers. The fact that it had a monopoly on the transit of Central Asian gas created leverage for the company. Since Turkmenistan is the largest exporter of gas in Central Asia and was also the subject of the Russian discussion during the ratification debate, my analysis focuses on relations with that country.

Under Vakhirev, Gazprom's approach had two elements of interest. First, whatever gas did leave Turkmenistan was bought by Gazprom or its partner firms<sup>786</sup> on a short term basis. In this way, Gazprom made minimal commitments but kept exclusive control over exports from Turkmenistan, which was in a weak bargaining position, having no alternatives to Gazprom for shipping its gas to Europe.<sup>787</sup> Second, this gas was to be marketed within the CIS, where prices were lower than in the EU and consumers often unable to pay, leading either to arrears or barter. This meant that the terms of trade that Turkmenistan received for its exports were significantly worse than what Gazprom enjoyed in the EU. In other words, Gazprom was using monopoly power to extract as much of the resource rents available in the Eurasian trade, and this was at the expense of its Central Asian competitor.

This was a short-sighted, heavy-handed, and ultimately risky approach to the Eurasian gas market because it did not create commitments over the long term, and more importantly because it shared very little of the wealth. The most dramatic manifestation of this approach was when Gazprom embargoed exports from Turkmenistan between 1997 and 1999 after a commercial dispute, leading to serious economic difficulty for that country. Not surprisingly, this compelled Turkmenistan to shop around. As Ivanov stated succinctly in his 2001 article, "[w]e've already undertaken the three year isolation of Turkmenistan. As a result, it has jumped toward the USA and Turkey, and both Gazprom and the country have lost."<sup>788</sup> The relations that developed between Gazprom and Turkmenistan were contrary to state policy. Yeltsin sought to draw the former Soviet states closer to Moscow, not push them into the arms of its geopolitical competitors.

Gazprom's relations with Central Asian gas producers were related to the ECH because, in the estimation of company management, the Treaty legally constrained its capacity to control access to its pipeline network. As we saw during the 2001 ratification hearings, management

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786 Incidentally, this arrangement also introduced intermediary companies (for example, Itera) in which Gazprom management had significant stakes. Thus, the CIS trade was one vehicle for managers to personally extract from the gas business.

787 When the Turkmen pipeline network was built during Soviet times, Turkmen gas was used to supply the western and southern regions of the USSR. Thus, the only pipelines through which Turkmenistan could ship gas to external markets (and Europe specifically) went through Russia. Since then, several alternative routes have appeared. In 1997, a 120-mile pipeline to Northern Iran (Korpeje–Kordkuy pipeline) was completed. A second, shorter pipeline with the potential to double exports was completed in 2010. Finally, in late 2009, the Central Asia–China gas pipeline, which transports gas from Turkmenistan through Uzbekistan and Kazakhstan to western China, was completed. For a map see Appendix B. From BBC News, Guide to Central Asia, Oil and Gas, accessed December 15, 2011. <http://news.bbc.co.uk/2/shared/spl/hi/guides/456900/456938/html/nn5page1.stm>

788 Ivanov, "The Energy Charter Treaty and the Interests of Russia."



argued that the Treaty threatened to create legal conditions for access to its transit system for the gas monopoly's Central Asian competitors. Overall, the agreement would undermine its transit monopoly position and capacity to influence the volumes of gas that reached Europe. With unimpeded access to transit, the logic went, these competitors could market gas directly to Gazprom's European customers at lower prices and on a spot basis. This contravened its export strategy and was a grave threat to business in its most lucrative market and the Russian state, which received significant contributions from the company. In short, since the ECT purportedly threatened Gazprom's ability to implement a vital part of its corporate strategy, the agreement made salient defensive interests at the company.

The state under Putin quickly adopted this part of Gazprom's corporate strategy. However, the state also demonstrated that there were other, more cooperative ways to implement this strategy with Russia's Central Asian neighbors. First, however, the state had to assert authority over this area of foreign economic policy. This actually started before Miller became CEO and Gazprom's identity changed. In May 2000, even before Vakhirev's ouster, a delegation of Gazprom managers accompanied President Putin to Turkmenistan. The president was now an important figure directly involved in negotiations concerning the gas trade.<sup>789</sup> As we saw in chapter 6, relations between the president and Vakhirev were very contentious at that time. It is not likely that the CEO welcomed Putin's participation in the process, but his participation was a sign of his direct authority over (and personal interest in) gas foreign policy regardless of Vakhirev's personal preferences. Putin was implementing the SS approach personally.

During the visit, the delegation proposed to Turkmen President Saparmurat Niyazov an increase in deliveries of an additional 8 billion cubic meters (bcm) to Russia for 2001. This moment was remarkable because Gazprom did not just want new volumes; for the first time, Gazprom proposed a LTC for 30 bcm annually from 2001 to 2015.<sup>790</sup> Negotiations took several years, but nevertheless in April 2003, Gazprom's daughter firm Gazpromexport and Turkmenneftegaz concluded a 25-year LTC for the purchase of 70 to 80 bcm of natural gas annually to begin January 1, 2004.<sup>791</sup>

The LTCs that were concluded were especially interesting because they included a price formula that offered Turkmenistan, after a specified transition period, European price equivalents (netback price).<sup>792</sup> For the first time, Gazprom was linking the terms of its trade with

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789 "Gazprom delegation to discuss Turkmen gas transit in Kazakhstan," *TASS Energy Service*, May 17, 2000.

790 "Energy Press Digest—Russia/CIS—Oil & Gas Industry," August 19-21, 2000 (Part 1),

"Russian Energy Digest," *Vremya Novostel*, August 21, 2000.

791 Andrew Neff, "FSU Regional—Turkmenistan, Russia Sign Accords on Gas Supply, CAC Pipeline Modernisation," *World Markets Research Centre Daily Analysis*, August 19, 2003; "Gazprom approves opening representative office in Turkmenistan," *Prime-TASS Energy Service*, August 21, 2003. The agreements provided for a transition period during which both the volumes and prices would be gradually adjusted. In addition, the two companies agreed to cooperate to refurbish the Central Asia–Centre pipeline, which transports gas from Turkmenistan to Russia. Finally, Gazprom opened a representative office in Turkmenistan that "will improve the quality of cooperation between Gazprom, Turkmenistan's government and Turkmen companies to facilitate activities in the gas sector."

792 Interviews in Brussels, fall 2006; in Moscow, 2008-9. Long term gas contracts are based on formulas that tie the price of gas to substitute fuels (the formula varies by contract; for the most part, the substitute fuels are oil products but can be coal or other sources of fuel or power). The netback price for Turkmenistan is the European

Turkmenistan to its sales on the lucrative European market. This was an extremely important shift because it took away the economic incentive for Turkmenistan to look for alternative transit routes to Europe that would bypass Russia's transit monopoly. It also meant that no matter what conditions for transit the ECH would ultimately establish, Turkmenistan would have little economic incentive to sell to the EU without Gazprom because it was already selling its gas to the company at EU price equivalents. Under these circumstances, it is unlikely that they could get a better deal elsewhere.

Essentially the new LTCs allowed Russia to achieve Gazprom's goal of controlling the gas volumes flowing from its Central Asian competitor to Europe by locking in purchase of all of it on a long term basis. However, in contrast to Vakhirev's heavy-handedness and greed, Russia was able to achieve the same goals by sharing a significant part of the wealth and cultivating cooperative, long term relations with its trade partner. Finally, under this new arrangement, the problem of transit access under the ECT for its competitor became less acute and Gazprom's defensive interest less urgent.

The president's assertion of state authority (in the guise of intervention in the policy making process) played a decisive role in this outcome. The option of pre-empting the Turkmen competitive threat through EU-priced LTCs had been available throughout the 1990s, although Vakhirev preferred short terms deals based on CIS terms of trade.

An important alternative explanation points to the character of the Eurasian gas market during the 1990s. Due to the severe depression in Russia, domestic demand for gas had fallen. At the same time, Gazprom's giant fields were still relatively young. Overall, Gazprom did not really need Central Asian gas to meet its supply commitments (domestic and export) since it had a surplus of its own gas. Immediately before the turn of the century, the situation changed. The Russian economy began to recover, and forecasts for domestic gas demand began to increase. Meanwhile, Gazprom's primary fields were past their production peak and future output was expected to fall, raising fears that there would not be enough gas for both domestic and foreign consumers. According to this logic, Gazprom concluded more generous LTCs because the balance between supply and demand had changed, and Gazprom urgently needed Central Asian gas to make up the shortfall in its gas mix.

There are two problems with this explanation. First, it does not explain why Gazprom would buy any gas from Central Asia in the 1990s at all. Second, in 1999 Vakhirev was well aware of the looming shortages and understood that the company would need Central Asian gas moving forward. However, when Gazprom contracted to buy Turkmen gas at the time, the terms were a one-year deal with no EU netback prices. The contract only changed after the state (Putin) intervened.

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contract price that Gazprom receives minus the costs of transit through Russia. See Energy Charter Secretariat, 2007.

*Authority over domestic gas markets: independent gas producers, structural reform, and Gazprom's defensive interests (part two)*

By signing LTCs with EU equivalent pricing, Gazprom was able to address the defensive interests raised by competition from the Central Asian producers. However, a similar defensive interest remained relative to competition from independent gas producers in Russia.

Independent gas comes from oil companies that own gas deposits or generate associated gas as they mine oil. There were also several smaller, non-Gazprom gas producers in Russia such as Novatek and Itera. Figure 8-1<sup>793</sup> shows the main independent gas producers in Russia and their production in 2005. Combined, these producers make up a growing share of Russian gas production. From 2001 to 2005, the proportion of gas produced by non-Gazprom companies ranged between 11 percent and approximately 14 percent. This data can be found in Figure 8-2.<sup>794</sup> In terms of volumes, these magnitudes are on par with the peak annual import volume from Turkmenistan according to the LTCs signed in 2003 (70-80 bcm). Furthermore, according to the Energy Strategy of Russia, this share rose to 17 percent in 2008 and was forecast to rise to 20 percent from 2013 to 2015, 25 percent to 26 percent from 2020 to 2022, and 27 percent from 2022 to 2030.<sup>795</sup> Though still small relative to Gazprom, the production is not insignificant and could change dynamics on even the largest markets, and this is especially true over the long term.

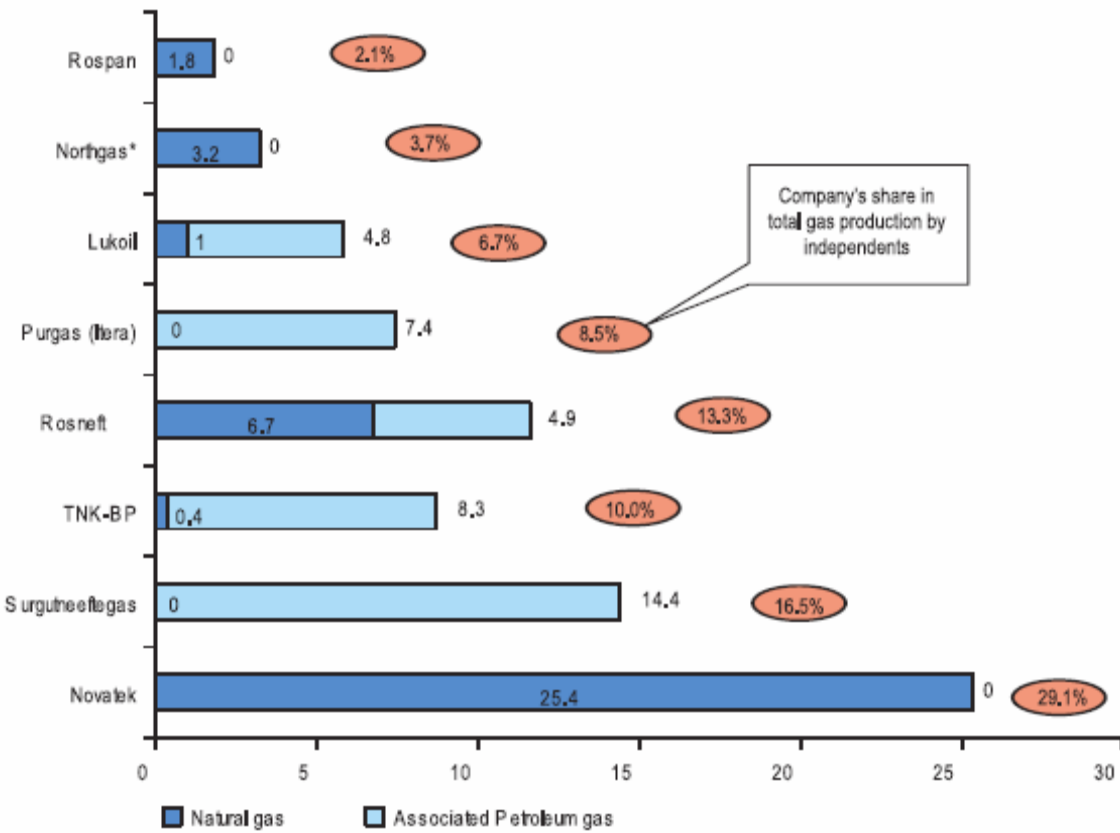
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793 “Gas Production Volumes—Actual, Forecasts and Reserves,” based on data from the RF Ministry of Industry and Energy, TsDU TEK, Gazprom, from *Brief Write-up on Russian Gas Reserves, Production, Consumption and Import-Export Volumes*, Advisory Assistance to the Ministry of Energy of Georgia, USAID, May 17, 2006, 8, accessed on December 8, 2011, [http://pdf.usaid.gov/pdf\\_docs/PNADK348.pdf](http://pdf.usaid.gov/pdf_docs/PNADK348.pdf).

794 “Gas Production Volumes.”

795 Ministry of Energy of the Russian Federation, “Energy Strategy of Russia for the Period up to 2030,” Institute of Energy Strategy, Moscow (2010) 140. Dates are approximate and correspond to three projected phases of implementation identified in the strategy. See 18.

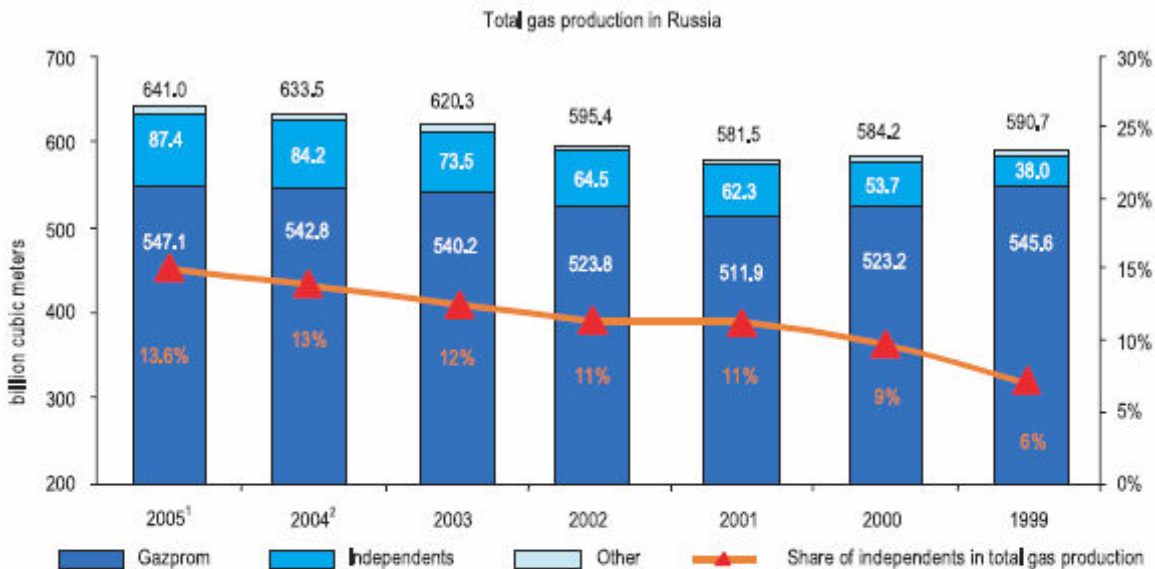
**Figure 8-1 : Major gas producers among independent companies in 2005 (billions of cubic meters)**



Source: RF Ministry of industry and Energy, TsDU TEK

Note: Rosneft's production figure does not include Rosneft-SMNG output

**Figure 8-2 : Russian Gas Production – Actual (billions of cubic meters)**



Source: RF Ministry of Industry and Energy, TsDU TEK, Gazprom

Notes:

1 - 2005 financial records by Gazprom include the share of Northgas for the 4Q

2 - The TsDU TEK and RF Ministry of Industry and Energy data for Gazprom production in 2004 in Figure differ from Gazprom's reports. The gas monopoly puts 2004 production at 545.1 billion cubic meters. The difference arises from Gazprom's inclusion, beginning in November 2004, of all production by Purgazdobycha in its production reports. Gazprom acquired Purgazdobycha in 2004 through an asset swap with NOVA TEK. (The transaction was concluded in late October 2004; earlier Gazprom had included 90 percent of Purgazdobycha's production in its reports.) TsDU and RF Ministry of Industry and Energy data do not reflect these changes.

Note: Other refers to regional companies and non-affiliated portions of companies in which Gazprom held interest.

To commercialize this gas, these companies needed access to the Russian gas transport network over which Gazprom had exclusive ownership and unilateral decision making power concerning access (whose gas was shipped, in what volume, to what destination, at what time, and at what price). In this respect, the independent gas producers in Russia were in the same predicament as Gazprom's Central Asian competitors. Russia's oil producers had become especially interested in exporting their gas in the late 1990s after they had consolidated control over their respective oil companies. All were interested in exports to Europe because European prices were much higher than the regulated domestic ones.

Therefore, just under the surface of discussions about restructuring the domestic gas industry and potentially breaking up Gazprom by business activity (production, transport, marketing, and distribution) as envisioned by the neo-liberal approach, were the interests of the independent producers in easier access to transport and Gazprom's interest in preventing this.

Structural reform was an exceedingly difficult and pernicious problem under Yeltsin. The state did not have sufficient authority over other actors to make a final settlement. In the context of a heterarchical political relationship, other actors could veto state decisions by putting the question on the agenda again. There were three battles of structural reform in the post-Soviet period: in 1992, 1996 to 1998, and finally 2001 to 2003.

The question of reforming the Russian gas industry deserves a study of its own. For our purposes here, it is enough to note that the last battle pitted Gazprom against the liberals in Prime Minister Kasyanov's government and particularly against the Ministry of Economic Development and Trade (MERT) under German Gref. The debate concerned many issues, but one was key: would Gazprom be broken up and if so, how? This question was very important because breaking up Gazprom dramatically increased the relative power of independent gas producers that wanted to freely market their gas. In fact, the corporate interests of the major oil companies and independent gas producers in transporting their own gas on the company's network for export were partly behind the policy initiative proposed by MERT to restructure the gas industry according to neo-liberal lines (unbundling Gazprom's monopoly). Therefore, reforming the gas sector was not just about finding the optimal structure but also about the particular interests of powerful economic actors.

In this respect, the third debate over structural reform in gas overlapped both temporally (2001-2003) and politically with the ratification debate that began in 2001. In fact, one of the reasons ratification was on the agenda in 2001 was that the independent producers thought the Treaty's transit provisions would support their efforts to enter the gas export business monopolized by Gazprom.<sup>796</sup> This meant that ECH policy was not just about Russia's foreign policy but also about the interests of domestic actors with particular agendas; I will return to this question later in the discussion of unitary actorhood.

In any case, structural reform and the ECH were politically related because they were both at the locus of conflict between Gazprom and the independent gas producers over the substance of Russia's domestic gas transport regime. Furthermore, both conflicts made salient Gazprom's defensive interest in maintaining control over access to its pipeline network and protecting its EU business vis-à-vis its domestic competitors. This meant that before any change in Gazprom's posture toward the ECH could take place, the question of Russia's domestic transport rules had to be resolved.

In other words, attenuating the domestic source of Gazprom's defensive interests depended on the state's establishing authority over gas policy and making these other powerful economic actors accept definitively Gazprom's continued monopoly over transport. Otherwise, this underlying conflict between Gazprom and the independent producers – whether expressed through the question of structural reform or ECT ratification – would continue. Furthermore, neither party would rest until its preferred arrangement for gas transport prevailed. This meant that the question of reform and ECT ratification would keep reappearing on the agenda and Gazprom's insecurity would persist.

We saw in chapter 6 that Putin's state-building strategy also addressed the state's relationship with other economic elites and large companies beyond Gazprom. By the end of 2003, particularly after the Khodorkovsky arrest, the state's authority over the entire economic elite had been consolidated. This meant that the state could finally make a settlement concerning the structure of the domestic gas market and specifically the domestic transport regime.

Unlike the second gas reform debate, which as we saw in chapter 5 was more a battle over power and ideology than about gas policy, 2001 through 2003 saw a genuine policy discussion. As during the 2001 ratification hearings, deliberation prevailed over polarization.

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796 Interviews in Moscow, fall 2006, fall 2007, fall 2008.

The debate lasted over two years.<sup>797</sup> Proposals were made, critical letters were sent to the president and the Duma, meetings were repeatedly postponed or cancelled, deputy ministers and CEOs debated each other at energy conferences, and a plethora of actors editorialized on the question in the media. Gas reform was very much a public discussion.

In September 2003, the Ministry of Energy prepared a memo for the Cabinet of Ministers (the government). Based on its analysis of both the MERT and Gazprom proposals, the ministry recommended, among other things, not unbundling the transit system from the rest of the company and maintaining the single export channel. At the government meeting that followed, Prime Minister Kasyanov took reform of Gazprom off the agenda. The MERT proposal had lost; there would be no radical reform of Gazprom, which would remain the dominant actor in the gas industry and maintain its pipeline monopoly. The following month, President Putin told the Europeans that breaking up Gazprom was out of the question.

In short, once the arguments were made and heard, the issue was settled definitively by the state; the political decision that emerged was final. This reflected that the state had authority over decision making; the decision was accepted by all the relevant actors, and the question of structural reform has not been raised since. It also reflected that the state had authority over actual gas policy. The blueprint for reforming Gazprom that was chosen has been largely implemented. The successful termination of the third gas debate according to terms set by the state (after policy deliberation that included different actors and perspectives) thus reflected that the state finally had authority over domestic gas markets.

Settling the issue in this way marked a turning point for Gazprom. With its transport monopoly fully preserved, the company's defensive interests abated (meaning it no longer had to worry about competition from Russian firms marketing gas to its customers at lower prices or on a spot basis while transporting on its pipeline). This was the last obstacle in the way of a favorable policy toward the ECH.

There is direct evidence that the resolution of the gas structural reform affected Gazprom's international policy posture in general. According to Dr. Tatiana Mitrova, a sectoral economist and head of the Center for International Energy Markets Studies at the Russian Academy of Science,

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797 For details about the third gas reform debate, see "V. Putin plans to give a series of orders to the government on the gas industry," *Novosti*, 20 November 2001; "Gas Industry News," *Interfax oil/gas summary*, November 28, 2001; "Alexei Miller will change nothing," *Kommersant Daily* January 25, 2002; the Concept for the Development of the Gas Market was discussed at the hearings by the State Duma Committee on Energy, WPS: Monitoring TV and Radio: Economics (Russia), March 4, 2002; "А.Миллер поручил рабочей группе в недельный срок подготовить план реорганизации структуры," Прайм-ТАСС, September 20, 2002; "Алексей Миллер переиграл Анатолия Чубайса," *Коммерсантъ*, November 1, 2002; "РАО ЕЭС будет покупать газ на бирже," *Коммерсантъ (Россия)*, November 5, 2002; Константин Смирнов, Алена Корнышева, "Михаил Касьянов не стал спешить с реформой «Газпрома»" *Коммерсант*, March 20, 2003; ОАО "Газпром", "Проект Концепции развития рынка газа в Российской Федерации," Правительство РФ, March 20, 2003; С. Бороздина, "'Газпром' будут не реформировать, а уговаривать," *Газета.Ру*, May 4, 2003; "Uniform Concept of Gazprom Development is not Prepared Yet," WPS: Russian Oil & Gas Report (from *Kommersant* April 29, 2004), April 30, 2003.

Once it was clear that there would be no restructuring or even break up of Gazprom, the Gazprom management was confident enough to start developing a new foreign strategy in line with the changes on the international markets.<sup>798</sup>

Finally, on June 25, at the Gazprom Annual Shareholders meeting, Miller presented his vision of Gazprom as a global, vertically integrated company “integrating gas exploration, production, transportation, storage, marketing and distribution of natural gas as well as production of a broad range of final products.”<sup>799</sup> He also declared that, “We are sure that Gazprom will be not just a noticeable player on the global energy market but will *dictate the rules of the game*.”<sup>800</sup> (emphasis added) With its defensive interests secured and a new international strategy in hand, Gazprom could finally see the value of the ECH for promoting its goals in the EU. Moreover, Miller’s statement reflected that Russia’s role identity as a regime maker affected how the company saw its position on international markets (for example, as one that dictates rules).

There is also direct evidence that the closing of the structural reform question influenced Russia’s ECH policy. As we saw in the previous chapter, the idea that a definitive template for structural reform needed to be adopted before beginning to develop ECH foreign policy had already been voiced during the 2001 ratification hearings. Even more revealing were the comments of the Russian delegation at the Energy Charter Conference in the summer of 2004, immediately before Gazprom began actively participating in the TP negotiations:

Russia is currently in the final stages of creating a comprehensive regulatory regime for its domestic natural gas industry; the shape of this regulatory system will undoubtedly influence the Russian position regarding the external conditions for gas supply.<sup>801</sup>

In short, state authority over domestic gas policy as a whole (not just Gazprom but other firms as well) allowed the finalization of gas reform, and the evidence suggests that this was directly linked to the shifts in Russian ECH policy we observed beginning with Gazprom’s move toward productive participation in the TP process.

#### *Increased policy initiative: Gazprom’s power and influence as a driver of Russian ECH policy*

Between 1994 (when negotiations on the Treaty were concluded) and 2004, Russia demonstrated relatively little initiative with respect to the ECH process. Prior to 1994, concluding a Treaty was a government priority, so Russia was actively engaged in negotiations. After 1994, Russia neglected to pursue arrangements within the regime that would normally be considered very important to the Russian side. For example, when the TP process began in 1998, Russia was not the initiator but rather Azerbaijan, prompted by oil producers in the North Caspian basin interested in transiting their crude oil through Russia. This is puzzling because 80 percent of Russia’s natural gas exports to Europe pass through Ukraine, and the Ukrainian transit problem has been a thorn in Russia’s side since the dissolution of the USSR. Nevertheless,

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798 Tatiana Mitrova, “Gazprom’s Perspective on International Markets,” *Russian Analytical Digest*, May 2008.

799 Ibid.

800 Ibid.

801 “Summary Record of the 14th Meeting of the Energy Charter Conference held on 15th June 2004,” Note from the Secretariat, July 7, 2004.



although it would publicly invoke the treaty when transit problems with Ukraine erupted, Russia did not initiate a process to actually tailor the ECH to deal with this serious problem.

The reason for Russia's lack of policy initiative with respect to the TP is not difficult to understand: Gazprom was opposed to the treaty in general, so there was little reason to initiate work to customize it to suit its needs. Nevertheless, Gazprom did begin participating in the process when negotiations over the TP began in 2000.<sup>802</sup> However, when a top level manager attended the first session, he concluded that there was no "political opportunity," and from that moment forward Gazprom's participation would be symbolic at most.<sup>803</sup> Thus, Gazprom joined the process but was only going through the motions.

With no interest from Gazprom, the only thing that remained during TP negotiations was the work of the negotiators from state ministries, technical experts, and representatives from other companies. Several of my interview respondents noted that the ECH process was being driven by bureaucratic inertia.<sup>804</sup> This was probably an exaggeration since other companies continued to participate and support the process, but their clout paled in comparison to that of Gazprom, which, as everyone understood, aggressively opposed the regime.

All the same, during 2002 and 2003, Russia's representatives in TP negotiations were able to conclude a favorable agreement with their EU counterparts that addressed many of Gazprom's interests in the EU. On both occasions Russia was unable to seal the deal. In 2002, Gazprom was still opposed to the agreement and blocking state action.<sup>805</sup> In 2003, the state could not commit because this was the climax of the battle over structural reform, which had momentarily put ECH policy on hold (since Gazprom's foreign strategy was still secondary to its defensive interests in protecting its monopoly). This of course belies the assessment by the Gazprom manager concerning political opportunity. In any case, conventionally these judgments are made by heads of state, not corporate big wigs.

Russia's policy initiative intensified when Gazprom became a productive participant for the first time. Gazprom began actively participating in the ECH process in the fall of 2004, when it joined the ongoing discussions on the draft TP. In June 2004, the 14<sup>th</sup> Charter Conference decided to resume bilateral negotiations between Russia and the EU, and in mid-August, the conference chairman Henning Christophersen proposed that the two parties begin work in the autumn.<sup>806</sup> The first expert consultation took place in Brussels on October 15. At the time, General Secretary Dr. Ria Kemper noted the "broad and active participation of both sides, which was an encouraging signal of the willingness to pursue the dialogue."<sup>807</sup>

The Russian delegation had submitted a list of questions to the EU that became the focus of the meeting.<sup>808</sup> Moreover, the Russian delegation stated that it,

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802 Interviews in Moscow, winter 2007, 2008-2009.

803 Interviews in Moscow, 2008-2009. The subject would not tell me who this figure was, only that he was a management heavyweight.

804 Interviews in Moscow, fall 2006, 2008-2009.

805 For details about Gazprom's obstruction of the ECT in 2002, see Konoplyanik, Andrei, "Energy Charter: Counter-acting through Inaction," *Vedomosti*, №193 (756), October 23, 2002.

806 Konoplyanik, "Russia-EU Summit."

807 "Summary Record of the 15th Meeting of the Energy Charter Conference held on 14th December 2004," Energy Charter Secretariat, January 12, 2005.

808 Ibid.

“welcomed the re-opening of consultations, pointing out the importance of transit issues for Russia...[and] considers the consultations constructive, that it is ready to continue them once it has the responses from the EU, and that it believes that compromise solutions can be found to the three outstanding questions in the draft text.”<sup>809</sup>

Two of my interview subjects corroborated that this moment marked the beginning of a new level of engagement on the part of Russia and Gazprom in the ECH process. During an interview in Brussels in November 2006, one subject who was a high level staff member at the Secretariat and observed negotiations commented that Gazprom had developed an “offensive interest” related to the regulatory structure in the EU:

Since late 2004, we have seen a consistently *increasing engagement* from the Russian Federation. You can see this in their preparation and participation. For example, today’s delegation is big and these are serious analysts and policy makers. You see bright people from Gazprom. They would not be sent if there were not a strategic interest. They would not send them just to be informed. This is symptomatic of the process. They take the negotiations seriously. They *want their voice heard* on Eurasian issues. There is a widespread perception that Russia is playing a defensive game to avoid third party access. This is inaccurate. There is a defensive interest and it appeared last in 2001. But it looms less large. Now you see the *importance to them of offensive transit issues*. This has been stable and increasing over time. Gazprom takes responsibility for delivery within the internal market and it has more interest in the regulatory structure. It wants to reduce the risk for transit. They have *seen the potential value of the Transit Protocol*. There have been many changes in the last ten years and now the Russian Federation is *starting a strategic discussion*.<sup>810</sup> (emphasis added)

Indeed, the conceptual distinction I make between offensive and defensive interests was a product of these discussions. Another respondent who was part of the Russian delegation also recounted the same transformation in late 2004: “Before 2004 Gazprom was against the Treaty. Once they realized they might be interested, they started sending a man from their international department.”<sup>811</sup>

Altogether, nine unofficial bilateral expert sessions were held between October 2004 and May 2006. Five of them were held in 2006.<sup>812</sup> In addition, experts from Russia met with the Secretariat twice, in February and March 2005. Each meeting led to encouraging comments concerning Russia and Gazprom’s engagement.<sup>813</sup>

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809 Ibid.

810 Interview in Brussels, fall 2006. It was this interview that pointed my attention to the fact that, in contrast to 2001 when it blocked ECT ratification, by fall 2004 Gazprom was interested in the agreement. Moreover, it was this subject who first made the distinction between offensive and defensive interests that I use in this chapter.

811 Interview in Moscow, fall 2007.

812 Andrei A. Konoplyanik, “Russia-EU, G-8, ECT and Transit Protocol,” *Russian/CIS Energy & Mining Law Journal* IV, 3 (2006): 10.

813 For details on the sequence of events and public statements concerning Gazprom and Russia’s transformed engagement in the TP process, see Konoplyanik, Andrei A., “Russia–EU Summit: WTO, the Energy Charter Treaty and the Issue of Energy Transit,” *International Energy Law & Taxation Review*, Issue 2, 2005; “Summary Record of the Trade and Transit Group Meeting on 24 and 25 May 2005,” Energy Charter Secretariat, June 21, 2005; Konoplyanik, Andrei A., “Russian Gas to Europe: From Long-Term Contracts, On-Border Trade and Destination Clauses to . . .?” *JOURNAL OF ENERGY & NATURAL RESOURCES LAW*, Vol. 23 No. 3, 2005, p.302; Konoplyanik, Andrei A., “2006: Year of New Opportunities,” *Neftgazovaya Vertikal’*, # 4, 2006; “16TH MEETING OF THE ENERGY CHARTER CONFERENCE on 9 December 2005, DRAFT ENERGY CHARTER PROTOCOL ON TRANSIT REPORT BY THE SECRETARIAT,” Energy Charter Secretariat, November 23, 2005.

The inclusion of Gazprom and growing policy initiative on the part of Russia, though politically significant from the perspective of the regime, did not really represent a radical break in the state's agenda positioning. Prior to the conclusion of negotiations on the Treaty in 1994, Russia was very active in the process, which reflected that creating a legal Treaty to protect foreign investments and sending a signal internationally to investors and states about the new state that Russia had become was a top government priority. During that time, Russia demonstrated significant policy initiative. For example, it proposed successfully to include provisions for a transition period during which states could prepare for implementing the Treaty's provisions. In this respect, Russia was at the head of the Eastern European bloc (the "transition" countries). Nevertheless, even this bold initiative, which the United States rejected entirely, was still within the neo-liberal framework; it did not challenge neo-liberal principles but rather asked for time to implement them.

Likewise, when Russia began promoting Gazprom's offensive interests within the EU, this was still very much within the context of an ongoing discussion. Moreover, the concerns were not new since Russian negotiators had already raised them previously. In terms of agenda positioning, the increased policy initiative beginning in 2004 was not particularly controversial. There is nothing unusual about states raising issues of concern during negotiations. Even small states do this. The novelty was that Gazprom was driving negotiations.

### **External events: the 2006 gas war with Ukraine, Centrica, and the St. Petersburg G8**

The year 2006 witnessed a series of international events that would change the context for Russian ECH policy. The New Year started with a bang: the first Russo-Ukrainian gas war. This episode had a profound effect on European leaders and in particular brought home the problem of energy security and Russia's reliability as an energy supplier. From that moment on, the EU – both at the supranational and national levels – began to lobby Russia aggressively and persistently to ratify the ECT.

The second event was the controversy in the United Kingdom over Gazprom's interest in its retail energy market. On January 18, Gazprom deputy CEO Alexander Medvedev stated in a *Guardian* interview that Gazprom might be interested in a number of acquisitions in the United Kingdom, including Centrica, the largest domestic distributor of natural gas and also a major electricity distributor in the United Kingdom. This generated an uproar in the media and visible concern on the part of the government (it did not help that this came only weeks after the gas war with Ukraine). Gazprom's acquisition did not go through, which was vexing both for the company and the state. From that moment on, Russia would insist that energy cooperation was a two-way street.

On one hand the EU was pushing ECT ratification because of concerns raised by the Russo-Ukrainian gas war. On the other hand, Russia was pushing the idea of reciprocity due to concerns raised by the Centrica episode. Moreover, Russia was hosting its first G8 summit in St. Petersburg the following July, and energy security (which, as we will see in the next chapter, was based on new principles) was the top item on the agenda. Because of this, an urgency to conclude the draft TP in time for a happy announcement concerning Russian ratification emerged within the ECH organization. All these factors coming together at the same time created a propitious environment for Russia to link ECT ratification to reciprocity in energy

investment with the EU. It was in this setting that Russian signals concerning a grand bargain in energy began to emerge.

### **The grand bargain: the ECH, investment, and asset swaps**

Russian government officials were already sending positive signals concerning the ECT contingent on satisfactory progress on the TP, a linkage that was made as a result of the 2001 ratification debate. In March 2006, at the G8 energy ministers meeting, industry and energy minister Viktor Khristenko replied to calls for Russia's ratification of the ECT that, "Negotiations [on the transit protocol] are ongoing, the talk process is not simple, and if results are reached, this would open up the possibility of ratifying [the Charter]."<sup>814</sup>

Russian action would intensify in the following months leading up to the G8 summit. At the EU-Russia summit in Sochi on May 25, in response to Commission President Barroso's request that Gazprom allow access for other producers to its gas pipeline, Putin replied that the company would keep its monopoly on transit and also expressed Russia's wish for direct access to the EU retail market. In relation to the ECH, Putin expressed an open mind and again alluded to reciprocity. It is worth citing him at length:

When one talks about our full accession to the Energy Charter and to the additional protocol on transit, what is one talking about? One is talking about free access to infrastructure for the extraction of hydrocarbons and to transport infrastructure. On our side, a natural question arises. All right, you get this free access to our infrastructure. And what do we get? But we still hear the same old thing from them. In fact, I asked them about this at the news conference. Where are the deposits which you will give us access to....Where are your trunk pipeline systems, like the ones which Gazprom controls? You don't have any. So, we are not against doing this - [pauses] in the future. But we need to know what we get in return. This is very easy to understand if you think back to our childhood. A child goes out into the playground, holding a sweet. Another child says: "Give me the sweet." The first child holds onto the sweet even more tightly and says: "What are you going to give me?" So we want to know what they are going to give us.<sup>815</sup>

A different media report expressed a similar sentiment coming from Putin:

The discussion is underway on how we will build our relations in future....If our partners expect us to be absolutely liberal in the issues of mining, transportation, then we would like to know, where will you allow us to go....[Later, Putin explained he was referring to the] possibilities of the Energy Charter.

We are ready to realize what is written in the Energy Charter, but we must understand what we get in exchange...If our European partners expect that we will allow them into the *sanctum sanctorum of our economy - the energy sector* - and allow in the way many would like us to do, than we expect reciprocal actions for our development.<sup>816</sup> (emphasis added)

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814 "Barroso to meet Putin on EU energy security," *Financial Times*, March 17, 2006.

815 "Putin reassures EU leaders on energy security, migration," *BBC Monitoring Former Soviet Union*, May 25, 2006.

816 Anna Nikolayeva, "The sanctum sanctorum," *Russian Press Digest-Russica Izvestia*, from *Vedomosti* 94 (May 26, 2006): A2.

An EU source also commented, “every time we talk I think we move forward in our mutual understanding...even on the Energy Charter, Putin was slightly more open.”<sup>817</sup> Putin also commented that the Sochi summit participants “were talking the same language.”<sup>818</sup>

As these passages demonstrate, Russia was suggesting that it was prepared to move forward with the ECH but on condition that the company get something in return. Therefore, Russia was creating a new linkage between (eventual) ratification and investment. Of course Russia had already created a new linkage between ratification and TP negotiations after the 2001 ratification debate. Moreover, investment was the most important part of the regime, and the ECT established rules that did not differentiate between upstream (resources, transit) and downstream (marketing, distribution) investments.<sup>819</sup> Russia was dissatisfied that the rules were not effective in terms of the immediate goals of its companies (especially Gazprom), and this became an acute question after the Centrica incident in the United Kingdom.

As a result, it proposed a particular form of investment: asset swaps. Putin alluded to this specifically earlier in the spring during his address at the G8 ministerial meeting for energy in Moscow:

I think that mutually beneficial exchanges of assets between energy companies could play an important part in distributing the risks more evenly. This is one of the instruments that can help us ensure sustained optimisation of global energy supplies. We are already taking the first steps in this direction and are working in this area with our German partners. We are open to similar projects with energy companies from other countries.<sup>820</sup>

For Russia, asset swaps refer to corporate deals whereby Russian firms acquire assets from foreign companies that can add value to their business in exchange for assets that they already possess. These deals can take a variety of forms and levels of complexity. One example was a deal that was finalized on December 17, 2007, between Gazprom and Germany’s BASF Group.<sup>821</sup> According to the terms of the agreement, BASF received a 35 percent stake in Severneftegazprom, a subsidiary of Gazprom that holds the development license to the South Russia (Yuzhno-Russkoye) gas field.<sup>822</sup> This acquisition was particularly significant for BASF because it meant that the company could add 35 percent of the gas reserves associated with the deposit to its reserve balance, something investors evaluate positively when choosing firms.<sup>823</sup>

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817 Jeff Mason, “Russia’s Putin more open to energy charter-EU source,” *Reuters News*, May 26, 2006.

818 “Russian state TV talked up cooperation with EU in the wake of the Sochi summit,” *BBC Monitoring Former Soviet Union*, May 30, 2006.

819 The upstream comprises activities that are relatively close to the beginning of the business chain, such as exploration, development, and production. The downstream relates to activities closer to the end of the business chain, such as marketing and distribution to retail customers. The midstream refers to activities in between, such as transit and sales to wholesale customers. The examples cited are not absolute since these are relative concepts; for example, transit is upstream from marketing.

820 Vladimir Putin’s speech at Meeting with the G8 Energy Ministers, G8 Energy Ministers Ministerial and Other Meetings, March 16, 2006, Moscow, accessed on August 14, 2011, [http://www.g8.utoronto.ca/energy/energy\\_putin060316.html](http://www.g8.utoronto.ca/energy/energy_putin060316.html).

821 BASF is a German conglomerate that originated as a chemical producer. It began cooperating with Gazprom in 1990 out of a mutual interest to cut out the then German national monopolist in natural gas, Ruhrgas. Accessed December 8, 2011, <http://www.gazprom.com/about/history/chronicle/2007/>.

822 25 percent minus 1 ordinary share as well as one non-voting preference share, which is equivalent to 10 percent of the project. Igor Tomberg, “Two aspects of Russian-German asset swap agreements,” *RIA Novosti*, December 20, 2007.

823 Ibid.

In exchange, Gazprom's share in Wingas, a gas trading, distribution, transit, and storage company<sup>824</sup> and grand-daughter of the BASF group,<sup>825</sup> went up from 35 percent to 50 percent minus one share.<sup>826</sup> It was also agreed that Wingas would participate in the construction of the pipeline. As part of the deal, Gazprom also purchased a 49 percent stake in two Libyan oil concessions owned by Wintershall, a subsidiary of BASF and Gazprom's partner in the Wingas venture.<sup>827</sup>

In conclusion, the Centrica affair made concerns about Gazprom's ability to invest in the EU politically salient for Russia. As a result, it took advantage of EU pressure to ratify the ECT and its hosting of the G8 to link its ratification to a particular form of investment – asset swaps – that would facilitate Gazprom's entry into the EU market, a key company goal.

The proximate cause for this shift was an external event. The fact that Gazprom's identity had changed and it was now an active participant in the ECH process and negotiating (with success) on the draft TP was also necessary to link investment to ECT ratification.

### **Turning the tables: sticks and carrots to pressure the EU**

After proposing the grand bargain, Russia began trying to pressure the EU to accept its proposal. This was an unexpected departure in the EU-Russian relationship, since previously it had always been the EU pressuring Russia (to ratify the Treaty, for example). In this sense, Russia was turning the tables on the EU.

Shortly after the May 2006 EU-Russia summit in Sochi, Gazprom's unofficial lobbyist, President of the Russian Gas Society and Chairman of the Duma's energy committee Valery Yazev introduced a bill in the State Duma that would put Gazprom's export monopoly into law. The bill was overwhelmingly approved by the State Duma,<sup>828</sup> moved through both houses of the Federal Assembly very quickly, and was ready ten days before the summit. Nevertheless, it was left unsigned by Putin prior to the G8. Although such behavior may seem puzzling at first glance, in fact Russia was creating sticks and carrots to use in negotiations with Europe. Roland Nash, chief strategist at Renaissance Capital, stated in an interview that, "given the G8 summit on July 15-17, Putin might wait a few weeks... the bill 'is upping the ante' in an energy dialogue already tipped in Russia's favor."<sup>829</sup>

In what sense was Russia putting pressure on the EU? It had been a long stated EU goal to create an open regime for natural gas exports from Russia. As we have seen, Russia, as a gas exporter, had an interest in coordinating gas supply to the European market to shape volumes,

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824 Company profile, accessed May 13, 2011, [http://www.wingas.de/daten\\_fakten.html?&L=1](http://www.wingas.de/daten_fakten.html?&L=1). In addition to Germany, Wingas trades and distributes natural gas in Belgium, France, the United Kingdom, Austria, the Czech Republic, and Denmark. It also owns the largest natural gas storage facility in Western Europe, located in Rehden, Germany, and is building additional storage facilities in the United Kingdom and Germany. "Construction of Baltic Sea pipeline Nord Stream begins," accessed May 13, 2011, <http://www.wingas.de/1486.html?&L=1>.

825 Gazprom's partner in Wingas is the German company Wintershall, which is a 100-percent subsidiary of the BASF group. "Collaboration along the entire value chain," accessed May 13, 2011, <http://www.wintershall.com/1393.html>.

826 "Gazprom's External Investments," *APS Review Gas Market Trends*, September 4, 2006.

827 "Gazprom's delegation visits Libya," *SKRIN Newswire*, July 14, 2008.

828 Boykewich, "Gazprom's Monopoly on Exports Backed by Duma."

829 Ibid.

support its terms of trade, and protect its market share and revenues. As an importer, Europe is interested in the opposite type of arrangement: uncoordinated gas supply that would lead to gas-on-gas competition in its market and lower prices.

Yazev's bill foreclosed the possibility of uncoordinated gas sales to Europe from within Russia; with a few exceptions,<sup>830</sup> only Gazprom would be able to sell gas outside Russia through its single export channel. This created a situation at the G8 in which Russia could "make itself felt" by shaping part of the EU's cost-benefit calculation. If the EU accepted the deal by the G8 deadline, Russia was proposing an added benefit for the EU: potentially uncoordinated gas exports from Russia to Europe. However, by threatening to foreclose the possibility of uncoordinated exports with just one presidential signature, Russia was also raising the costs for not accepting its deal before the Russian-determined deadline. In contrast to the 1990s, the Russian state was making clear that there was a downside to not accommodating its policy preferences; the EU now had something to lose.

In early June, Yazev commented, "I think that the bill can become one of the arguments of the Russian side at the G8 summit in St. Petersburg. We don't hide that our position is 'hawkish.'"<sup>831</sup> The article concluded by saying, "The final decision still depends on the Russian president. Informed sources of *Kommersant* believe that Vladimir Putin is very likely to veto the bill On Gas Export if Moscow manages to get some concessions from the Europeans."<sup>832</sup> Another press report stated that:

Timing this move to the eve of G8 summit in St. Petersburg could be viewed as a response to the EU calls for gas market liberalization. Once the bill is approved by the Federation Council, it will become a solid lever for President Vladimir Putin in his talks with the G7 [sic] leaders. Using it requires just signing a bill into law.<sup>833</sup>

Thus, there is very compelling, direct evidence that the aim of the law was to pressure the EU.

The remarks by Yazev were reminiscent of his statements during the ratification hearings. Both were an expression of the new ideological line, which saw Russia as a great power that could use tough tactics in bargaining with other powerful states. Again, these ideas have become institutionalized into policy making and constituted Russia's new role identity as a regime maker; this was an important background factor for the emergence of this kind of pressure tactic. There is no evidence that Russia used this type of approach in ECH relations with Europe during the 1990s.

Ultimately, the principles of the Treaty were included in the G8 declaration. However, the broader bargain linking ratification to reciprocal investments was not concluded, and Russia and the EU continued bargaining. The day after the summit, Putin signed the law on Gazprom's export monopoly, thereby legislatively foreclosing any possibility of gas exports to Europe without Gazprom's coordination.

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830 Sales of gas produced according to Production Sharing Agreements were not included in the bill. This concerned the projects Sakhalin-1 and Sakhalin-2. Boykewich, "Gazprom's Monopoly on Exports Backed by Duma." However, this gas would be destined for the Pacific market and in principle would not compete with Gazprom in Europe.

831 Maxim Shishkin, Dmitry Butrin, and Olga Pleshanova, "Russia shuts off the valves," *Russian Press Digest-Russica Izvestia* from *Kommersant*, June 7, 2006, 1.

832 Ibid.

833 "Armed by Gas," *SKRIN Newswire*, July 7, 2006.

When compared to the 1990s, Russia's ability to turn the tables – to not just be pressured but also pressure other states – reflects that the EU-Russia relationship had changed in important ways. What is even more striking was Russia's ability to pull off this maneuver in such a short time. This required a capacity to act as a unitary actor, something that had been absent in Russia, particularly in the ECH sphere. The next section examines this development.

### **Unitary actorhood**

To understand how Russia became a unitary actor by 2006, we have to start by looking at the cleavages that existed in ECH policy earlier. The first cleavage was between the executive branch and the parliament. All the governments under Yeltsin and the Kasyanov government under Putin supported the ECH. This was consistent with the ideological line from the 1990s, which suggested that by accepting neo-liberal principles, Russia was sending a signal to the international community that it had become a different type of state than the USSR. Russia was signaling that it embraced free market principles and had a legal understanding of sovereignty. This created a “comfortable” environment for business and made Russia worthy of integration into the international economy. Within the neo-liberal framework, Russia's policy to accept the ECH and its principles was the only way to attract investment and shed the Soviet legacy of international isolation. These ideas became institutionalized into the Russian state and constituted its regime taker role identity under Yeltsin.

However, the State Duma, which was dominated by communists and nationalists during the 1990s, did not support this policy. To begin with, since the opposition did not accept the neo-liberal principles, Yeltsin's ECH policy did not make economic sense. More generally, relations between the executive and parliament were marred by ideological disagreements over the reform course that Yeltsin had chosen. The opposition did not accept neo-liberal domestic reforms they thought were both misguided economically and too concessionary to the West. Zhirinovsky's vicious attack on Professor Yershov during the 2001 ratification hearings (chapter 7) was an expression of these bitter ideological divisions over Yeltsin's policy course. The battle over the ECH in the 1990s was symptomatic of the general polarization in Russian politics at that time;<sup>834</sup> it was a rehashing of the ideological and political battle concerning Yeltsin's economic reforms. These deep disagreements created a toxic environment for policy making.

The “red-brown coalition” in the Duma saw Russian ECH policy as “pandering to the West” and “selling out the homeland.” This was consistent with the dependency perspective that dominated the views of the opposition. During my interviews, a common refrain voiced by critics of the neo-liberal line (not just communists and nationalists) was that for Russia in the 1990s, cooperation with Western states through international institutions (such as the ECH) was an “end in itself.” One interview participant noted that, “In the 1990s, our foreign policy was to join all the clubs. We were crawling toward Europe.”<sup>835</sup> Just underneath the ECH debate was a hostile disagreement over national loyalty to Russia.

The second cleavage was between the government and Gazprom. We have examined this relationship in great depth, so it is sufficient to recall that there were conflicts of interests

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834 Michael McFaul, “A precarious peace: domestic politics in the making of Russian foreign policy,” *International Security* 22, 3 (December 22, 1997).

835 Interview in Moscow, spring 2009.



over who reaped the benefits of the gas natural resource rent, the managers or the state. There was also a disagreement over economic strategy. The neo-liberal approach embodied in the ECH and followed by government officials dictated that, as Ivanov argued in 2001, Russia had to become legally competitive in the sphere of transit (providing reliable access to transit according to multilateral, non-discriminatory principles). This made salient defensive interests at Gazprom whose strategy was to leverage its monopoly on transit as a way of shaping the EU gas market to its advantage. In 1997, Gazprom lobbied against ratification; as Russia's largest company it had considerable clout in the Duma, and this contributed in no small measure to the Duma's turning down the agreement.

Another cleavage was between Gazprom and the independent gas producers. As noted earlier, the monopolist and its competitors had diametrically opposed interests relative to Russia's domestic transport regime. The ECH, which was ambiguous on this subject, was thus a venue to play out this battle. According to several interview participants, one of the reasons the government promoted ratification in 2001 was because of the influence of the independent producers, including the oil lobby. In this respect, ECH policy also represented a conflict between different domestic corporate interests over Russia's natural gas rents.

ECH policy in previous years was not just about one question. It brought together several different issues and political conflicts: the ongoing political and ideological confrontation between the president and nationalists and communists in the Duma over the reform course Yeltsin had chosen; the conflict between the government and Gazprom over control of the gas business, energy rents, and Russian gas policy; and the battle over resource rents in natural gas between different corporate actors. Each of these conflicts brought forth competing visions of Russia's interests and a different approach to ECH policy. Finally, in the context of heterarchy, all actors saw themselves as authoritative, and policy decisions were either blocked or not definitive because the losing side would put the question back on the agenda with the hope of prevailing in the next round. In more general terms, there was no single locus of authority to frame the question for debate and enforce a settlement.

When Putin became president, his state-building project was to invest authority in the central state. Clearly, the new approach concerned the energy sector and the gas industry. The project emerged from Putin's vision of the state and was consistent with the ideological line that he articulated at the beginning of his first term. Overall, this produced several results. First, as we saw earlier in this chapter, Gazprom was incorporated into the ECH process in a productive way. Second, since the new ideological line was closer to the mainstream of attitudes within the elite, it was less polarizing. As we saw in the previous chapter, this meant that debate led to genuine deliberation over policy. Third, the focus of policy making debates turned to identifying the interests of the state; it was framed around a single concept – the state interest – which was possible since state power was legitimate. Finally, the state had authority to end debate, take a decision, and impose a settlement that would be accepted. In the context of the new hierarchical relationship in policy making between the state and societal actors, societal actors could not veto policy, and the losing party could not put the question back on the agenda in hope of a different, more favorable outcome. Once the policy question was resolved, it was closed.

What did this mean concretely for ECH policy? By 2006, the ECH policy debate and the gas reform debate closely connected to it were largely over. There was a consensus that promoting state interests in the ECH sphere meant protecting the interests of Gazprom, which had become Russia's leading national champion. In particular, the state interest had a fiscal

basis related to Gazprom's contributions to the budget (the largest in Russia), which were based on its export business in Europe.

Moreover, even actors with competing agendas accepted this settlement and in any case had very little influence to change policy. As an example of this, we can look at the process through which the bill passed. Not only did it enjoy overwhelming support within the assembly, but it moved very quickly. This did not have to be the case since it infringed on important competing interests. Specifically, when the bill "On Exports" was moving through the Federal Assembly, the independent gas producers lobbied to carve out a space that would protect their ability to access Gazprom's pipeline and participate in exports. They were once again raising the gas transport regime (and export channel) question that had already been settled, largely in Gazprom's favor. According to one media report:

A virtual who's-who of Russian energy companies unsuccessfully lobbied to restrict the bill's scope after it was introduced in the Duma in early June.

Vladimir Volubyov, a spokesman for joint Russian-British energy company TNK-BP, said his company sent its proposals to the Duma's Energy Committee along with those from oil companies LUKoil and Rosneft, and independent gas producers Itera and Novatek but that they were rejected without explanation.

"The law itself is a necessary one. No one is saying that it shouldn't exist," Volubyov said. "But we need to define the system of rules by which independent producers' access [to Gazprom's pipelines] will be regulated."<sup>836</sup>

This text is interesting for a number of reasons. First, it demonstrates the inability of other powerful corporate actors to change the agenda even when acting collectively. The bill was not about the transport regime or sharing rents across companies, but a tactical lever in negotiations with the EU. It had to be passed quickly and could not be derailed for debate on what were peripheral questions given the context.

Second, it shows that even actors with competing interests accepted state policy as legitimate. The official from TNK-BP did not reject the bill even though it certainly did not promote the interests of the independent gas producers, who preferred a free transport and export regime in which Gazprom did not play a coordinating role. He also did not argue that the idea of an export monopoly was illegitimate because it discouraged competition and led to inefficient production, arguments that had been voiced previously. Both the policy and the concept behind it were legitimate. Instead, Volubyov was pressing to make marginal changes that would accommodate the interests of the independent gas producers.

In conclusion, we can explain the emergence of unitary actorhood in Russia as an outcome of the president's changed vision of the state and the state-building project it motivated. These resulted in: 1) more cooperative relations between different agencies of the state (the president and the Duma; the government and Gazprom); 2) the ability to reconcile competing approaches and interests concerning policy through deliberation anchored by a single concept – the state interest (as opposed to an alternative guiding concept like free market or "efficiency" as articulated by neo-liberalism or several competing concepts); and 3) hierarchical relations that meant a final decision could be taken and policy could be implemented without obstruction from parties that did not get what they wanted.

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836 Stephen Boykewich, "Gazprom's Export Monopoly Cemented," *The Moscow Times*, July 6, 2006.

## Summary

This chapter has argued that by 2006, Russian ECH policy had changed in important ways. For the first time, Gazprom was a productive participant in the process and driving ECH policy in very important ways. In advance of the G8, Russia proposed a deal to the EU linking its ECT ratification to the creation of investment opportunities for Gazprom in the EU through asset swaps with EU firms. Moreover, Russia began using sticks and carrots to compel the EU to accept its proposal. Previously it was the EU that had pressured Russia, but now Russia had turned the tables and was pressuring the EU. Finally, putting pressure on the EU in this way required a high level of coordination within the state and demonstrated that Russia had become a unitary actor.

The transformation of Gazprom's corporate identity (the operational logic of the company) was a key development behind these changes in Russian ECH policy. Before the state could promote Gazprom's interests through a deal that included the ECH, the powerful gas monopoly had to see the ECH as a potentially valuable policy instrument and be a productive, rather than destructive, participant in the ECH process.

I have examined all of these developments through the lens of the legitimacy of state power, which produced several effects. The legitimacy of state power motivated a state-building project that created hierarchical relations between the state and the economic elite in strategic sectors (including energy and natural gas). This eliminated conflicts of interest that had interfered with state-firm cooperation in the ECH sphere and transformed Gazprom's corporate identity (fiefdom to national champion). The legitimacy of state power also meant that policy debates were anchored by a single concept (the state interest) and characterized by deliberation rather than polarization. Moreover, when difficult and controversial policy issues (structural reform) were finally decided, the legitimacy of state power meant that the settlement was final; the hierarchy of relations between the state and societal actors that legitimate state power produced meant that disgruntled parties could not veto the outcome or put the question back on the agenda again.

The legitimacy of state power therefore: 1) motivated state building, which produced a hierarchy of relations; 2) transformed societal identities; 3) structured debate conceptually (state interest as anchor) and politically (deliberation rather than polarization); and 4) enforced policy settlements. All of these factors combined to change the balance of interests at Gazprom (from defensive to offensive) and create a new, positive attitude toward the ECH, which was necessary for the regime to be a plausible instrument for promoting the company's goals.

An external event (the Centrica affair) made Gazprom's interests urgent and led to the grand bargain proposal. However, for the proposal to be supported by sticks and carrots, the idea that Russia could drive a hard bargain had to be available. Here, the idea that Russia was a great power that bargained with other powerful states and used tough tactics was an important facilitating background factor.

More generally, these two ideas—state as legitimate power in strategic sectors and state as great power that drives a tough bargain—were the source respectively of the Russian state's corporate identity (high sovereignty) and role identity (regime maker). Therefore, these ideas about the state—or the SS ideological line—are the link between Russia's mercantilist identity and the 2006 policy outcomes we observe.

The fall of 2006 following the G8 summit saw Russia undertake an intentional, concerted effort to transform the ECH regime. This policy lasted until 2008 and was ultimately unsuccessful. The next chapter examines these efforts and explores why they failed.

## CHAPTER NINE: TRANSFORMING THE ECH REGIME – TOO CONTROVERSIAL (2006 TO 2008)

### Overview

In the previous chapter, we saw that Russia used the occasion of the July G8 summit to pressure the EU to conclude a deal that linked eventual ratification of the ECT by Russia to facilitated access for Gazprom (the company's attempted investment in the UK firm Centrica was derailed due to political opposition) to downstream (European) markets. Thus, in the summer of 2006, Russia was still amenable to the Treaty and using it as a bargaining chip in negotiations with the EU.

This chapter examines the period from 2006 to 2008, when Russia worked actively within the ECH framework to adapt the regime to meet its needs. To analyze and evaluate Russia's attempt to adapt the ECH regime, I will use the definition of regime proposed by Krasner et al., which focuses on principles, norms, rules, and decision-making procedures. However, the standard definition needs to be elaborated to make a distinction between substantive norms and procedural norms. According to Finlayson and Zacher,

It is the *norms* that provide the foundation of a regime since they constitute the general obligations and rights that are to guide states' behavior in designing decision-making procedures and in formulating and implementing rules. They can be divided into *substantive* norms, which provide standards for drawing up specific behavioral prescriptions, and *procedural* norms, which provide guidelines regarding how states should design and use decision-making mechanisms. These decision-making or *procedural mechanisms* define who participates in different types of decisions and whose consent is necessary for the formulation of rules and their implementation.<sup>837</sup> (italics in original)

Russia's goals for modifying the ECH touched on almost all aspects of the regime. In terms of substance, Russia was interested in changing the rules related to transit, investment, and energy materials. It also wanted to expand the membership of the regime. This included inviting both energy exporters (for example, Saudi Arabia) and importers (China and India). Additionally, Russia wanted to bolster the regime's provisions concerning state sovereignty and modify how energy security was understood within the regime. This meant modifying the norms and principles of the ECH or the meta regime.<sup>838</sup> However, in calling for reform, Russia was violating the procedural norms of the ECH regime.

Although Russia was able to begin a serious discussion about reforming the Treaty, and despite the fact that some other states were open to the possibility, Russia's attempts were unsuccessful. As a result, the initiative evolved into extended debate that did not lead to any tangible developments by December 2008. Fundamentally, the regime was not adapted to accommodate Russia due primarily to a lack of political will on the part of the other states. The EU, the members of which had grown since the regime was created and made up more than half

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837 Jock A. Finlayson and Mark W. Zacher, "The GATT and the Regulation of Trade Barriers: Regime Dynamics and Functions," in *Regimes*, ed. S. Krasner (Ithaca, NY: Cornell University Press, 1983), 276.

838 V. K. Aggarwal, "Reconciling multiple institutions: Bargaining, linkages, and nesting," in *Institutional Designs for a Complex World: Bargaining, Linkages, and Nesting*, ed. V. K. Aggarwal (Ithaca, NY: Cornell University Press, 1998).

of the regime's constituency by the time Russia began attempting to change the ECH,<sup>839</sup> played a decisive role.

The focus of our attention will be on Russia's attempts to adapt the regime and how this initiative was received by other actors in the ECH context. The purpose of this discussion is threefold. The first goal is related to the larger theoretical agenda of this dissertation: state identity. This chapter demonstrates that during this period, Russia's identity was that of a mercantilist: in terms of role identity it was a regime maker, and in terms of corporate identity (which did not change), it had high sovereignty. The empirical analysis, however, focuses on Russia's regime making rather than its corporate identity.<sup>840</sup> In terms of outcomes, we can see that Russia's agenda position was very controversial.

The second goal of this chapter is to show the substance of Russia's regime making. During the period examined, Russia proposed significant changes to the ECH regime. Exploring its demands is a window for understanding important parts of the regime that were developed during the 1990s. The discussion on rules will examine important parts of the Treaty and the draft TP.

The final goal is to show how other states reacted to Russia's initiative. Although the reaction to the substance of Russia's arguments varied, the states were universally opposed to changing the ECT, which was the centerpiece of the ECH regime. The factors behind the other states' reactions are largely outside the scope of this dissertation. However, preliminary evidence suggests that the states, EU states in particular, objected not so much to the substance of Russia's demands but to the way Russia made them. Particularly controversial was the demand to significantly modify the Treaty, which had become somewhat of a sacred cow within the regime. In fact, negotiations on the draft TP yielded considerable agreement between the EU and Russia. When Russia followed the procedural norms, its demands could be accommodated. The larger point is that in trying to adapt the ECH, Russia did not generate sufficient support from other states, and as a result its initiative was not successful; the regime was not adapted. This outcome is important for understanding the general evolution of the ECH regime and specifically Russia's policy from 2009 to 2010, which is the subject of the next chapter.

## Organization of chapter

The first section presents evidence that Russia was intentionally trying to adapt the regime; the attempt at regime adaptation was not the tactical byproduct of another goal as it had been in the run-up to the G8 summit meeting in July 2006. The second section focuses on Russia's demands for changing the provisions of the ECT or the rules of the regime. Specifically, Russia was raising demands related to transit, investment, energy materials, and

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839 With the accession to the EU of Romania and Bulgaria on January 1, 2007, EU states composed 27 of the regime's 52 members, or 52% of the regime. If we include "candidate countries" (Croatia, Iceland, the former Yugoslav Republic of Macedonia, and Turkey) and "potential candidates" (Albania and Bosnia and Herzegovina) for accession as defined by the European Commission, the number rises to 33 states or almost two-thirds of the ECH regime (62%). Accessed December 9, 2011, [http://ec.europa.eu/enlargement/countries/index\\_en.htm](http://ec.europa.eu/enlargement/countries/index_en.htm).

840 This is justified since the previous chapter demonstrated that by 2004, Russia's corporate identity corresponded to high sovereignty, and no significant changes in Russia's corporate identity occurred during 2006-2008. In particular, Gazprom continued to work with the state within the ECH context to promote its interests.

membership. This section also discusses the changing EU market, which was a significant background factor that motivated several Russian demands.

The third and fourth sections examine Russia's proposals for changing regime norms and principles. Russia proposed to make the sovereignty norm more robust within the regime, which reflected that it no longer understood sovereignty in strictly legal terms. The state would play a much more active role in energy beyond making laws and treaties. Russia also proposed to change a key principle with the regime: the understanding of energy security. This perspective enjoyed limited support from the Secretariat and industry groups participating in the process. Ultimately, however, it failed to persuade the EU. The final section explores the preliminary sources for EU reluctance to accommodate Russia. I argue that the EU was particularly intransigent because Russia's attempts to change the regime violated key procedural norms that reflected the EU vision for international cooperation to overcome anarchy, a vision Russia no longer shared.

### **The new policy in Moscow: reforming the ECH**

As we saw in the previous chapter, Russia began attempts to adapt the regime in the run-up to the G8 summit. These attempts were significant in that they violated the regime's decision-making norms and suggested new principles. Ultimately, however, they were tactical elements of the grand bargain that Russia proposed to the EU. Once the bargain fell through, Russia began arguing explicitly that the agreement itself was inadequate and needed to be changed. Thus, by the fall of 2006, adapting the regime became an explicit and central part of Russia's ECH policy. According to Yershov,

A historical landmark in the acknowledgement of a new perspective on global energy security was the meeting of the leaders of the "Big Eight" or the G-8 summit in St. Petersburg under the chairmanship of Russia during July 15-17, 2006.

The decision of the St. Petersburg summit, having established the orientation of the development of foreign economic relations in the sphere of energy, was immediately seized upon to arm Russian diplomacy, first and foremost in the arena of the complex of relations within the framework of the ECT.

At the top of the agenda was placed the aim of showing the real short comings of the provisions of the ECT and its growing inadequacy with respect to the developments in world energy and on world markets for fuel and energy goods, which were keeping Russia from ratifying the ECT and thereby depriving other parties of the agreement of the most important partner – producer and exporter of energy resources...

Beginning in 2006, the question of the necessity of the partial change of the ECT as a condition for its ratification by Russia became an important vector in Russia's political line in relation to the ECT and the Conference of the Energy Charter.<sup>841</sup>

Konoplyanik agreed that Russia took the lead in adapting the regime at this time: "the fruitful 2007 discussions [on adapting the Energy Charter process to the new realities on Energy markets] were in large part initiated by Russia."<sup>842</sup>

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841 Y.A. Yershov, *Global Energy Security and Russia's Interests* (Moscow: Higher School of Economic State University, 2009), 180, 199, 201.

After the 2001 ratification hearings, the State Duma linked Russia's ratification of the agreement to the successful conclusion of the TP which was already in the process of being negotiated. The run-up to the G8 saw Russia link eventual ratification to the grand bargain. In the fall of 2006, Russia began declaring publicly that it would not ratify the ECT without changes.<sup>843</sup>

### **Adapting the ECH: changing the rules**

This section examines the substance of Russia's demands for change relating to the rules of the Treaty. Russia was interested in changing the rules of transit and investment. Transit rules were the subject of negotiations in the TP and included several important issues, which we will examine separately. Russia also wanted nuclear energy to be included within the regime. Finally, it wanted to expand the membership of the regime to include both energy exporters (for example, Saudi Arabia) and importers (China and India).

#### *Transit vs. internal transport tariffs*

The transit rules created by the ECH regime were perhaps the single most urgent issue for Russia. During the 2001 hearings, the Duma had already linked ratification of the agreement to a successful resolution of negotiations on the TP. All of the major transit-specific demands were related to Gazprom's business and had emerged prior to 2006.

The first transit issue that gave Russia pause was that the provisions in the Treaty were ambiguous concerning the relationship between tariffs for transit (defined as movement of energy materials through a state that is neither the origin nor destination) and transport (defined as movement of energy materials that originate in or are destined for that state).

In fact, the Treaty only deals with the question of tariffs minimally, so the rules are open to interpretation. According to ECT article 7.3:

Each Contracting Party undertakes that its provisions relating to transport of Energy Materials and Products and the use of Energy Transport Facilities shall treat Energy Materials and Products *in Transit in no less favourable a manner* than its provisions treat such materials and products originating in or *destined for its own Area*, unless an existing international agreement provides otherwise.<sup>844</sup> (emphasis added)

The most obvious interpretation of this article is that transit should be accorded national treatment. According to Dr. Ivan V. Gudkov, the deputy head of Gazprom's legal department for international projects and a participant in expert discussions on the TP:

This article essentially designates the application of the national regime for transport to the transit of energy resources. It follows that it can be interpreted as requiring the application of internal

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842 Andrei Konoplyanik, "Energy Charter: On Understanding and Trust," *Vedemosti* 232 (December 7, 2007).

843 Andrei Konoplyanik, "Energy Charter: There Will Be No Losers," *Neftegazovaya Vertikal* 3 (2007); Y. Yershov, "The Energy Charter Treaty and the National Interests of Russia (part two)," *Investment in Russia* 1 (2009): 5-6.

844 "The Energy Charter Treaty and Related Documents, A Legal Framework for International Energy Cooperation," Brussels: Energy Charter Secretariat, 48; accessed December 9, 2011, [http://www.encharter.org/fileadmin/user\\_upload/document/EN.pdf](http://www.encharter.org/fileadmin/user_upload/document/EN.pdf).



tariffs for transport for the transit of energy materials from neighboring countries. Internal tariffs for gas transport in Russia are the subject of state regulation and their level is significantly lower than in the majority of European countries.<sup>845</sup>

Thus, article 7.3 can be construed to mean that transit tariffs are equal regardless of origin or destination. This interpretation has been adopted by the EU.<sup>846</sup>

What then are the sources of ambiguity? First, the last portion of article 7.3 (“unless an existing international agreement provides otherwise”) itself provides for exceptions to applying NT to internal transport as well as transit. According to Gudkov,

In this way, the ECT leaves the possibility of concluding international agreements which establish conditions for the transit of gas on Russian territory (including tariffs and the system for their settlement) and which make it possible to make transit economically attractive.<sup>847</sup>

A second source of ambiguity is that ECT article 4 establishes that for relations between members of the GATT/WTO, the GATT/WTO rules take priority over the ECT.<sup>848</sup> GATT article V, which is dedicated to transit, establishes MFN treatment for transit, not NT. At the same time, the GATT establishes NT for imports (article III (4)), but this does not apply to transit.<sup>849</sup>

Why did Russia insist on differentiated tariffs? First, since transport tariffs are passed on to Russian consumers, they are both politically sensitive and economically significant. Under certain circumstances, it might be expedient to keep domestic transport tariffs (for domestic consumers) lower. For example, during an economic recession, lowering tariffs can be an instrument for helping domestic producers and households. By agreeing to equal tariffs, Russia would be limiting its freedom of action; if it lowered tariffs for domestic consumers, it would be compelled to lower tariffs for energy transiting through Russia as well.

Second, lower internal tariffs benefit Russian industrial and household consumers. Insofar as Russian industry can pay less for natural gas due to lower tariffs, they have a competitive advantage over their foreign counterparts. Thus, Russia has argued that lower internal tariffs – which are possible due to the elaborate pipeline network built during Soviet times – are a source of comparative advantage for its industry internationally. This advantage is attenuated if the same low tariffs have to be applied to transit gas going to European producers.

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845 Ivan V. Gudkov, “Transit of Energy Resources According to the Energy Charter Treaty: Open Questions,” June 6, 2007, 5 (from the personal collection of an interview subject).

846 In fact, the question of equal tariffs was raised by the EU during Russia’s bilateral WTO negotiations in 2003 as a part of the six-point Lamy Package; this elicited a “very sharp public response” from then President Putin. Konoplyanik, “Gas Transit in Eurasia,” 472.

847 Gudkov, “Transit of Energy Resources,” 6.

848 Ibid.; “Article IV—Non-Derogation from GATT and Related Instruments: Nothing in this Treaty shall derogate, as between particular Contracting Parties which are parties to the GATT, from the provisions of the GATT and Related Instruments as they are applied between those Contracting Parties,” 45. The question of whether article V of GATT can be applied to energy transit is contested; the key issue appears to be whether energy and energy products can be considered “goods.” It has also been argued that freedom of transit in GATT is not an absolute right given the significance of state sovereignty within the regime. See B. Clark, “Transit and the Energy Charter Treaty: Rhetoric and Reality,” 3 in Gudkov, “Transit of Energy Resources,” 6, fn. 7, accessed December 9, 2011, <http://webjcli.ncl.ac.uk/1998/issue5/clark5.html>; also M. Roggenkamp, “Transit of Network-bound Energy: The European Experience,” in *The Energy Charter Treaty: An East-West Gateway*, 506-507.

849 Gudkov, “Transit of Energy Resources,” 6.

Finally, being able to differentiate between transit and transport tariffs is also a potential source of competitive advantage for Gazprom on the European market. By definition, gas moving westward from Central Asia through Russia to Europe is considered “transit” gas, while gas produced in Russia for export to the same destination is considered “transport.” Charging higher tariffs for transit gas than for its own gas (defined as transport) becomes a potential lever for Gazprom to make its Central Asian competitors’ gas more expensive. However, if both tariffs have to be equal, this would not be possible.<sup>850</sup>

It appears that this issue has been resolved at the expert level with a draft Understanding to the Transit Protocol proposed by Russia, which states that domestic transport tariffs need not necessarily equal transit tariffs.<sup>851</sup>

### *Dispute settlement in transit*

Russia was also not satisfied with the regime for the settlement of disputes that the ECT established. Once again, this question related primarily to Gazprom’s business in Europe.

Gudkov has identified three issues.<sup>852</sup> The first concerns the relationship between the decision of a conciliator (provided for by the Treaty) and that of an arbitrator (potentially foreseen in other contract agreements between the parties). According to article 7.7 of the Treaty, the ECT’s dispute settlement procedure only kicks in “following the exhaustion of all relevant contractual or other dispute resolution remedies previously agreed between the Contracting Parties party to the dispute or between any entity referred to in paragraph (6) and an entity of another Contracting Party to the dispute.”<sup>853</sup> Thus, conciliation under the ECT’s auspices appears to be a secondary channel for dispute resolution. However, for Russia, it is not clear whether the conciliator can change or nullify an arbitrator’s decision or indeed whether the party that has lost in arbitration can appeal to the ECT’s conciliation procedure as a vehicle for not executing the arbitrator’s decision.

Second, according to article 7.7.c, if the dispute is not settled 90 days after the appointment of a conciliator, the conciliator can set interim terms of transit (including tariffs). Article 7.7.d states that the parties undertake to observe the interim decision for a period of 12

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850 The issue is actually more complicated. In addition to wanting to make Central Asian gas more expensive than Russian gas on the European market, Gazprom is generally concerned with controlling the overall volume of gas on the European market (to limit gas-on-gas competition between Russia and Central Asian exporters). Thus, prohibitively high tariffs can be used to prevent shipment of competitors’ gas from Central Asia to Europe. Relatedly, Russia also depends on Central Asian gas to supply Russia’s southern regions, which are adjacent to Central Asia, with gas (interviews in Moscow, fall 2007, 2008-9). One of the levers Russia can use to compel Central Asian exporters to sell its gas to Russia is to limit access to transit. This can be done either by denying access based on lack of capacity in the pipeline network or by setting tariffs sufficiently high to make selling on the European market less commercially attractive. However, the ECT provisions concerning nondiscriminatory transit conditions combined with the commitment to allow for the construction of additional capacity on Russian territory jeopardize these strategies. *Ibid.*, 5.

851 Konoplyanik, “Gas Transit in Eurasia,” 476; also Note from the Secretariat, An updated unofficial version of the Draft Transit Protocol (based on CC 251) compiled by the Secretariat, incorporating text proposals up to the TTG meeting on February 12-13, 2009, Attachment, 8, March 11, 2009.

852 Gudkov, “Transit of Energy Resources,” 7; see also Theodore I. Shtilkind, “Energy Charter Treaty: A critical Russian perspective,” *Transnational Dispute Management* 2, 3 (June 2005).

853 “The Energy Charter Treaty and Related Documents,” 49.

months following the conciliator's decision or until the dispute is resolved, whichever comes first. However, what happens if the dispute is not resolved after 12 months? Gudkov has suggested that there are three possibilities. One scenario would be that the transit state's commitment under article 7.6 to provide uninterrupted transit expires. Another possibility is that the parties have to restart conciliation under article 7.7 from scratch. Under a third scenario, the parties might start dispute resolution under ECT articles 26 (settlement of disputes between an investor and a contracting party) and 27 (settlement of disputes between contracting parties). Which of these scenarios should prevail is not clear in the Treaty and needs to be further specified.

Finally, it is not clear what the relationship is between the conciliator's final and interim decisions. In particular, "no compensation mechanism is foreseen relative to the difference in transit tariffs established on an interim basis and those that emerge from the final decision concerning the transit dispute."<sup>854</sup>

Article 21 of the latest draft of the TP addresses "settlement of disputes between contracting parties" and states that:

If a dispute concerning the application or interpretation of this Protocol, either exclusively or in conjunction with the Treaty, has not been settled through diplomatic channels within a reasonable period of time, either Contracting Party may, upon written notice to the other party to the dispute, submit the matter to an ad hoc arbitral tribunal in accordance with, *mutatis mutandis*, the procedures of Article 27, paragraph 3, of the Treaty.

In contrast to the provisions for transit dispute settlement in the ECT (articles 7.6 and 7.7),<sup>855</sup> the draft TP points to diplomatic channels for dispute resolution. In addition, if the dispute has not been settled by diplomatic means "within a reasonable period of time," state-to-state arbitration under the Treaty (article 27) is available; this appears to address the question of what happens if the dispute is not resolved after 12 months.

Since the formal mandate for bilateral consultations on the draft TP between Russia and the EU (since December 2002) concerned only the three outstanding issues (contractual mismatch, tariffs, and application of the protocol in the EU), conciliation was not the focus of attention in this setting.<sup>856</sup> However, when multilateral consultations began in 2008, Russia proposed an understanding stating that "any difference between the interim tariffs and the tariffs determined in the final resolution of the dispute shall be restituted inclusive of interest at a commercial rate established on a market basis."<sup>857</sup> It appears that this understanding also had provisional approval from EU experts.<sup>858</sup>

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854 Gudkov, "Transit of Energy Resources," 7.

855 ECT article 7.7 states that "The following provisions shall apply to a dispute described in paragraph (6), but only following the exhaustion of all relevant contractual or other dispute resolution remedies previously agreed between the Contracting Parties party to the dispute or between any entity referred to in paragraph (6) and an entity of another Contracting Party party to the dispute." "The Energy Charter Treaty and Related Documents," 49.

856 Note from the Secretariat, Summary Record of the 11th Meeting of the Energy Charter Conference held on December 17-18, 2002, January 28, 2003, 3.

857 Discussion of Draft TP, Presentation by Russian Federation, Group on Trade and Transit, Sofia, June 10, 2008, 5; Konoplyanik, "Gas Transit in Eurasia," 476.

858 Note from the Secretariat, An updated unofficial version of the Draft Transit Protocol (based on CC 251) compiled by the Secretariat.

Finally, in my non-expert opinion, it is not clear whether the article on dispute settlement in the draft TP resolves the question of whether arbitration under article 27 can be used to nullify the decision of a previous conciliator (for example, as provided for in a contractual agreement). However, this issue has not been raised by the Russian side in recent negotiations.

The remaining transit issues that gave Russia pause relate specifically to Gazprom's business on the EU market and need to be seen against the backdrop of the ongoing creation of a single gas market within the EU and also the geographic expansion of the EU eastward closer to Russia. These are the questions of utilization of available capacity, transit tariffs and congestion management mechanisms, and the status of transit within the EU as a Regional Economic Integration Organisation. All three issues were discussed during negotiations on the TP prior to 2006. Before discussing these questions, it is worth examining the transformation of the EU energy markets in greater detail.

### *Changes in the EU and its energy markets*

One of the most significant developments on Eurasian energy markets since the signing of the ECT in 1994 is the transformation of the EU and the ongoing reforms of its energy markets. Due to the accession of new states from Eastern and Central Europe, the geographic borders of the EU have moved closer to the East. As a result, by 2006, more than half the members of the ECH regime were EU states.

The ECH played an important role in the enlargement process, "preparing [new members] for EU accession in the field of energy."<sup>859</sup> Indeed, the ECT is part of the *acquis communautaire*, the body of Community law,<sup>860</sup> which "bind[s] all the Member States together within the European Union."<sup>861</sup> In practical terms, this meant that for new members, giving the ECT the status of domestic law was a requirement for joining the European Union. Therefore, every new member has signed and ratified the ECT. From the perspective of the theory of identity developed in this dissertation, these states are all disciples.

The expansion of the EU, however, is not limited to geography. The EU has also developed instruments to extend the reach of its legislation and policy outside of its current political borders. The most significant example of this is the European Energy Community, a project of the EU and neighboring states in Southeastern and Eastern Europe. These include not only candidate countries for accession (the former Yugoslav Republic of Macedonia, Croatia, and Montenegro) but also potential candidates (Albania, Bosnia and Herzegovina, and Serbia), and, since 2009, Ukraine and Moldova.<sup>862</sup> By becoming contracting parties to the ECT, all of

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859 Ad Hoc Strategy Group, "Meeting new challenges in International Energy Markets," discussion paper reflecting contributions by delegates at the meeting of June 12, 2008, Brussels.

860 Energy Charter Secretariat, "Is the Energy Charter an institution of the European Union?" accessed December 9, 2011, <http://www.encharter.org/index.php?id=18>.

861 ACTRAV-Turin Labour Education Programme (the training arm of the Bureau for Workers' Activities (ACTRAV) of the International Labour Organization (ILO)), Glossary – The reform of the European Union, accessed June 14, 2011, <http://actrav.itcilo.org/actrav-english/telearn/global/ilo/law/eug1.htm>.

862 "Energy Community," accessed December 9, 2011 at: [http://www.energy-community.org/portal/page/portal/ENC\\_HOME/ENERGY\\_COMMUNITY](http://www.energy-community.org/portal/page/portal/ENC_HOME/ENERGY_COMMUNITY). Three other ECH states, Georgia, Turkey, and Norway are observers

these states have committed to implement EU laws domestically. According to the Energy Community,

Title II of the Treaty “The Extension of the *acquis communautaire*” addresses the ...Contracting Parties....Under the Treaty, they have agreed to implement core parts of the EC *acquis communautaire*, both sector-specific and general.<sup>863</sup>

According to the ECH Secretariat, the agreement goes even further: “[t]he contracting parties of the Energy Community have agreed to implement the relevant *Acquis Communautaire* of the EU, to set up regulatory structures and to liberalize their energy markets.”

The concept behind this project appears to be almost identical to that of the ECH nearly twenty years earlier. According to the EC, the:

Energy Community is about investments, economic development, security of energy supply and social stability; but – more than this – the Energy Community is also about solidarity, mutual trust and peace. The very existence of the Energy Community, only ten years after the end of the Balkan conflict, is a success in itself, as it stands as the first common institutional project undertaken by the non-European Union countries of South East Europe.<sup>864</sup>

Therefore, in addition to serving as a vehicle to export EU legislation and policy, the project is also embedded in a larger political vision of creating peace in Europe. In any case, between EU accession and the Energy Community, the legislative and policy reach of Brussels regarding energy has moved significantly to the East. From the perspective of our state identity theory, clearly these two processes are destined to integrate regime takers. The more significant question is whether they have the domestic sovereignty to actually implement the agreement they have signed.

EU expansion is important in the ECH context because it is creating a progressively larger voting bloc of states that shapes decision making. However, it is equally important since the legislative and policy dimension of this expansion means that it is affecting market governance rules over an ever growing territory. This affects Gazprom’s European business and as a result, reforms on EU markets have been raised by Russia in the ECH context. According to the Secretariat, “[T]he discussion on the EU’s 3rd energy package is affecting the discussions between the EU and Russia, as some of its elements are perceived to be to the detriment of Russian downstream participation.” Since some of the reforms affect transit, this conversation has also affected TP negotiations.

These two important developments related to Europe – the expansion of the legislative and policy reach of Brussels through enlargement and other instruments and the reform of European markets – form a significant backdrop for understanding Russia’s demands for rule changes. In the following sections, specific features of EU expansion/market reform will be discussed as relevant. The next section continues our discussion of Russia’s transit demands.

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863 “About the Treaty,” accessed December 9, 2011, [http://www.energy-community.org/portal/page/portal/ENC\\_HOME/ENERGY\\_COMMUNITY/Legal/About\\_the\\_Treaty](http://www.energy-community.org/portal/page/portal/ENC_HOME/ENERGY_COMMUNITY/Legal/About_the_Treaty)

864 European Commission (COM(2011) 105 final), cited in: “Energy Community.”

*Utilization of available transit capacity: mismatch between supply and transit contracts*

The contractual mismatch issue concerns the relationship between the terms of gas sales and access to gas pipeline capacity. During earlier TP negotiations, this issue was referred to as “the right of first refusal” (RFR).<sup>865</sup> Gazprom sells gas to Europe primarily through LTCs, the durations of which vary from roughly 10 to 25 years.<sup>866</sup> To deliver contracted gas to its customers, Gazprom must be able to physically transport it to the designated destination. From Gazprom’s perspective, long term supply contracts should be matched with long term pipeline access contracts to ensure a secure and reliable supply. According to Gudkov,

The Russian side proposes to provide for, in the Transit protocol, the privileged right for consumers of transit services to conclude new transit agreements upon the expiration of existing transit agreements...when this is necessary to fulfill commitments that have been undertaken related to the supply of hydrocarbons. The aim of this proposal is to guarantee the fulfillment of long term contracts for gas supply, the duration of which exceeds the duration of gas transit contracts that have been concluded “under them.”<sup>867</sup>

However, with the creation of an EU internal gas market, the idea of pipeline capacity LTCs has become problematic. The specific problem for the EC relates to the principle of nondiscrimination. Gudkov writes,

[The Russian] proposal is important as a means for lowering the uncertainty created by the diffusion in the EU of a legal regime for transit associated with the liberalization of the gas sector (Second gas directive and Regulation on access to gas transport networks).

The EU expresses doubt about the compatibility of the Russian proposal with EU law, not allowing discrimination in access to energy transport systems. The discriminatory behavior of dominant firms, which generally includes the owners of energy transport infrastructure, is expressly prohibited by article 82(c) of the Treaty on European Union, as well as by the Second gas directive.<sup>868</sup>

To enhance competition, the EC expected that pipeline capacity would be sold through contracts of short duration. From the perspective of the EC, allowing one firm to buy up a significant amount of the available pipeline capacity on a long term basis would be an impediment to competition.<sup>869</sup> How are other firms supposed to compete if there is no means for them to transport their gas because a major producer has booked up a significant portion of the available capacity on a long term basis to transport its own gas? Moreover, the Russian wish for a right of first refusal was unattractive to the EU, which felt that, “providing the transit capacity user with the right to accept new transit terms and conditions upon expiration of its EMP transit

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865 Konoplyanik has written that: “A right of first refusal (RFR) gives the holder of the right an option to take the terms offered by a third party before the owner enters into a transaction with that third party. RFR is a common concept in the United States where it was introduced by FERC Order 636 in 1992.” He has also written that RFR is the accepted practice in the CIS and non-EU states for dealing with contractual mismatch. “Gas Transit in Eurasia,” 480-1.

866 According to Konoplyanik, “It should be recalled that the typical size of most long-distance gas and oil export projects to justify a new pipeline is in the order of at least ten billion cubic metres per year for gas and ten million tonnes per year for oil and that the project duration is usually not less than ten years, with 20–25 years being most common.” Konoplyanik, “Gas Transit in Eurasia,” 479.

867 Gudkov, “Transit of Energy Resources,” 8-9.

868 Ibid.

869 Konoplyanik, “Gas Transit in Eurasia,” 481-2.

agreement was anticompetitive.”<sup>870</sup> In other words, allowing one party to automatically renew its transit contract repeatedly would be the equivalent of a long term transit contract and create barriers for accessing capacity for potential competitors and/or market entrants.

According to one interview subject from the Secretariat who worked with the delegations on this question, the contractual mismatch problem consists of a conflict between the principle of security of supply (which suggests that supply and transport contracts should be of equal duration) and the principle of competition (which assumes that transport capacity is a commodity that is commercially available to all potential market entrants).<sup>871</sup>

Subsequently, wording was added to draft TP article 8 to give contracting parties the opportunity to meet reasonable transit capacity requests by expanding capacity. This obviates the need for RFR since with expanded capacity all reasonable requests can be accommodated. All non-EU states preferred to keep the option of RFR so they would not be obliged to expand capacity. As a result, both options are available.<sup>872</sup>

Therefore, it appears that Russian and EC experts have agreed on how to settle the mismatch problem in a way that addresses both Gazprom’s concerns about being able to deliver gas contracted through LTCs and also EU concerns about not stifling competition.<sup>873</sup>

### *Transit tariffs and congestion management mechanisms*

In addition to debating the relationship between transit and (internal) transport tariffs as well as interim and final tariffs in the context of a dispute, Russia was also concerned about the question of transit tariffs on the EU gas market. This issue was a key question during negotiations on the transit protocol and was dealt with in draft TP articles 1, 10, and 10-bis, and the Understandings with respect to article 10. The controversy boiled down to whether tariffs should reflect the *cost* of transit or should be determined through market mechanisms such as auctions that reflected *demand* for transit. While the EU favored the latter approach, Russia felt that prices determined by auctions could depart significantly from the underlying costs of transit. Since Russia has to transit natural gas to European markets, it was especially concerned that auctions would give third party traders, most of whom do not actually own any gas, the opportunity to bid up the transit price.<sup>874</sup> As a result, over the long term, “cost would be removed from the structure of transit pricing.”<sup>875</sup> This would create difficulties for Gazprom, which does own gas and has long term delivery commitments to customers.

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870 “Multilateral consultations on the Draft Transit Protocol,” paper submitted by the Russian delegation concerning the outstanding points of the draft Transit Protocol, June 10-11, 2008, 4.

871 Interview in Brussels, fall 2006.

872 “Multilateral consultations on the Draft Transit Protocol,” 5.

873 Ibid., 7; 20th Meeting of the Energy Charter Conference on December 9, 2009, Agenda Item 5—Reports from the Energy Charter Groups Report by the Chairman of the Group on Trade and Transit on the outcome of the multilateral consultations on the draft Transit Protocol, and Recommendation and draft mandate to re-start the negotiation on the draft Transit Protocol, Brussels, November 25, 2009, 2; text confirmed by EU in 2009.

874 Interviews in Moscow, fall 2007, 2008-2009.

875 Interview in Brussels, fall 2006.

This issue has been largely resolved between the parties at the unofficial expert level.<sup>876</sup> The compromise appears to be that tariffs “shall be based on operational and investment costs, including a reasonable rate of return,” and may be determined “by appropriate means, including regulation, commercial negotiations or congestion management mechanisms.”<sup>877</sup> Auctions are determined to be one type of “congestion management mechanism” and may only be used “for allocating Available Capacity, and in the formation of Transit Tariffs, with respect to congested points or sections in the relevant Energy Transport Facilities.” In addition, to deal with chronic congestion or with “recurrent use of a congestion management mechanism and notably the use of auctions caus[ing] a Transit Tariff to be in excess of that required under Article 10.3,” the extra revenues generated are supposed to be used for measures to relieve congestion and/or reducing tariffs charged for the relevant facilities.<sup>878</sup>

The agreement also includes an understanding on congestion management mechanisms that explicitly states that there is an obligation for operators to prevent “speculative hoarding” and develop “use it or lose it” rules. In addition only “bona fide” requests for capacity, “supported by a credible commitment having regard to the volume, duration and commercial value of the requested capacity,”<sup>879</sup> will be considered. These parts of the understanding appear to address the Russian concern that transit tariffs will be bid up by parties that do not actually intend to ship gas.

Obviously it is also necessary to define “available capacity,” and here too the experts reached an agreement. According to article 1 (definitions), paragraph two of the draft TP, available capacity does not include capacity reserved for the fulfillment of existing LTCs or for future hydrocarbon supplies from fields where the license holder is also the owner of the transport system.<sup>880</sup> This was a key concern for Gazprom, a vertically integrated firm wanting priority access for gas booked on LTCs and its own gas in general.

### *The EU as a Regional Economic Integration Organisation: transit or internal transport?*

The final transit issue concerned the status of transit within the EU and was addressed in Draft TP article 20. Again, this issue concerned Gazprom’s business in Europe. During multilateral TP negotiations in late 2001,<sup>881</sup> the EU proposed text signifying that since it was a “Regional Economic Integration Organization” (REIO), transit did not exist within its single

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876 20th Meeting of the Energy Charter Conference, Agenda Item 5, 2;

“Multilateral consultations on the Draft Transit Protocol,” 7; Note from the Secretariat, Multilateral consultations on the Draft Transit Protocol—An updated unofficial version of the Draft Transit Protocol (based on CC 251), 7.

877 Konoplyanik, “Gas Transit in Eurasia,” 478; “Multilateral consultations on the Draft Transit Protocol,” 7; 20th Meeting of the Energy Charter Conference, 2.

878 Konoplyanik, “Gas Transit in Eurasia,” 479.

879 Note from the Secretariat, Multilateral consultations on the Draft Transit Protocol – An updated unofficial version of the Draft Transit Protocol (based on CC 251), 7; “Multilateral consultations on the Draft Transit Protocol,” 7; 20th Meeting of the Energy Charter Conference, Agenda Item 52.

880 Konoplyanik, “Gas Transit in Eurasia,” 474; Note from the Secretariat, Multilateral consultations on the Draft Transit Protocol—An updated unofficial version of the Draft Transit Protocol (based on CC 251), 15; 20th Meeting of the Energy Charter Conference, Agenda Item 5, 2.

881 Interviews in Brussels. fall 2006.



market; there was only internal transport.<sup>882</sup> Russia objected vigorously to this application of the REIO principle since it effectively meant that whatever agreement emerged within the TP would not apply to the EU except for in relatively insignificant cases, such as when Russia transits energy materials through the EU to a non-EU member like Switzerland.<sup>883</sup>

During negotiations, the EU suggested that Russia would have favorable conditions for intra-EU transport since “the provisions of the *acquis* go beyond those of the draft Transit Protocol, and provide at least the level of treatment for third countries that is foreseen in the draft Protocol text.”<sup>884</sup> Russia countered that it was highly unusual for a state to make an international agreement based on the promise of another party to provide favorable conditions exclusively through domestic legislation. According to Yershov,

This formula effectively takes the entire territory of the EU out of the jurisdiction of the Protocol on Transit before the development of the complex of documents that would provide, as the EU asserts, a regime for the transit of goods that is at least equivalent to the regime established by the ECT and protocol. At the same time, the EU reserves the right to use the transit regime established by the Protocol for the transit of its goods through other countries participating in the Protocol on transit and not part of the EU....In the practice of international agreements, it is hard to find an agreement that contains concrete commitments for the parties at the same time that one party makes a promise to develop the relevant legislation.<sup>885</sup>

In addition to changing the transit regime established by the ECT with a protocol that cleared up ambiguities and made transit rules more elaborate, Russia also wanted to make sure that whatever new transit regime did emerge as a result of the TP actually applied within the EU despite the creation of a single market. Moreover, the question of transit within the ever expanding EU was growing more urgent for Russia.

The question is equally important to the EU since it concerns its integrity as a single political economic space. Therefore, at the 20<sup>th</sup> Charter Conference in December 2009, the

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882 The ECT does make provisions for states to be part of a REIO. However, it also defines transit as movement of energy materials *through* a contracting party that is neither the origin nor destination for those materials. EU member states were contracting parties (CP) to the ECT individually, as was the EU as a whole. However, unlike article 20 of the draft TP, there were no provisions in the ECT for transit across CPs (the individual EU member states) that are part of a REIO (the EU as a whole) to be treated as internal transport. According to Konoplyanik, the issue is a question of “whether the definition of ‘transit’ should apply only to a crossing of the entire EU territory as a single REIO (as proposed by the European Union in the draft TP (Article 20)), and thereby narrowing the definition of ‘transit’ in the ECT, or should ‘transit’ also include the crossing of each single EU member country and of the European Union as a whole (as REIO) as defined in the ECT.” Konoplyanik, “Gas Transit in Eurasia,” 470. An example may be useful to clarify what in fact is a subtle legal difference: according to the ECT, Gazprom gas moving from Poland across the Czech Republic to Austria is in transit through the Czech Republic, since all three EU members were contracting parties to the agreement. Article 20 of the draft TP proposed by the EU states that this movement is not transit but internal transport since all three are part of a REIO.

883 18th Meeting of the Energy Charter Conference on December 7, 2007, Agenda Item 8—Draft Energy Charter Protocol on Transit, Brussels, November 20, 2007; Konoplyanik, “Gas Transit in Eurasia,” 482. Other cases include transit through the EU to Kaliningrad and Turkey.

884 17th Meeting of the Energy Charter Conference, November 20, 2006, Brussels, November 7, 2006, Agenda Item 8—Draft Energy Charter Protocol on Transit, “State-of-Play and Recommendations for Further Work on the Draft Energy Charter Protocol on Transit.”

885 Yershov, “The Energy Charter Treaty and the National Interests of Russia (part two),” 7.

chairman of the Group on Trade and Transit reported that “the European Communities re-emphasised that Article 20.1 is a sine qua non for a potential agreement on the Protocol.”<sup>886</sup>

The EU proposed additional text (article 20.2 of the draft TP), which essentially accorded NT to energy materials and products from a non-EU contracting party and “in free circulation in its Area.” The same article also committed the EU to provide transit terms that did not go below the standard “that ... would result from the provisions of this Protocol were it not for Article 20(1) of this Protocol.”<sup>887</sup> The latter was proposed by the EU in February 2005 and, after some prevarication, was again endorsed by the EU in 2009.<sup>888</sup>

However, Russian experts argued that the commitment created by this proposal was not enough:

[T]his modification was only a “statement of intent” rather than a real obligation. In fact, instead of agreeing to the applicability of the TP, there is a reference to REIO documents which are now non-existent in the EU (with the notion of “transit” deleted from the EU legislation and the internal transportation rules constantly changing) and it is not clear what they will be like.<sup>889</sup>

Creating a minimum standard for what the EU claimed was internal transport (by virtue of its single market) by promising to create EU rules (for non-EU states) that treated this transport (when crossing through EU national states) as if it were transit subject to the TP was not a sufficient guarantee for Russia. As a result, in April 2005, Russia proposed an additional article (20.3 of the draft TP) creating a stronger commitment:

When the movement of Energy Materials and Products originating from outside the territory of the REIO and destined for this REIO and /or its members is covered by the definition of Transit as contained in Article 7(10) of the ECT in relation to crossing the borders of a Contracting Party – member of the REIO, the Contracting Party through whose Area the Energy Materials and Products pass shall ensure that the owners or operators of Energy Transport Facilities under its jurisdiction implement in its territory the provisions of the Energy Charter Protocol on Transit in relation to these Energy Materials and Products, up to the first change of property right for this EMP occurring in the territory of the REIO.<sup>890</sup> (emphasis added)

With this proposal, Russia was pointing to the fact that what the EU claimed was internal transport during TP negotiations (by virtue of being a REIO), was in fact defined as transit in the ECT. Moreover, the underlying commitment in the text was for the EU *member states* (“the Contracting Party through whose Area the Energy Materials and Products pass”), not the EU as a whole. According to the Russian experts,

The intent of this proposal was to ensure the application of the TP at least where it is needed to comply with contractual provisions on energy supplies while they are moving (are in transit) through the territory of each state-member of the REIO. Given that contracts have been concluded

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886 Article 20.1 of the draft TP states that: “For the purposes of this Protocol, the ‘Area’ of a Contracting Party referred to in Article 7(10)(a) of the Treaty shall, as regards Contracting Parties which are members of a Regional Economic Integration Organisation, mean the area to which the treaty establishing such a Regional Economic Integration Organisation applies.” This is the key provision that means transit does not exist through EU states due to the existence of a single market.

887 This text essentially means that although 20.1 eliminates intra-EU transit, transport would be accorded the same terms as if it were transit and covered by the TP.

888 “Multilateral consultations on the Draft Transit Protocol,” 2, 3; 20th Meeting of the Energy Charter Conference, Agenda Item 5, 2.

889 “Multilateral consultations on the Draft Transit Protocol,” 2.

890 Ibid., 2, 3.

and are in full force and effect, this provision does not in any way diminish the significance of market liberalisation and integration processes, etc.<sup>891</sup> (emphasis added)

With this explanation, Russia was again insisting that movement through an EU member state was transit even though it was part of the REIO. For the EU, this was totally unacceptable.<sup>892</sup> Moreover, when the question of restarting negotiations on the draft TP came up in late 2009, the EU also made the acceptance by other parties of its position on the REIO/internal transport question a requirement to proceed, “as this reflects the Community's status and competence in international trade relations.”<sup>893</sup> During the 2009 Charter Conference, the report from the Group on Trade and Transit also pointed to the legal significance of the REIO issue for the EU:

Member states are still searching for a solution concerning TP Article 20 on TP application in the European Communities as a Regional Economic Integration Organisation (REIO). The European Communities emphasize the necessity to protect the integrity of its legislation.<sup>894</sup>

At the same time, the question appears to be just as important to Russia:

The applicability of the TP provisions within the EU territory is of essence to the Russian side and its treatment of the Protocol and, consequently, of the ECT will largely depend in the future on reaching agreements on this matter.<sup>895</sup> (bold in original)

However, no agreement has been found yet at the expert level.<sup>896</sup>

This section has looked at Russia's demands for rule changes related to transit. As the foregoing has demonstrated, almost all of the issues have been agreed upon at the expert level. The one major exception was whether the rules established in the Transit Protocol will apply within the EU.

At the same time, it is important to note that discussions and agreements between experts do not constitute official negotiations. Once bilateral EU-RF discussions are completed, they move to the multilateral setting to bring on board the other states, which may have conflicting demands and wish to revise the textual agreements made between the EU and Russia. Ultimately, the agreement has to be endorsed at the political level by all the ECH members. Finally, the norm for negotiations is that “nothing is agreed until everything is agreed,”<sup>897</sup> so the very significant progress on these many difficult issues does not mean that the draft TP is out of the woods yet.

Finally, the terms of access to pipeline capacity within the EU and neighboring states as agreed upon through the Energy Community Treaty will be governed by the *acquis*

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891 Ibid.

892 20th Meeting of the Energy Charter Conference, Agenda Item 5, 2.

893 Ibid., 3

894 Note from the Secretariat, Summary Record of the 19th Meeting of the Energy Charter Conference held on November 28, 2008, Report by the Chairman of the Group on Trade and Transit, March 4, 2009.

895 “Multilateral consultations on the Draft Transit Protocol,” 3.

896 Ibid.

897 Konoplyanik, “Gas Transit in Eurasia,” 471.

*communautaire* as implemented into law by the national states. The ECT, which all EU states have signed and ratified, says very little about the conditions of access to pipeline capacity. However, should the EU and the Energy Community states negotiate, sign, and ratify a TP that is acceptable to Russia and applies within the EU, then the TP, as an international agreement that these states have adopted, would trump domestic legislation and eliminate much of the risk that ongoing market reform poses to Gazprom's business. From this perspective, proponents of the ECT in Russia have argued that the TP can be used to promote Gazprom's interests in an otherwise unpredictable and expanding economic space.

This section has looked at Russia's demands for rule changes related to the ECH transit regime. The next section looks at its demands related to investment.

### *The Supplementary Treaty on making investments*

As we saw earlier, the primary goal of the ECT was to create a favorable framework for business to invest in energy development and production in the former USSR and particularly Russia, the largest energy producer/exporter among the former Soviet republics. One of the distinctions that emerged during negotiations on the investment provisions of the Treaty was between the pre-investment stage (which essentially corresponds to market entry through licensing rounds, tenders, and so on) and post-investment stage (investments after a firm is established in a country).<sup>898</sup>

Concerning the rules governing investment, various states had different preferences. At one extreme was the United States, which wanted NT at all stages with no transition period for former socialist states to adapt their legislation. At the other, more conservative, extreme was Norway, which argued that NT was unnecessary and that MFN would give states the flexibility to develop energy policy. Many of the European states held the view that NT was appropriate for the post-investment stage, whereas the pre-investment stage would be governed by the principle of MFN.<sup>899</sup>

To placate the United States, the participation of which was essential to many countries, including Russia, a consensus emerged that the investment provisions should be based on the principle of NT at all stages of investment. According to Dore et al.,

National treatment as a guiding principle for making investments was adopted as a Treaty principle corresponding to the US priority of securing access to markets for US companies....observers note that the principle of pre-investment national treatment was more important to the US than participation in the Charter negotiations. Since by then many countries, including Russia, considered US participation vital for a successful Treaty, national treatment at the pre-investment stage was embodied within the draft Treaty.<sup>900</sup>

...After initial debates, most parties agreed that national treatment should provide the basis for all stages of investment.<sup>901</sup>

However, an additional obstacle still remained before the Treaty could be finalized. Many of the Eastern states, including Russia, supported the idea of NT at all stages. However, they were

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898 Doré et al., *The Energy Charter Treaty*, 28.

899 Ibid., 29, 31.

900 Ibid., 29-30.

901 Ibid., 28.

concerned that they did not have sufficient legislation in place to comply with the Treaty and required a transition period.<sup>902</sup> Moreover, they faced domestic opposition to such an open investment regime; nationalists in parliament worried that this portended “economic domination by Western investors.”<sup>903</sup> This concern was particularly acute in Russia, where the parliament would have to accept whatever investment principles emerged for ratification to be possible.<sup>904</sup> The difficulty was compounded by the fact that the government’s relations with the legislature were rapidly deteriorating.<sup>905</sup> According to Dore, “The Russian position caused a deadlock over negotiations over the summer months of 1993.”

To break the impasse, in October the EU proposed a two-stage process as a compromise. The NT principle would be applied to the post-investment stage in the Treaty. At the same time, the Treaty would include a softer (less binding) “endeavour” commitment to accord MFN<sup>906</sup> in the pre-investment stage. Finally, negotiations on a supplementary investment treaty would begin immediately with a view to have states undertake binding commitments to NT in the pre-investment stage as well. The commitment to craft this kind of second agreement was actually written into the Treaty. Thus, according to article 10.4 of the ECT, negotiations on the Supplementary Treaty (ST) were supposed to begin “not later than 1 January 1995, with a view to concluding it by 1 January 1998.”<sup>907</sup> In addition, one of the understandings that precede the actual ECT states that in elaborating the conditions for granting NT the ST will include, among other things, provisions related to “the sale or other divestment of state assets (privatization) and to the dismantling of monopolies (demonopolization).”<sup>908</sup> In this way, the Conference could accommodate the needs of the Russian delegation, finalize the first Treaty quickly, and still maintain a commitment to NT at all stages of investment.

Quickly finalizing a Treaty in at least some form was important to the EU because, as a political crisis was brewing in Russia in 1993, the “need to signal support for the reform process in Moscow to the Russian parliament became increasingly urgent.”<sup>909</sup> The EC was also motivated by self-interest since it had initiated the Charter process and was using it to demonstrate that it was capable of “taking the lead in international politics.”<sup>910</sup> The compromise was welcomed by the Russian delegation, which saw the successful conclusion of a Treaty as enhancing its political capital in the domestic sphere. According to Dore, Russia

was becomingly increasingly eager to see a final Treaty take shape, since the Energy Charter was also being used as a tool in the domestic policy arena in Russia, where supporters of reforms were determined to bring the Charter to a conclusion, hoping that signing a document with such a wide

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902 “Transition problems complicate Energy Charter,: *EC Energy Monthly*, May 11, 1993, 8 in *The Energy Charter Treaty*.

903 Doré et al., *The Energy Charter Treaty*, 32.

904 “Russia stresses Charter support,” *EC Energy Monthly*, August 4, 1993, 13 in *The Energy Charter Treaty*.

905 Negotiations on this question were held in 1993.

906 “EC and US clash over Charter,” *EC Energy Monthly*, December 16, 1993, 9 in *The Energy Charter Treaty*, 32-33.

907 “The Energy Charter Treaty and Related Documents,” 53-54.

908 “The Energy Charter Treaty and Related Documents,” 27. According to Bamberger et al., “the purpose of such provisions would not be to require privatization or demonopolization, but rather to prescribe how the treaty would apply in case they occurred.” Craig Bamberger, Jan Linehan, and Thomas Walde, “The Energy Charter Treaty in 2000: In a New Phase,” *Energy Law in Europe*, ed. Martha M. Roggenkamp (Oxford and New York: Oxford University Press, December 2001).

909 Doré et al., *The Energy Charter Treaty*, 31, 33.

910 *Ibid.*, 33.

range of Western actors was bound to have some impact on domestic struggles. If a reform oriented government were able to come up with a document suiting the Federation on terms that both government and Parliament could accept, the government could then cite this as proof that Western support and advantageous agreements could be secured if reforms were upheld.<sup>911</sup>

The Russian government was essentially allied with Western governments against the Russian domestic opposition.

The strongest objections to the two-stage compromise came from the United States, which insisted on NT at all stages of investment. From the US perspective, it was better to delay the signing and only sign one Treaty. It argued that multiple treaties would introduce uncertainty, thereby deterring investments, and also that Congressional ratification would be more difficult. According to one American official, the states “should take the time to get it right the first time.”<sup>912</sup> It is likely that this unsatisfactory approach to investment was the main reason for the US refusal to sign the ECT. However, by that point, a successful Treaty had become more important to both the EU and Russia than US participation.<sup>913</sup>

To meet the January 1, 1995, deadline stipulated in the ECT, the ST process was formally inaugurated in Lisbon after the signing ceremony for the first Treaty (on December 17, 1994). Actual negotiations began on “Working Group I – Supplementary Investment Treaty”<sup>914</sup> several months later<sup>915</sup> and were provisionally concluded on schedule in December 1997. However, despite broad agreement on much of the contents in the draft ST and the importance of the document in general, it was not adopted.<sup>916</sup>

The main objection came from the EU, which was dissatisfied with the fact that numerous OECD countries were included in an Annex that provided for exceptions to NT in the case of privatization.<sup>917</sup> During two subsequent formal adoption conferences, other issues also emerged. However, “Substantial progress was made in these sessions in resolving the issues.”<sup>918</sup> Nevertheless, in June 1998, the EU indicated that it could not adopt the Treaty due to “serious hesitations at a political level” in some of the national states.<sup>919</sup>

According to Bamberger, the EU balked due to pressure from domestic groups including, among others, labor and environmental interests, that wanted to be heard before negotiations on an agreement liberalizing investment were completed.<sup>920</sup> Konoplyanik has connected the failure to adopt the ST to the collapse of negotiations on the Multilateral Agreement on Investment (MAI) among OECD states.<sup>921</sup> The MAI, which shared many of the same goals as the ST, was

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911 Ibid.

912 “EC and US clash over Charter,” 34.

913 Doré et al., *The Energy Charter Treaty*, 34.

914 Note from the Secretariat, Reciprocity in Terms of Access for Investors and Reciprocity in Access to Markets, September 1, 2008, Investment Group Meeting, October 20, 2008.

915 “No room for complacency on Energy Charter,” *EC Energy Monthly*, February 23, 1995, 10.

916 2nd Meeting of the Energy Charter Conference, 1999 Work Programme, November 13, 1998, December 3-4, 1998, 1.

917 Bamberger et al., “The Energy Charter Treaty in 2000.”

918 Ibid.

919 Ibid.

920 Ibid.; 2nd Meeting of the Energy Charter Conference, 1999 Work Programme.

921 Konoplyanik, “Russia-EU, G-8, ECT and Transit Protocol.”

derailed by widespread opposition in civil society.<sup>922</sup> Ultimately, many OECD states did not have sufficient domestic political support to liberalize investment, and this doomed both the MAI and ST.

Despite these setbacks, it appears that the states continued to work on concluding an agreement. Therefore, a year later, in its review of the Charter process, the Secretariat reported that “Preparations for the finalisation of the Supplementary Treaty are now in hand, and it is hoped that a resolution of the very few outstanding issues relating to it can be achieved in the near future, thus allowing for the Supplementary Treaty Adoption Conference to be resumed.”<sup>923</sup>

However, discussions on the ST were finally put on hold at the end of 2002. Since work on investment was taking place in parallel within the WTO, the Investment Group (IG; this group was the successor to Working Group I in which negotiations on the ST were conducted) decided that it was best to temporarily suspend work on the ST. In a report to the Charter Conference, the chairman of the IG stated that:

The Group stressed the value of the process of establishing in a legally binding manner the principle of non-discrimination concerning the making of foreign investment. At the same time, it was noted that important work is currently being undertaken on the issue of foreign investment in the framework of the WTO. To minimize the risk of an inappropriate overlap or inconsistency between the ST project and investment-related activities in the WTO, it was agreed to put temporarily on hold further discussions of the ST, until developments in the WTO become clearer.<sup>924</sup>

The question of resuming negotiations on the ST was revisited again in 2003 and 2004, but to no avail. Finally, in May 2005, the IG concluded that there was no reason to resume negotiations on the ST. In a report to the Conference at the end of the year, the group chairman wrote that:

[T]he Investment Group had a discussion of the prospects for concluding the Supplementary Treaty (ST). There was a consensus in the Group that while the reasons for concluding the ST still are valid there is currently no basis for restarting the ST negotiations.<sup>925</sup>

Unable to recommend restarting ST negotiations, the IG agreed to the Secretariat’s proposal to launch a “second best” initiative to reduce exceptions to NT in the pre-investment stage, which were being catalogued in the “Blue Book” on a voluntary basis.<sup>926</sup> This is an example of a mechanism to promote ECH goals that does not involve the ECT or legal instruments. In

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922 Katia Tieleman, “The Failure of the Multilateral Agreement on Investment (MAI) and the Absence of a Global Public Policy Network,” *UN Vision Project on Global Public Policy Networks*, accessed on June 1, 2011, [http://www.gppi.net/fileadmin/gppi/Tieleman\\_MAI\\_GPP\\_Network.pdf](http://www.gppi.net/fileadmin/gppi/Tieleman_MAI_GPP_Network.pdf).

923 4th Meeting of the Energy Charter Conference, Report under Article 34 (7) of the Energy Charter Treaty, November 19, 1999, December 7, 1999, 8.

924 11th Meeting of the Energy Charter Conference, Report by the Chairman of the Investment Group, November 27, 2002, December 17-18, 2002, 2.

925 16th Meeting of the Energy Charter Conference, Report by the Chairman of the Investment Group, November 18, 2005, December 9, 2005.

926 According to the Secretariat, “The Energy Charter Treaty obliges member states to endeavour to provide non-discriminatory treatment to investors from other member states in the ‘pre-investment phase,’ i.e., the making of investments....described in more detail in Article 10(2) of the Treaty....Any country that maintains measures that do not conform to this standard of treatment are obliged to register them. The full register of such non-conforming measures is published in the so-called ‘Blue Book.’ Progress towards removal of the measures recorded in the Blue Book is kept under regular review by the Energy Charter Conference and its Investment Group.” Energy Charter Secretariat, “The Blue Book,” accessed on June 16, 2011, <http://www.encharter.org/index.php?id=33>.

addition, the member states and the Secretariat continue their work improving the investment climates in the ECH constituency through other soft instruments. Along with cataloguing restrictions on investment in member states in the Blue Book, these include reviewing the investment climate and market structure in member states,<sup>927</sup> developing best practices for investment, and consulting with businesses.

From Russia's perspective, the failure to develop a binding mechanism to promote investments was a significant flaw in the design of the regime. Russia's interest in the ST stems from the need to find ways to promote access – outward investment into the mid- (transit) and downstream (distribution and retail) markets of other contracting parties' energy sectors - for Russian companies. This need became even more acute after Gazprom's highly publicized bid to acquire Centrica was derailed due to a media scandal that provoked significant opposition within the UK government.<sup>928</sup>

### *Nuclear materials*

The ECT was designed to be both comprehensive (covering a broad swathe of questions related to business in the energy sector) and broad (covering as wide an array of energy products and materials as possible). The one notable exception is nuclear energy, the trade of which was largely removed from the ECH regime at the initiative of the EU due to the concerns of the European nuclear supplier, Euratom. According to Bamberger et al.,

[D]uring the ECT negotiations...[nuclear trade] was an especially hard-fought subject between the EU and the Russian Federation; indeed, so difficult was this subject to resolve that on 16 December 1994 it became necessary to adjourn the ceremonial meeting in Lisbon at which the text of the ECT was to be adopted by the negotiating Conference, in order to allow time for overnight negotiations (on this and on several lesser issues of Treaty interpretation).<sup>929</sup>

Ultimately, the parties agreed that the trade of nuclear energy would be governed by Article 22 of the EU-Russia Partnership and Cooperation Agreement (PCA), which was signed on June 24, 1994, several months before the ECT.<sup>930</sup> In a joint declaration at the time the ECT was signed, the EU reiterated that:

The European Commission and the Euratom Supply Agency have never made it their policy to apply quotas on imports of nuclear materials from Russia and do not intend to do so in the future unless a situation should arise requiring safeguard measures in accordance with Article 15 of the Agreement between the European Economic Community, the European Atomic Energy Community and the Union of Soviet Socialist Republics on Trade and Economic and Commercial

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927 Interestingly, the practice of reviewing the investment climate was first aimed at the transition states. When transition states requested that the practice be extended to the advanced OECD states, no volunteers emerged. In response, the Secretariat "prepared an overview of the investment climate and market structure across a number of selected economically advanced OECD countries." The goal of this exercise was to "provid[e] insights for consideration when formulating reform policies for the energy sector in economies in transition." Report by the Chairman of the Investment Group, November 18, 2005.

928 Konoplyanik, "Russia-EU, G-8, ECT and Transit Protocol."

929 Bamberger et al., "The Energy Charter Treaty in 2000."

930 The EU also concluded similar agreements at that time with Ukraine, Kazakhstan, Kyrgyzstan, Tajikistan, and Uzbekistan. ECT, Declarations, 33-4; Bamberger et al., "The Energy Charter Treaty in 2000."



Co-operation signed in Brussels on 18 December 1989. This means, a fortiori, that no quotas have been or will be applied on a utility by utility basis.<sup>931</sup>

The declaration also noted that the PCA established “national treatment with respect to nuclear materials imported from Russia.”<sup>932</sup> Finally, the EU acknowledged the intention to review the supply policy of the Euratom Supply Agency “with a view to take full account of both Parties’ legitimate interests, including inter alia the interest expressed by Russia in increasing the volume of trade.”<sup>933</sup>

However, although nuclear materials was moved under the PCA, which established NT, by moving it outside the ECT it is not clear whether violations of the PCA can be remedied by the trade dispute settlement provisions in the Treaty's Annex D, which are modeled on the GATT. Bamberger et al. ask: “[D]o the statements in the Final Act declarations, that the nuclear trade shall be governed by the PCA or other specified agreements, make compliance with those agreements a right protected by the ECT?”<sup>934</sup> In any case, Russia sought a more effective regime that would protect and promote its exports of nuclear materials. As with transit, the urgency of this question increased with the enlargement of the EU since many of the new members, as former Soviet satellite states, were major importers of Russian nuclear energy materials.

### *Expanded membership*

The final substantive change that interested Russia was to expand the ECH constituency. Originally, the ECH was a project meant to promote peace in Europe based on the idea of economic integration. The project was inspired by the experience of France and Germany after WWII and the creation of the European Steel and Coal Community. When concerns were raised that the EEC was promoting a project to create advantages for its own companies in the East at the expense of other states (“Fortress Europe”), it was decided that non-European members of the OECD would be allowed to be members of the Charter process as well. In addition, to placate various EEC states,<sup>935</sup> some of the energy exporters from North Africa and the Middle East were allowed to participate as observers.<sup>936</sup> However, OPEC was not invited.<sup>937</sup> At the time, EC Energy Commissioner Cardoso e Cunha noted that OPEC states were excluded as full-fledged Charter members to prevent the discussions from “collaps[ing] into cumbersome UN-style debate.”<sup>938</sup> When Venezuela petitioned the 1991 conference to be invited, its request was declined.<sup>939</sup> At the same time, as we saw in chapter 4, when the Treaty was being crafted Russia

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931 “The Energy Charter Treaty and Related Documents,” Joint Memorandum of the Delegations of the Russian Federation and the European Communities on Nuclear Trade, 159.

932 Ibid.

933 Ibid.

934 Bamberger et al., “The Energy Charter Treaty in 2000.”

935 For example, Spain, which imports energy from North Africa, wanted to include these states. Doré et al., *The Energy Charter Treaty*, 3.

936 Michel Chatelin and Marc van Beuge, “The European Energy Charter,” *The Newsletter of the Canadian Institute of Resources Law* 37 (Winter 1992), <http://dspace.ucalgary.ca/bitstream/1880/47116/1/Resources37.pdf>; Doré et al., *The Energy Charter Treaty*, 3.

937 However, the Gulf Cooperation Council, which includes Saudi Arabia, Kuwait, the UAW, Bahrain, Qatar, and Oman, were invited to be observers. Chatelin and van Beuge, “The European Energy Charter.”

938 Brooks Tigner, “European Energy Charter Launched; Targets Include Nuclear Safety,” *Nucleonics Week*, July 25, 1991, 5; see also Andersen, “East of Market—West of State.”

939 Archive of Travaux Préparatoires Documents, Energy Charter Secretariat, Brussels.

was primarily interested in adopting models from Western countries, both energy importers and exporters.

In fact, the ECH regime had been evolving almost since the moment the original group of states signed the Treaty in 1994.<sup>940</sup> A decade later, however, one of the demands that Russia was making was to expand the Charter constituency to include states outside the OECD countries and the FSU that would be formal members<sup>941</sup> of the regime. During a meeting of the Strategy Group (SG)<sup>942</sup> in June 2008, Russia circulated a memo that urged the group to:

consider as a priority activity the attraction of large producing countries, including OPEC members, to participate in the ECT, including OPEC member countries [sic], bearing in mind that currently the ECT Contracting Parties are predominantly consumer countries.<sup>943</sup>

At first glance, it appears that Russia was trying to balance out the membership of the ECH regime by including major energy producer/exporters. This was certainly part of the goal. The new conventional wisdom in Russia was that the ECH was primarily a consumer/importer-oriented regime. Thus, during a January 2009 meeting with Gazprom CEO Alexei Miller regarding the second gas war with Ukraine, President Medvedev stated,

Everyone knows about the so-called “Energy Charter,” which was developed to a large extent with a view to protecting the interests of consumers – which is not a bad thing. One should not forget, though, that sellers are equally parties in any contractual relations and their interests should also be protected.<sup>944</sup>

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940 New members that have signed the Treaty include Bosnia and Herzegovina (June 14, 1995), Macedonia (March 26, 1998), and Mongolia (July 21, 1999). In addition, the ECH regime has expanded through the granting of observer status. Observer states include Serbia and Montenegro\* (July 4, 2001; signed as the Republic of Serbia on December 23, 2008), China (December 17, 2001), South Korea (December 17, 2002), Iran (December 17, 2002), Nigeria (June 26, 2003), Pakistan\* (December 9, 2005), Afghanistan\* (August 4, 2006), Jordan\* (December 7, 2007), the Palestinian National Authority (November 28, 2008), Egypt (November 28, 2008), Indonesia\* (June 18, 2009), and Syria\* (June 28, 2010). Asterisk denotes observer states that have signed the 1991 Energy Charter political declaration. Accessed December 9, 2011, <http://www.encharter.org/index.php?id=61>; “The Energy Charter Treaty and Related Documents,” Geographical Expansion of the Energy Charter, 19.

941 To become a member, at a minimum, a state has to sign the ECT. Whether a state then has to ratify the ECT to be a member is, as we shall see later in this chapter, controversial.

942 After the Treaty was concluded in December 1994, the Conference became the regime’s decision-making body. However, in 2005, the conference began meeting only once a year. In November 2006, an “Ad Hoc Strategy Group” was proposed by the Conference chairman, “given that the regular meetings of the Charter Conference take place only once a year.” (Note from the Secretariat, Summary Record of the 17th Meeting of the Energy Charter Conference.) The group was focused on the question of “strategy” (which included adapting the regime), so it was an important arena for debating the need to reform the ECH. It met in between the Conferences four times during 2007-2008 (April 23, 2007, November 19, 2007, June 12, 2008, and October 17, 2008) and four times in 2009 (March 27, June 16, September 22, and November 6). At the end of 2009, the Conference decided to make the SG a standing body. Note from the Secretariat, Summary Record of the 20th Meeting of the Energy Charter Conference, December 9, 2009, Brussels, November 10, 2010, 15; Summary Annex 6 (The Energy Charter Conference 2009 Draft Joint Statement, Rome, December 9, 2009). For simplicity I will refer to it as the Strategy Group (SG). However, I will not change citations when they refer to the Ad Hoc Strategy Group (AHSG).

943 Delegation of the Russian Federation, Speaking Points at the Ad Hoc Strategy Group Meeting on June 12, 2008.

944 “Beginning of the working meeting with the CEO of the Company ‘Gazprom’ Alexei Miller,” January 20, 2009, accessed June 14, 2011 at: <http://archive.kremlin.ru/text/appears/2009/01/211884.shtml> in Andrei A. Konoplyanik, “A Common Russia–EU Energy Space: The New EU–Russia Partnership Agreement, Acquis Communautaire and the Energy Charter,” *Journal of Energy & Natural Resources Law* 27, 2 (2009) 271.

However, balancing the regime to reflect the interests of producers by including the OPEC states appears to be only part of Russia's goal, since it also urged the group to include the two most important energy consumer/importers outside the OECD: India and China. Thus, the delegation also urged other ECH states to:

consider it a priority to include as ECT members China and India, as well as other developing countries, as these countries will account for the largest increase in energy consumption in the long term and will determine market behaviour (between 2005 and 2030, the developing countries will be responsible for 75% of the increase in primary energy consumption, with China and India accounting for 45%).<sup>945</sup>

Finally, Russia also proposed to include a number of other important players. At the same meeting, the delegation suggested that current ECH members: "...welcome possible signing [sic] of the ECT by the USA, Canada, Mexico, and Brazil."<sup>946</sup>

There is little doubt that in attempting to change the ECH regime, Russia, which after all is an energy producer/exporter, was promoting the interests of a producer/exporter state. This is interesting since the idea that producers/exporters and consumers/importers might have conflicting interests was not prominent in Russian ECH policy during the 1990s, but had since become salient.

However, Russia's initiative to expand the ECH membership reflected a deeper concern: the need to create a new international structure that would promote the energy security of all states. This involved changing not only the membership of the ECH but also the norms and principles on which it was based, or what Aggarwal has called the "meta-regime." The following section examines this issue in greater detail.

### **Changing regime norms: the sovereignty norm and state participation in the energy sector**

As argued previously, at the heart of the ECH regime was the neo-liberal approach, which dictated that the state was to create a protected economic sphere for firms by undertaking international legal commitments through treaties and creating domestic laws that were consistent with these commitments. Beyond that, it was firms that engaged in business activities (including investment), not states. This was consistent with the neo-liberal conception that economics and politics were separate and that states should not interfere in the economic sphere. This also underpinned a particular understanding of the sovereignty norm as legal sovereignty.

As we saw earlier, a significant development in Russia once Vladimir Putin became president was the return of the state to key sectors of the economy, first and foremost the energy sector. This was inspired by a different view of the state and the emergence of the SS ideological line. In evaluating recent Russian state energy policy, Umbach has written that:

The Kremlin will have majority control over any significant energy project...the Russian government has the political will for that objective to use all means, whether political, regulatory ones or legal pressure, and.. has been successful with its gradualist policy steps.<sup>947</sup>

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945 Delegation of the Russian Federation, Speaking Points.

946 Ibid.

947 F. Umbach, "Global energy security and the implications for the EU," *Energy Policy* 38 (2010): 1239.

Dr. Mark L. Entin, professor of European Law, director of the European Studies Institute at MGIMO,<sup>948</sup> and close observer of Russian ECH policy, has made a similar appraisal:

The main components of the ideology of depending on the fuel and energy complex for the rebirth of the country are well known....Building up national sovereignty, *the return of the state to the commanding heights of the economy*, and confirming the country's grandeur in the international arena is an integral part of this.<sup>949</sup> (emphasis added)

In contesting the idea that the free market model espoused by the EU for organizing its internal energy sector is appropriate for Russia, Gudkov, Gazprom's legal expert in the Charter setting, has cited Professor D. Helm's presentation at a conference on EU foreign energy policy:

90% of world gas resources are controlled by governments. This presupposes the rationalization of resource use and state control over infrastructure. As a result, it is not in Russia's interest to apply the rules of the internal EU market.<sup>950</sup>

Helm's allusion to rationalization is reminiscent of the Norwegian arguments during negotiations on the ECT.

Certainly, concern with rational resource use is at least partly behind the Russian state's transformed role in the energy sphere. In describing "the new energy policy" in Russia, Dr. Stanislav Zhiznin, a professor at Gubkin State University of Oil and Gas and MGIMO and president of the Centre of Energy Diplomacy and Geopolitics,<sup>951</sup> has also noted the renewed significance of the state and its focus on rationalization of the energy economy:

Significant attention is paid to more rational administration of the state fund of mineral resources which entails solving the problem of the depletion of large oil and gas deposits....State policy in this sphere aims for the more rational development of deposits, the coordination of the tempos for their development in the interest of providing internal and foreign markets with energy materials....In addition, the aim is... to consolidate control over the rational development of natural resources.

The administration system in the Russian fuel and energy complex is being reformed and a transition is occurring from management through directives to methods of state capitalist regulation in the context of a market economy. This means cardinal changes in the role of the Ministry of Industry and Energy...Its basic functions include the development and realization of an energy policy, which takes into account the interests of the state and firms, the federal center and the regions, and the fuel and energy complex and other sectors.<sup>952</sup>

The state has also positioned itself to play a key role in Russian natural gas policy: "[l]ooking over the structure of the gas industry, it is worth noting that the general coordination of the gas

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948 MGIMO refers to the Moscow State Institute of International Relations, which is affiliated with the Ministry of Foreign Affairs. Professor Entin was also the dissertation adviser of Dr. Gudkov, who was a legal expert for Gazprom during bilateral discussions with the EU on the draft TP and is also cited in this dissertation.

949 M. L. Entin, *International Oil and Gas Pipelines—Law, Geopolitics, Economy* (Moscow: Eastbrook, 2006), 80. 950 Gudkov, "Transit of Energy Resources," 53.

951 The Centre of Energy Diplomacy and Geopolitics was founded in 2003 with the support of the Union of Oil and Gas Producers of Russia and the Ministry of Foreign Affairs. It consults to the MFA, the Ministry of Industry and Energy, the administration of the President of the Russian Federation, and other agencies. According to its website it also "prepared the analytical reports on the economic, geopolitical and organizational aspects of the global energy security (in the context of the concept of Russian Presidency in G-8) for the Russian Government." Accessed June 16, 2011, [http://cedg.info/eng\\_history.shtml#](http://cedg.info/eng_history.shtml#).

952 Stanislav Zhiznin, *Russian Energy Diplomacy* (Moscow, March 23, 2006), 99, 101.

component of the country's energy policy is fulfilled by the Ministry of Industry and Energy."<sup>953</sup> In short, the role that the Russian state plays in the energy sphere has changed dramatically since the turn of the century.

The shift in the state's domestic role has also had direct implications for the changes that Russia has proposed to the ECH regime. In other words, not only has the behavior of the Russian state changed, but also the norms that it promoted within the ECH context. The argument in earlier chapters was that Russia embraced the neo-liberal approach, which became institutionalized into the ECH regime. According to Zhiznin, who participated in negotiations on the ECT as an expert: "[t]he Russian position when the Treaty was being prepared was influenced to a considerable degree by the diffusion in the country during the early 90s of the last century of market liberal euphoria."<sup>954</sup> Beginning in 2006, Russia began challenging the neo-liberal approach by, among other things, legitimizing a new norm that was not consistent with that perspective: a more active role for the state in the energy sphere. This can be seen both in its statements during ECH meetings and in the pronouncements of its experts.

A common refrain both in publications by experts and during presentations by the Russian delegation in the ECH context is that circumstances have changed since the early 1990s. In particular, Russia (as well as other transition economies) no longer needs Western models for building capitalism. In his speech at the October conference "Role of Governments & International Organisations in Promoting Energy Security," Gorban stated that:

After the signature of the Energy Charter Treaty in 1994 the world has undergone considerable changes, which, as it seems to us, have put on our agenda the need for an appropriate correction of the Treaty, which in its present form is in many respects at odds with the prevailing realities...Transition economies, which in the early 1990s were in dire need of experience in building a market oriented model, today have become full partners in the international economic cooperation.<sup>955</sup>

Similarly, Yershov has written that:

Countries with transition economies which in the beginning of the 1990s acutely needed to borrow experience for building a market economy have come a long way and more and more assume the role of full-fledged partners in international cooperation.<sup>956</sup>

At the same time, Russia began critiquing prevailing (neo-liberal) norms related to state participation in the economic sphere. One instance of this was a presentation by the Russian delegation at a Strategy Group (SG) meeting in June 2008 in which they claimed that the state was being discriminated against as an economic actor. This was identified as a problem within the ECH constituency that needed to be addressed by reforming the ECT:

We believe it is necessary to underline... increased attempts of discrimination against the activities of state-owned companies of producing countries, particularly in the field of asset

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953 Ibid., 107.

954 Ibid., 317.

955 A. V. Gorban, Speaking Notes at the International Conference on the Role of Governments and International Organizations in Ensuring Energy Security, unofficial translation by the Energy Charter Secretariat, Brussels, October 25, 2006, 4.

956 Y. Yershov, "The Energy Charter Treaty: To be or not to be—that is the question (article 2)," *Rossiiskaya Gazeta*, July 7, 2006, 9.

acquisition in consumer countries on mutually beneficial terms, as well as in the sphere of using the sovereign funds of producing countries.<sup>957</sup>

In his October 2006 speech, Gorban similarly alluded to the exaggerated international response to the Russian state's changed (and yet still limited) role in its energy sector.<sup>958</sup>

This critique of the prevailing norm related to the state's economic role was also connected to the need to update the Treaty. The work of Dr. Y. Yershov, a professor at the Higher School of Economics and participant in the ECH process as an expert since Soviet times, shows clearly that reform of the ECT entailed creating a more prominent place for state economic participation:

[T]he state sector has become definitively consolidated in the oil production sector.<sup>959</sup>

New tendencies in the development of world energy connected to the ubiquitous improvement of the basis for the state sector demands a more balanced approach to changes in ECT articles related to state and privileged enterprise putting enterprises from the state sector in the fuel and energy complex at a disadvantage compared to private business.<sup>960</sup>

In reviewing how the ECT might be modified in a different article, Yershov echoed the sentiments expressed by the Russian delegation cited above: “[i]t is necessary to develop and propose such important new directions for us as the defense of the state sector in energy and the principle of the freedom of use of sovereign funds.”<sup>961</sup> Russia had come full circle. In the fall of 1991, the first Yeltsin government had articulated a view of the state as the oppressor of private economic initiative. By corollary, it adopted the neo-liberal approach promoted by the West. By 2010, Russia was arguing that it was the state as an economic agent that needed to be protected against discrimination inspired by those very same norms.

Russian policy has not only consisted of promoting norms legitimizing state participation in the energy economy, it has also included a limited critique of free markets and the most basic assumptions of the neo-liberal model. For example, in an analysis of investment in transport infrastructure, Gudkov has argued that the EC's belief that the maximization of legally promulgated free markets is a reliable vehicle for the development of the energy sector may not be well founded:

In the opinion of the Commission, juridical guarantees of free trade in energy create stimuli for its actual development. However, history has shown that this assumption is to a certain extent debatable; if two packets of liberalization measures in the electricity and gas sector have not given tangible results, then why should their long term amplification lead to success?<sup>962</sup>

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957 Delegation of the Russian Federation, Speaking Points, 3.

958 Gorban, Speaking Notes, 3.

959 Y. Yershov, “The Energy Charter Treaty and Russia's National Interests (part one),” *Investment in Russia* 12 (2008): 6.

960 Y. Yershov, “The Energy Charter Treaty and Russia's National Interests (part two),” *Investment in Russia* 1 (2009): 8.

961 Y. Yershov, “Global Energy Security and the Recipe for Its ‘Treatment,’” *Investment in Russia* 6 (2009): 6.

962 Ivan V. Gudkov, “The Energy Policy of the EU: the European Commission's New Proposals,” *Oil, Gas, and Law* (February 2007), 44.

A core assumption of the neo-liberal approach is that liberalization in conjunction with an attractive investment climate (characterized by legal guarantees that minimize political risk) are necessary and sufficient to attract investment and generate competition and efficiency. However, Gudkov has explicitly challenged this posited relationship between liberalization and investment:

The EU energy sector is in need of colossal investments. It follows that it is important to find a balance between liberalization measures, aimed at competitiveness, and maintaining an attractive investment climate which is necessary for attracting large scale capital investments into infrastructure for producing and supplying energy, i.e. to provide for reliability of supply.<sup>963</sup> (emphasis added)

From this perspective, too much liberalization might actually deter investment.

The logic becomes clearer in Gudkov's critique of the Commission's proposals for breaking up vertically integrated firms (unbundling; a form of structural liberalization) and the associated problems this poses for investment into transport infrastructure:

In justifying its proposal to break up the property of vertically integrated companies, the Commission points to the fact that this measure will allow for first, the total elimination of discrimination against third parties [barriers to entry into the gas business] and second, will provide for the necessary level of investment to create infrastructure. The second claim is debatable. It is well known that private initiative is successfully realized in those segments of the economy, where the benefits of investment surpass the risks associated with them. A private investor – the independent system operator – *may prefer to invest resources into a regulated network business with strictly limited revenue norms and an unstable legal regime related to participation* in a more profitable market segment.<sup>964</sup> (emphasis added)

For Gudkov, too much liberalization can drive down profitability and thereby discourage investment into infrastructure, leading to long term shortages in transport capacity. One solution is to ensure a certain level of profitability through regulation. From the perspective of encouraging investment, this can be preferable to liberalization.

The foregoing argument suggests that states should regulate profitability to ensure investment and security of supplies. What is the role of vertical integration? For Gudkov, unbundling creates the risk that market signals will be wrong:

[T]he property unbundling of vertically integrated companies can increase the risk of incorrect planning. An independent operator will plan not understanding how supply is developing, following market signals that are not always correct. The means for attenuating this risk is effective long term planning of the system's development.<sup>965</sup>

Ultimately, whether price signals are accurate and lead to firm decisions that result in the sufficient development of infrastructure (and security of supply) depends on how a specific market is positioned within a larger complex of markets that include the upstream. Because they connect different market segments, vertically integrated companies are able to plan effectively. The more general claim is that a separate, competitive market in transport can produce price signals that are incorrect from the perspective of long term development and security of supply.

Ultimately, Gudkov appears to be suggesting that the optimal solution is vertical integration (which allows for accurate investment planning across multiple market segments) in

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963 Ibid.

964 Ibid.

965 Ibid.

the context of greater regulation, which modulates competition and profitability (to motivate firms to actually invest the necessary resources):

It is obvious that from the perspective of vertically integrated companies, to stimulate investment demands not strengthening measures for structural unbundling, but an increase in the effectiveness of regulatory activity. Applying an elevated revenue norm in tariffs for access to new objects within the infrastructure system and exceptions from the regulated access regime capable of making the network business more attractive for investors.<sup>966</sup>

In short, Gudkov was making a significant revision to the neo-liberal conventional wisdom that prevailed in the ECH context. First, the neo-liberal complex of relationships — liberalization, legal elimination of political risk, investment, competition, and efficiency — was problematic. In particular, liberalization (in the form of structural unbundling) may jeopardize investment. Second, although political risk is important, investment hinges on returns. When the latter is sufficiently high, it can outweigh the significance of the former. Finally, liberal structural reforms are not a panacea. How a particular market functions cannot be properly understood in isolation from other markets to which it is related (in other words, the upstream). Ignoring this broader context risks creating a market that generates incorrect market signals and leads to underinvestment in infrastructure. One solution is vertical integration. However, this alone is not sufficient since firms still need to be able to expect an adequate return before investing. This implies an expanded role for the state, which needs to regulate profitability to promote investment. Interestingly, Gudkov's analysis is reminiscent of the claims made by Abalkin during the late Soviet period concerning the important role that the state played in ensuring investment in socially significant infrastructure. It is worth emphasizing that Gudkov was a Russian expert participating in discussions on the draft TP and that the types of arguments we observed in his article were also made by the Russian delegation during expert discussions with the EU.<sup>967</sup>

This section has argued that since the turn of the century the role of the Russian state in the energy economy has changed, and that this was associated with Russian policy concerning the norms of the ECH regime and proposed changes to the content of the ECT. In particular, Russia has called for bolstering the articles on state sovereignty within the agreement and defended the state's participation in the energy business. This was a very different understanding of sovereignty from legal sovereignty, where the state's primary role was to make laws and treaties to protect private actors from, among other things, state action. The analysis of Gudkov's work suggests that Russia's discussion of norms related to the legitimacy of state action also involves a partial critique of free markets and an important revision of the neo-liberal perspective. Finally, this analysis of norms related to the state has also touched on important principles (defined as causal beliefs) within the ECH regime. The next section focuses on principles related to energy security, which Russia began revising in 2006.

### **Changing regime principles: energy security and security of demand**

During the 2006 G8, Russia began an ambitious initiative to change the conventional understanding of energy security. During its presidency of the G8, Russia chose to make energy

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<sup>966</sup> Ibid., 45.

<sup>967</sup> Interviews in Moscow, 2008-9.



security the top item on the agenda. Thus, the Chair's Summary of the summit states that: "[o]n July 17 we...[discussed the] priority themes of the Russian Presidency (global energy security, development of modern education systems and fight against infectious diseases)."<sup>968</sup> The importance of energy security can also be seen in President Putin's address to visitors of the official website for Russia's G8 presidency:

Russia, as the presiding country, regards it as its duty to give a fresh impetus to efforts to find solutions to key international problems in energy, education and healthcare.

This year, we plan to urge our partners to redouble efforts to ensure global energy security. We believe that today, it is crucial to find a solution to a problem which directly influences the social and economic development of all countries, without exception.<sup>969</sup>

Russia was aiming to begin a discussion about numerous issues related to energy including energy conservation and the environment; development of nuclear energy, non-proliferation, and the creation of a network of international uranium enrichment centers; development of technologies for energy efficiency and alternative sources of energy; protection of infrastructure from terrorist attacks; and energy poverty (the gap in energy provision between developed and underdeveloped countries). Here I focus on the redefinition of energy security that Russia was proposing for the first time at the international level.

#### *Energy security in the ECH: the consumer perspective*

According to Konoplyanik, energy security has been synonymous with supply diversification since at least 1911, when Winston Churchill switched the fuel used by the British navy from coal to heavy fuel oil (mazut).<sup>970</sup> While Britain was self-sufficient in coal, it had to rely on external sources for oil, and so diversification of sources became important.<sup>971</sup> Of course the World Wars and the more recent oil embargo during the 1970s made concerns over security of supply even more acute. This understanding of energy security as security of supply and diversification persists in the EU to this day. Under the rubric "Security of supply," in response to the question "What do we want to achieve?" the EC writes:

With both energy consumption and dependency on oil and gas imports growing and supplies becoming scarcer, the risk of supply failure is rising. Securing European energy supplies is therefore high on the EU's agenda. Besides promoting energy efficiency, the EU promotes a broad mix of energy sources. Moreover, it aims for diversity in suppliers, transport routes and transport mechanisms.<sup>972</sup>

The European goals for energy security reflect the concerns and interests of a net energy importer state: reliable access to supply. Therefore, energy security is equated with security of supply, and the primary foreign policy vehicle for achieving security of supply is diversification

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968 "Chair's Summary," G8 2006 St. Petersburg Summit, St. Petersburg, July 17, 2006.

969 Address by President Vladimir Putin to visitors to the official site of Russia's G8 Presidency in 2006, accessed May 10, 2011, <http://en.g8russia.ru/agenda/>.

970 Andrei Konoplyanik, "Energy Charter will Secure a Balance of Interests," *Political Journal* 3, 4 (February 5, 2007), 42-43, accessed May 10, 2011, <http://www.konoplyanik.ru/ru/publications/articles/411-PolitJournal-5.02.pdf>.

971 Daniel Yergin, *The Prize: The Epic Quest for Oil, Money, and Power* (New York: Simon & Schuster, 1992).

972 European Commission, "Security of supply: What do we want to achieve?" accessed May 10, 2011, [http://ec.europa.eu/energy/security/index\\_en.htm](http://ec.europa.eu/energy/security/index_en.htm).

of fuels, producers, or transport routes. This perspective should be familiar to the American reader since debates about energy security in this country inevitably focus on reducing our reliance on politically unstable energy producers, particularly in the Middle East, in favor of other sources (geographic diversification). Again, this reflects a net energy importer perspective, for which supply is paramount.

ECH documents also reflect this perspective. Overall, the ECT (including annexes, conference decisions, amendments, memoranda, letters, statements, and the protocol on energy efficiency and related environmental aspects) takes up 184 pages. Security is mentioned six times. Of these, only three occurrences are concerned with energy security proper, and all three suggest a concern with security of supply.<sup>973</sup> The ECH political declaration from 1991 is only ten pages long, and security is mentioned five times. Of these, again only three refer to energy security, and all three reveal a concern with security of supply.<sup>974</sup>

That energy security is so rarely mentioned in ECH texts is surprising. However, this should not obscure the fact that security of supply and diversification were key European motives for initiating the ECH regime in 1990. Ruud Lubbers, the former prime minister of the Netherlands who initiated the whole project at the June 1990 Dublin European Council, has stated explicitly that he proposed the “European Energy Community” in part due to concerns about security of supply:

I was once more confronted with an analysis of world energy markets ...[which] made clear that OPEC's share in the world's oil supply was going to rise again....The vulnerability of the industrial world's oil supply would increase.

In the run-up to the European Council on June 25, 1990 in Dublin, I combined my concern for the long-term energy supply with the situation in Eastern Europe.

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973 Two of these relate to the physical security of infrastructure and mention security of supply. The specific provisions concern reasons why a transit state might not allow the construction of additional transit infrastructure (or modification of current infrastructure): “A Contracting Party through whose Area Energy Materials and Products may transit shall not be obliged to (a) permit the construction or modification of Energy Transport Facilities; or (b) permit new or additional Transit through existing Energy Transport Facilities, which it demonstrates to the other Contracting Parties concerned would endanger the security or efficiency of its energy systems, including the security of supply,” 48-49. The third mention is in the preamble of the protocol on energy efficiency and related environmental aspects and also relates to security of supply: “Aware of the improvements in supply security, and of the significant economic and environmental gains, which result from the implementation of cost-effective energy efficiency measures; and aware of their importance for restructuring economies and improving living standards,” 141. The other three occurrences relate to: 1) security of investments (53), 2) state security (70), and 3) social security payments (127).

974 Thus, the second page of the declaration states: “Willing to do more to attain the objectives of security of supply and efficient management and use of resources,...Convinced of the essential importance of efficient energy systems in the production, conversion, transport, distribution and use of energy for security of supply and for the protection of the environment,” 212. At the very beginning of the section “Objectives,” the parties declared that: “The signatories are desirous of improving security of energy supply and of maximising the efficiency of production, conversion, transport, distribution and use of energy, to enhance safety and to minimise environmental problems, on an acceptable economic basis,” 214. The other two mentions of security relate to: 1) the Conference on Security and Cooperation in Europe (CSCE), 211; and 2) legal security related to investments, 218.

...[O]pening up the rich energy resources in Eastern Europe (primarily Russia, but also Kazakhstan, Azerbaijan, and other republics) contributes toward reducing the vulnerabilities in Western Europe's energy supply.<sup>975</sup>

In fact, it was the Iraqi invasion of Kuwait in August 1990 and the ensuing concerns over security of supply that gave the project momentum. In response to the Gulf crisis the British, who had been lukewarm to Lubbers' initial proposal, took the initiative, and security of supply became an important motive. In announcing support for the Dutch initiative during a speech to the Conservative Association in Oxfordshire, then UK Foreign Secretary Douglas Hurd noted the precarious situation of all energy importers due to supply vulnerability associated with political instability in the Middle East:

Mr. Hurd emphasised that the Gulf crisis had highlighted the dependence both of the industrialised countries and the developing world on oil and gas. The new democracies of eastern Europe and some Third World countries were among those suffering most from increased energy prices.<sup>976</sup>

It was the British who changed Lubbers' idea for a European Energy Community to a European Energy Charter. The Gulf crisis also made concern for security of supply salient in the EC, and against this backdrop energy cooperation with Eastern bloc exporters became very attractive. Thus, the European Energy Commissioner Mr. Cardoso e Cunha noted that, "I can hardly imagine that Prime Minister Lubbers knew in advance that this crisis would break out, but I must say that his memorandum (initiative) was launched at a very suitable moment."<sup>977</sup> Finally, it was not controversial at the time that the Europeans construed energy security in terms of security of supply. The official statement released after the London G7 meeting in July 1991 (which Gorbachev attended) declared that:

We all intend to take a full part in the initiative of the European Community for the establishment of a European Energy Charter on the basis of equal rights and obligations of signatory countries. The aim is to promote free and undistorted energy trade, to enhance security of supply, to protect the environment and to assist economic reform in Central and East European countries and the Soviet Union, especially by creating an open, non-discriminatory regime for commercial energy investment.<sup>978</sup>

Thus, as the ECH regime was being created, energy security was an important concern, and it was understood as security of supply. That energy security is mentioned explicitly in the ECH documents on so few occasions reveals that access to resources for foreign investors and the freedom for them to transit and trade these resources satisfied European concerns related to security of supply and diversification at the time. After all, the Treaty was being developed in a context where it was broadly understood that foreign investors would be primarily European firms that would invest in the former USSR, extract resources, and then transit them for sale in Europe. Ultimately, this was seen as a way to diversify away from the Middle East, which was considered relatively unstable at the time.

The foregoing discussion provides a window into further understanding the structure of the ECH regime and how it was challenged by Russia in 2006. Energy security understood as

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975 Lubbers, "Foreword," *The Energy Charter Treaty: An East-West Gateway*, xiii-xiv.

976 Robert Mauthner, "Hurd backs plan for EC energy group," *Financial Times*, September 8, 1990, 4.

977 NRC Handelsbad, in Chatelin and van Beuge, "The European Energy Charter."

978 G7 statement on charter, Europe Documents, 1728—G7 London Summit: Economic Declaration (3 of 6), *Agence Europe*, July 30, 1991,.

security of supply was a key goal within the regime. Moreover, liberal legal rules for firms in the areas of investment, transit, and trade were seen as an effective vehicle for enhancing security of supply. Finally, the logic was causal: creating conditions for firms to invest in the development and production of energy in the East and then transit and sell their energy to the West would cause energy diversification away from the Middle East and enhance European importers' energy security. Therefore, the causal relation between a liberal regime and security of supply through diversification was a key principle of the ECH regime.<sup>979</sup>

During its G8 presidency, Russia proposed a modified understanding of energy security that included not only security of supply but also security of demand. The reconceptualization of energy security was presented by President Putin himself. In his speech to the G8 Energy Ministers on March 16, 2006, Putin stated that:

[Energy] is a key sector in the world economy.

But we also see that development in this sector is very uneven and is subject to serious risks – political, economic and environmental risks. The issue of global energy security proposed by Russia is clearly not a choice dictated simply by the situation of the moment. It is clear that the situation in the world energy sector is a real challenge for us all, a challenge that we must respond to. It is by combining our efforts that we can respond most effectively.

... One of the keys to global energy security is a fair distribution of the risks among energy resource producers, transit service providers and consumers.

The energy market must be insured against unpredictability and its level of investment risk must be reduced. In other words, *measures taken to ensure reliable supplies must be backed up by measures taken to ensure stable demand.*

In our view this is the optimum way to harmonise the interests of all the players on the energy market.

Open and predictable supply of energy resources should be matched by open and predictable energy resource demand. This formula creates a *responsible interdependence* that is in everyone's interests.

...In conclusion I would like to stress that we have today a unique opportunity to open a new chapter in global energy, a chapter that would see us move from one-off projects and bilateral dialogue to relations based on a global energy partnership. The G8 summit in St Petersburg will give us a good opportunity to begin this work and to define together a common approach to building an effective energy foundation for our civilisation in the long term.<sup>980</sup> (emphasis added)

By reconceptualizing energy security to include security of demand, Russia was not trying to diminish the significance of security of supply for energy importers. However, it was highlighting the importance of the interests of both consumers and producers. In the same speech, Putin noted that:

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979 According to Krasner, principles are “beliefs of fact, causation, and rectitude.” Krasner, *International Regimes*, 2.

980 Vladimir Putin, “Speech at Meeting with the G8 Energy Ministers,” The Kremlin, Moscow, March 16, 2006, accessed December 9, 2011, [http://archive.kremlin.ru/eng/speeches/2006/03/16/1302\\_type82912type82914type84779\\_103208.shtml](http://archive.kremlin.ru/eng/speeches/2006/03/16/1302_type82912type82914type84779_103208.shtml).

Russia supports the entire international community uniting efforts in order to work together to resolve the whole range of tasks that we have before us.

Above all, these tasks are to guarantee supplies of traditional energy sources for the world economy on conditions that are acceptable for both producer and consumer countries.

Russia was pointing the world's attention to a new understanding of interdependence ('responsible interdependence') and the significance of balancing the interests of consumer and producer (or alternatively net importer and net exporter) countries. From this perspective, a harmony of interests and energy security in the international energy economy would require concerted political action by states.

Russian attempts to change how energy security was understood within the ECH context began soon after the G8. In October 2006, during the conference "The Role of Governments and International Organisations in Promoting Energy Security" (organized by the ECS and International Energy Agency), Alexander Gorban, deputy director of the Economic Cooperation Department, Ministry of Foreign Affairs, made a speech in which he expressed Russia's views on energy cooperation. Gorban connected his remarks with the G8 statement on energy security the previous summer. He also raised many of the key points that Russia began making in its effort to reform the regime.

The main theme was that although energy producers and consumers had different interests, energy cooperation needed to be based on the principle of meeting the interests of all states in a balanced way, regardless of their position on energy markets.

We clearly realize that the energy interests of the members of the international community do not always coincide...we are keen on developing a model of energy security cooperation and implementation mechanisms that serve the interests of all partners.

Guided by these considerations, Russia initiated inclusion of Global Energy Security as a key agenda item for its G8 presidency.<sup>981</sup>

This concerned acknowledging security of both supply and demand, which was a major concern for Russia:

The [G8] Statement clearly stipulates the principle of common responsibility of producers and consumers for stable and sustainable development of the world energy sector, including through security of demand and supply....

.... [F]or us the important thing is to ensure on a long term basis a stable market for Russian energy. In this connection....long term reliability of supply plays an important role.

Gorban concluded by connecting his comments to the need to adapt the Treaty:

A new higher level of energy cooperation calls for changes in the Treaty application mechanism.

The main tool missing in the ECT machinery is a means to promote both, security of supply and security of demand, to establish a balance of interests between producers, consumers, and transit countries and to find "a golden medium" between market liberalization and strengthening the long-term contractual relations.<sup>982</sup>(emphasis added)

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981 Ibid.

982 Gorban, Speaking Notes.

During the period of 2006 to 2008, Russia raised the question of energy security repeatedly. Another example was the Russian paper “Speaking Points of the Delegation of the Russian Federation,” distributed two days prior to the June 2007 meeting of the SG.

The paper starts out by noting that Russia felt the Conference’s mandate to the group to “identify... the new challenges in the energy sector” and “consider... in which way the Energy Charter Process and its instruments can most efficiently respond to such challenges” was too narrow and that it aimed to complement this work “by the work on preparing the 2009 Review.” Clearly, Russia was trying to move the discussion closer to updating the Treaty, which seemed more likely within the context of the review than within the mandate set by the conference. Russia also drew the group’s attention to the key issues identified at the G8 summit in 2006, which included “improving the investment climate in the energy sector; balancing the interests of consuming and producing countries; [and] increasing predictability and stability of global energy markets.”<sup>983</sup>

With respect to its views on the role of the Charter process, Russia noted that the ECT had become “outdated to a certain extent.”<sup>984</sup> In this connection, it underlined the significance of energy security, which it argued was not adequately ensured by the ECT. Indeed, it commented that the Treaty did not even include such a concept. It pointed to the significance for energy security of balancing both supply and demand, which it argued was the responsibility of both producer and consumer states.

Moreover, to meet the interests of both consumers and producers, the Treaty should provide for “*inter alia*...the responsibility of parties not only for security of energy supply, but also for security of energy demand.”<sup>985</sup>

### *The new logic of energy security: the producer perspective*

What exactly was the logic that Russia was proposing that would connect consumer interests (security of supply) to the interests of producers? In his speech, Putin alluded to the key factor – investment risk. A detailed intellectual exposition of the argument can be found in a speech made by Dr. Andrei Konoplyanik shortly after the G8 summit (on October 25, 2006) during the conference, “The Role of Governments and International Organisations in Promoting Energy Security.” It was organized by the Energy Charter, the International Energy Agency (IEA), and the OSCE,<sup>986</sup> and at the time, Konoplyanik was the deputy secretary general of the Energy Charter Secretariat in Brussels.

Konoplyanik began his presentation by specifically linking the conference’s interest in energy security to Russia’s initiative during its G8 presidency: “[t]he discussions on energy security, being intensified during the 2006 Russian G8 Presidency, have once more underlined that investment is a key to international energy security.”<sup>987</sup> A major premise for his argument

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983 Delegation of the Russian Federation, Speaking Points.

984 Ibid.

985 Ibid.

986 Role of Governments & International Organisations in Promoting Energy Security, Brussels, October 25, 2006, accessed May 11, 2011, <http://www.encharter.org/index.php?id=179&L=0>.

987 Andrei Konoplyanik, Deputy Secretary General, Energy Charter Secretariat, “The Role of an International Legal Framework,” Presentation at the international conference “Role of Governments & International

was that demand for energy was growing. The international trade in energy was also growing because consumption was becoming increasingly concentrated in states with relatively scarce resources. As a result, to meet their energy needs, consumer states were becoming increasingly reliant on imports through capital intensive infrastructure from states with large resource endowments.

Demand for energy has been and would be continuously growing in absolute terms... Due to asymmetry between energy production and consumption areas (Markets/Resources Mismatch) major energy consumers will face growing import demand. That leads to continued growth in international energy trade with its increasing cross-border character and to a shift to more use of infrastructure-bound energy.

...Linking together consumers and producers by common (usually immobile) infrastructure increases their mutual interdependency. Internationalization and globalization of the energy markets put an end to the earlier existing concepts of “energy independency.” We are [living] in the interdependent energy world nowadays.<sup>988</sup>

What Konoplyanik calls the “Markets/Resources Mismatch” results in a world that was becoming increasingly interdependent in energy. The idea of energy interdependence was the basis for his claim that a new understanding of energy security was necessary that went beyond security of supply and took into consideration the interests of all participants in energy markets:

As long ago as in 1911, at the time when Winston Churchill switched the Navy from coal to oil, it was recognized that “safety and certainty in oil lie in variety and variety alone.” Since then diversification is the synonym of energy security. This is only true though when the term “diversification” is interpreted in the broad sense and reflects the balance of interests of players representing all units of the energy value chain.<sup>989</sup>

The pivotal idea that links the interests of producers and suppliers was related to the capital intensive nature of the energy trade and the large risks assumed by investors. However, the concept of investment risk in his argument went beyond the problem of political risk from the state, which was the focal point for discussions when the ECH regime and Treaty were being crafted. Although political risk was still important, according to Konoplyanik’s logic, investment risk also included economic risk. Specifically, for the very projects (in development, processing, and transport) on which consumers relied to meet their future growing demand to be implemented, investors needed a stable and predictable economic environment not only in the upstream (where energy was developed and produced) but also in the downstream market (where energy was transported, marketed, and consumed):

Demand for energy and diversification in the energy area requires creating new infrastructure, hence is related to investments, mostly...large-scale ones. Any - and especially large-scale - investments are aimed at establishing stable long-term relations to the mutual benefit of suppliers and consumers, investor and host-state - relations, which are balanced and are based on clear, predictable and enforceable rules.

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Organisations in Promoting Energy Security,” Brussels, October 25, 2006., accessed May 11, 2011. Konoplyanik’s speech and accompanying PowerPoint slides are available respectively at

[http://www.encharter.org/fileadmin/user\\_upload/Conferences/2006\\_Octii/Konoplyanik\\_text.pdf](http://www.encharter.org/fileadmin/user_upload/Conferences/2006_Octii/Konoplyanik_text.pdf) and [http://www.encharter.org/fileadmin/user\\_upload/Conferences/2006\\_Octii/Konoplyanik.pdf](http://www.encharter.org/fileadmin/user_upload/Conferences/2006_Octii/Konoplyanik.pdf)

988 Ibid.

989 Andrei Konoplyanik, “When One Treaty is Worth a Thousand,” *Neft Rossii* 4 (2007) 8.

Such rules ...are needed to mitigate risks of cross-border energy flows from suppliers to consumers. As well as to mitigate the reverse risks – related to flow of income going from consumers to suppliers for the energy delivered.<sup>990</sup> (emphasis added)

In short, unstable or unpredictable demand created income risks for suppliers, and this jeopardized future investment. Without the minimum expectation that they will get an adequate return, investors cannot be expected to make the investments necessary to meet consumers' energy needs. In this way, energy security has to include both security of supply and security of demand.

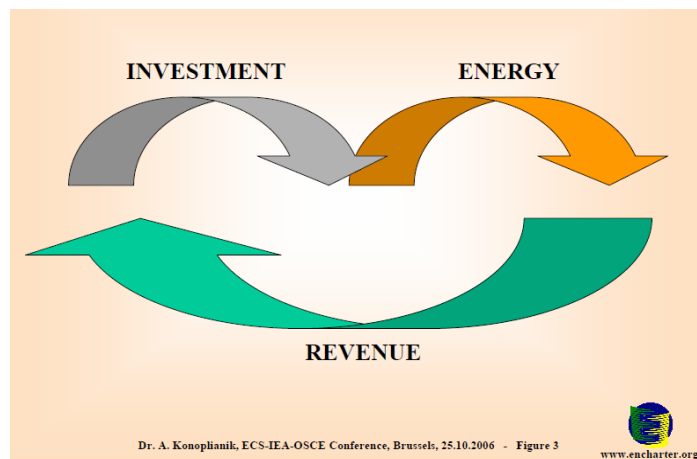
Konoplyanik captured this reasoning in what he called the “economic ‘circle of life’ of energy projects,” found in Figure 9-1 which included three types of flows: energy, investment, and revenue.<sup>991</sup> The conventional understanding of energy security included only supply and investment. However, without addressing risk in all three parts of “the circle of life” – including revenue flows – energy security was not possible.

Only in case of reduced risks and ensuring transparency, predictability and reliability of all three types of flows related to the energy business (or: to the full investment cycle in energy) – investment flows, energy flows and revenue flows – one can talk about a balanced approach to the issue of ensuring energy security.<sup>992</sup>

Finally, as Deputy Secretary General of the Energy Charter Secretariat, Konoplyanik was saying that it was this broader and more comprehensive view that prevailed in his organization:

It is in this context that we in the Energy Charter interpret the concept of “energy security” as a triad consisting of security of supplies, security of infrastructure, security of demand, including, thereafter, the issues of access to the resources, infrastructure and markets. But it is investment that is the “starting point” of the economic “circle of life” regarding energy projects.<sup>993</sup>

**Figure 9-1 : Economic “Circle of Life” of Energy Projects**



990 Konoplyanik, “The Role of an International Legal Framework,” 3.

991 Andrei Konoplyanik, "Energy Security: the Role of International Legal Framework," PowerPoint slides from presentation at the international conference “Role of Governments & International Organisations in Promoting Energy Security,” Brussels, October 25, 2006.

992 Ibid.

993 Ibid.



### *Effect on the Secretariat*

Russia's new approach to the ECH and its initiative to update the Treaty had a significant impact on the activity and thinking of the Secretariat. We saw earlier that during his presentation to the October seminar in Brussels, Deputy Secretary General Konoplyanik made a presentation that very much communicated the new Russian line and presented it as the thinking that the Secretariat had adopted.

After the April meeting of the SG, as a direction forward, the Secretary General Ambassador André Mernier, who was the chair of the ad hoc group, proposed an additional meeting for the group, asked for written proposals, and underlined that the focus should be on policy rather than legal questions. The ultimate goal was to have both an understanding of the issues at stake and ways to resolve them.

In August, in advance of the second, supplemental meeting of the SG, Mernier wrote to all the members and the observers of the ECH that pending the outcome of the discussion on "The response of the Energy Charter to new challenges and opportunities on international energy markets," he planned to propose to the annual Charter Conference, which was scheduled to meet in Istanbul on December 7, the adoption of a "Political Declaration on the Energy Charter in a New International Energy Environment," which could be considered for adoption on April 2008, marking the tenth anniversary of the Treaty's coming into force.<sup>994</sup>

Two weeks before the November 19 SG meeting (November 5), the Secretariat sent out a paper, titled "Meeting New Challenges in International Energy Markets," that would constitute part of the discussion on modifying the Treaty. The paper was divided into two parts. The first part, titled "New Developments and Challenges on International Energy Markets," identified some of the "new developments, challenges and risks that have emerged or become more prominent since the Treaty was negotiated in the 1990s, along with a brief discussion of possible implications for the Energy Charter."<sup>995</sup> The paper touched on a number of issues,<sup>996</sup> but here I will focus only on the questions directly related to energy security: investment, transit, and the role of the state.

The section on investment begins with an unexpected revelation:

High prices for oil and gas should provide an economic driver for new investment and expanded supply, but it is not certain that this standard economic assumption is holding true for international supply of oil and gas – and [there is] an attendant risk that investment will be insufficient to meet future demand at affordable prices.<sup>997</sup>

This is a major revision of the conventional economic wisdom that had prevailed within the ECH regime. The paper then argues that firms are underinvesting in resources due to, among other things, the "specificities of resource economics" and the fact that the "incentives and interests of

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994 Ad Hoc Strategy Group Meeting, Letter from the Secretary General, 702/07, Brussels, August 31, 2007.

995 Secretariat, "Meeting New Challenges in International Energy Markets," for the Ad Hoc Strategy Group– 19 November 2007, Brussels, November 5, 2007

996 The paper discussed: 1) investment, resource development, and supply; 2) climate change and energy efficiency; 3) internationally traded energy (transit); 4) changes in the pricing mechanisms for intra-CIS gas trade; 5) the pivotal role of non-OECD countries and the need for new partnerships; and 6) uncertainty over future policy and the role of governments.

997 Secretariat, "Meeting New Challenges," 1.

different parties along the energy value chain do not automatically coincide.”<sup>998</sup> Finally, it also claimed that an important factor is the asymmetry in the role of the state in energy production and consumption countries:

In resource-owning countries, the state’s depletion and rent-taking policy, however it is implemented, is a major component of the energy supply side. For this reason, a resource-owning state is in a position to promise and secure physical supply; security of supply implies that the exporting state keeps its promises, and does not misuse its sovereign position to interfere into supply deals. By contrast, an energy importing state cannot guarantee physical demand in a comparable way; this is the result of market-driven decisions by consumers. What an importing state can provide, though, is a certain predictability of the market framework and the rules under which energy is imported into a country or region.<sup>999</sup>

Thus, the state’s centrality to energy production means that it can guarantee supply. From this perspective, the state’s participation in energy decision making is a source of security. However, the same is not true for consumption, where state decisions give way to those made by market actors. In other words, energy security depends on security of supply and demand, and the latter is jeopardized because it depends on market processes. At the same time, the state can create predictability in the market framework and rules that it creates, but it is not clear how this relates to energy security.

The paper acknowledges that there are “different ways to balance security of supply and security of demand” and these include “long-term contracts” and well-functioning, “deep, liquid market places.”<sup>1000</sup> However, it notes that when “supply is tight,” energy security depends not just on the supplier’s ability to deliver but also on consumer competition for incremental supply. Therefore, intra-consumer competition can also jeopardize security since it can raise prices to the point where affordable energy is no longer available.<sup>1001</sup>

The paper notes that patterns of investment flows have changed since the time when the ECT was developed:

In the 1990s, the predominant direction for investment flows was from OECD countries to countries engaged in the transition away from a centrally planned system. Today, many of the “transition” economies are now capable of mobilising the investment capital needed and – in the case of energy producers – are increasingly interested in investment downstream.<sup>1002</sup>

The paper then makes a reference to the St. Petersburg G8 Conclusions, stating that it was important for companies “from energy producing and consuming countries [to be able to] invest in and acquire upstream and downstream assets internationally in a mutually beneficial way.”<sup>1003</sup> It points out that since the ECH protects investments at any stage of the energy business, it can accommodate changes in investment flows. However, it also notes that the ECH process “has to reflect the changing environment by taking a broad view of impediments and obstacles to

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998 Ibid.

999 Ibid.

1000 Ibid., 2.

1001 “New context for energy policymaking, some elements of which have been described above: energy security is now discussed against a backdrop of high prices for oil and gas, reflecting competition for limited supply. The dominant impact on energy demand now comes from highly-populated and fast-developing countries outside the OECD.” Ibid., 5.

1002 Ibid., 2.

1003 Ibid.

investment, not only upstream but also downstream, by addressing issues of access to capital and access to technology for the new/emerging international investors, and also by providing a forum for discussion of the terms for ‘mutually beneficial’ investments along the energy value chain.”<sup>1004</sup>

In the discussion about the state, the paper reflects on the approach that prevailed in the 1990s:

In the 1990s a major objective of national policy in many parts of the Energy Charter constituency was to reduce or remove obstacles to the functioning of competitive energy markets. Key policy objectives were market liberalisation, a reduction in the role of state and the introduction of competition, often accompanied also by a shift from state to private ownership.<sup>1005</sup>

However, the context for policy making has changed; in particular, high prices<sup>1006</sup> have made the question of energy security more urgent, and environmental concerns have expanded. Thus, although “Economic efficiency remains an important goal of energy policymaking,” a new debate has emerged on how to balance and what tradeoffs to make with respect to “security, efficiency and environmental protection.” However, this very debate creates uncertainty, which can deter investment flows. Even more problematic is the general “lack of transparency on policy intentions” in both consumer and producer countries, which adds an additional layer of risk for investors. In this respect, the ECH would be a valuable forum “for international dialogue and policy coordination” between members from different segments of the energy business. However, the “role and priorities” of the Charter also needed to be seen in a new context due to the expansion of the EU, the growth of the internal market through the Energy Community Treaty and the accession of member countries to the WTO.<sup>1007</sup>

The paper also notes that transit needs have changed since the 1990s. When the ECT was being developed, the primary concern was to maintain existing energy flows (important for trade and the security of consumers) and provide access to spare capacity (important to upstream investors interested in bringing their resources to market). With growing demand for energy internationally, new infrastructure had to be built, so investment in new capacity has become an increasingly important.

Finally, the paper addressed the change in pricing mechanisms within the CIS and the consequences this has posed for transit. It noted that price differentials within Eurasia were narrowing (due to higher prices in Central Asia and a single price mechanism based on the netback from European prices for Russian exports and gradually for domestic sales as well). On the one hand this took “some of the heat out of the debate over access to infrastructure.” However, it also created transit risks due to bilateral supply disputes concerning the “basis and speed of this transition,” which have multilateral consequences. In this respect, the Treaty, which provides “binding energy-specific disciplines, applicable along the entire value chain, for reliable cross-border supply through the creation and reliable operation of grids and networks,”<sup>1008</sup> could benefit from stronger mechanisms:

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1004 Ibid.

1005 Ibid., 5.

1006 Related to, among other things, growing demand from non-OECD countries.

1007 Secretariat, “Meeting New Challenges,” 5.

1008 Ibid., 3-4.

The Treaty's legal provisions could be strengthened; energy transit has some specific characteristics, and member countries have recognised in the discussions on a draft Transit Protocol the need to clarify further the operational requirements associated with the obligation to provide "freedom of transit" in terms of rules for creating new capacity, providing access to this capacity, and setting transit tariffs.<sup>1009</sup>

Finally, after enumerating all the instruments available within the ECH to address these issues and noting that they create different levels of commitment and are associated with negotiations that vary in complexity, the Secretariat recommended that the debate continue and proposed two more meetings of the SG in 2008. It also suggested that the group begin preparation for the next regular review of the ECH, which was scheduled for 2009.<sup>1010</sup>

As we have seen, in response to Russia's initiative, the Secretariat clearly adopted much of the policy line that Russia was promoting and created additional venues for discussion concerning the issues that Russia was raising. How do we explain the Secretariat's behavior? Part of the reason for this shift within the organization was Konoplyanik's activism. The deputy secretary general was, after all, a Russian national. However, there was a more fundamental reason related to the broader interests of the organization and the structure of decision making within the regime. It is clear that Russia was a central actor within the ECH regime. Not only was the original purpose of the regime, its initial *raison d'être*, related to the political significance of the USSR and its Russian successor, but Russia was also a major energy producer, supplier, consumer, and transit state for energy materials. Without Russia, the regime and organization could perhaps survive, but its character would be very different, and as a result, its mission would need to be reinvented. Thus, from the perspective of regime maintenance and organizational survival, the Secretariat had an interest in keeping Russia engaged. Second, the changes Russia was proposing had the potential for bolstering the importance of the organization within the regime. At a minimum, Russia's proposal was conducive to turning the Secretariat into a forum for policy discussions and coordination. We shall see shortly that as the discussion on adapting the ECT progressed, the Secretariat did just that.

The change within the Secretariat is also related to decision making within the regime. The primary decision-making body within the ECH regime is the Conference, which through 2010 has met 21 times and since 2005 meets annually. In general, decisions are taken by full or nearly full consensus. Controversies are either kept off the agenda or addressed through informal discussions, which can then generate consensus. The Secretariat's role is to support the Conference, and as an organization it is heavily dependent on its goodwill. As a result, it is careful to respect individual states' wishes and follows the consensus norm very closely. This can be seen for example, in how the Treaty was developed. Examination of the iterations of various drafts reveals that all states' preferences are considered and if possible integrated into the text when revisions are made. Bargaining between states then ensues. The Secretariat then proposes even-handed compromises. Finally, agreement is reached, and decisions are taken by consensus. Absent agreement, discussions and bargaining continue.

Russia's views affected the work of the Secretariat not only because of Konoplyanik's personal initiative and Russia's particular political and economic significance, but also because

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1009 Ibid., 4.

1010 According to the Treaty, beginning in 1999, a review has to be conducted at intervals not to exceed five years. "The Energy Charter Treaty and Related Documents," Article 34 (7). The first review was held in 2004.

of how decision making works within the ECH and the role that the Secretariat plays in this process.

*Support from the industry advisory panel (IAP)*

Russia's initiative to change the ECH regime also received qualified support from an unexpected source: the industry advisory panel (IAP) within the ECH regime. The IAP was created in 2004 within the context of the working group on investment. The purpose of the panel was to create "an additional forum for discussions with high-ranking representatives of the energy industry in order to learn about the industry experience and views on energy market developments."<sup>1011</sup>

The group would meet two or three times per year to discuss significant issues in the energy sector. Its main goal was to "advise the Energy Charter Conference on the basis of expert input from commercial companies covering the full range of energy supply activities (exploration, production, generation, transmission, distribution, finance, equipment, services and technology) and with representation from across the Charter constituency."<sup>1012</sup> In this connection, it would also hear presentations from companies (both energy and financial), trade associations, and public and private experts concerning specific developments in particular sectors or countries.<sup>1013</sup> Like the other working groups, the IAP would summarize its discussions and make recommendations to the year-end Charter Conference.

The IAP supported several of the principles, norms, and goals that Russia had been articulating since the 2006 G8 summit. In its 2007 communication to the Conference, the group agreed that energy markets had changed since the 1990s. Paralleling Konoplyanik's arguments from the October 2006 conference, the group concurred that the production of resources will be increasingly concentrated moving forward, and this will entail a growing internationalization of the energy trade and interdependence between producers and consumers.<sup>1014</sup> Moreover, the group argued that the near to medium term threats to energy supply did not result from the depletion of energy resources (such as peak oil), but rather had political origins related to the terms of access to resources, markets, and infrastructure:

[T]he IAP is of the view that the principal risks to energy supply do not arise for the foreseeable future from resource availability but are essentially "above the ground."....These risks essentially revolve around access to resources, markets and infrastructure.<sup>1015</sup>

In pointing to the importance of conditions of access for firms, the group was implicitly supporting the Russian initiative to facilitate access for its firms to downstream markets and infrastructure in the EU.

The group emphasized that the problem of access resulted from policies that produced an unpredictable, and therefore risky, investment climate:

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1011 Ad Hoc Strategy Group, Meeting new challenges in International Energy Markets, May 28, 2008, Brussels, June 12, 2008.

1012 Communication from the IAP to the Energy Charter Conference, 18th Meeting of the Energy Charter Conference, December 7, 2007, Industry Advisory Panel (IAP), Brussels, November 20, 2007.

1013 Ibid.

1014 Ibid.

1015 Ibid.

In this context, the assurance of adequate production and delivery capacity is of critical importance, as are the terms of access to resources, infrastructure, markets, finance, and technology. Such terms need to be stable and predictable to allow for a lower risk investment environment across the full range of industry activities and geographic locations.<sup>1016</sup>

By pointing to the disruption created by unpredictable regulatory changes, the IAP was supporting the Russian claim that ongoing changes on the emerging EU market – which related very much to the conditions of firm access to markets and infrastructure – created risk for its companies and jeopardized energy security. At the same time, it should also be interpreted as a reference to changes in Russian legislation that would restrict access to resources.

More significantly, the group supported the Russian focus on the causal significance of return on investment for suppliers to ensure energy security:

Producers and consumers of energy share a common interest in ensuring that adequate supplies of energy are available on a continuous basis at a competitive price providing *adequate remuneration to investors* throughout the entire supply chain.<sup>1017</sup> (emphasis added)

Without saying so explicitly, the group was supporting the Russian concern for the security of demand, which was the basis for “adequate remuneration,” as an integral part of energy security.

The group also partly legitimized the Russian claim of the importance of the state as an economic actor in the energy sector:

The state is often represented in the global oil and gas sector through the participation of a state owned oil and/or gas company in the exploration, production, refining and distribution phases. This participation may be on an exclusive basis or as one of a number of public and/or private companies engaged in the sector.

It should be noted that the majority of global oil and gas reserves are owned and produced by state owned entities. Figures for 2006 are estimated as follows:

	Non-state Companies	State Companies
Reserves		
Oil	12%	88%
Gas	10%	90%
Production		
Oil	36%	64%
Gas	44%	56%

The well-known international oil companies account in total for around 4% of global oil and gas reserves and 14% of production.<sup>1018</sup>

In citing the above figures about the role of states and private actors in energy, the group was supporting the idea that state participation in the energy business was normal. Moreover, insofar as the activity of the Western majors is indicative of the neo-liberal model (development of energy through private firms protected by law), the latter was actually quite rare. This was the

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1016 Ibid.

1017 Ibid.

1018 Ibid.

very argument that many Russians had been making in legitimizing the state's new role in the energy sector.<sup>1019</sup>

The group did not renounce market principles, but it recognized the significance of policy and the need to reconcile policy with the interests of business:

In the view of the IAP [adequate supplies of continuous and competitively priced energy] is most securely achieved through the functioning of competitive and effective markets at both the national and international level, with fair access for qualified participants throughout the supply chain.

Regarding sovereignty, markets and access, IAP believes that:

- sovereign jurisdiction should as far as possible be exercised through appropriate regulatory mechanisms *consistent with national and international policy objectives* and the operation of competitive and efficient markets;
- an appropriate *alignment of sovereign, regulatory and market interests* is necessary to ensure adequate investment flows and the desired objective of a continuous supply of energy at a competitive price.<sup>1020</sup> (emphasis added)

In so doing, the IAP was articulating a position that was remarkably close to the Norwegian argument concerning state sovereignty and state policy a decade earlier. As we saw in chapter 4, Norway contended during negotiations on the ECT that state policy was a legitimate consequence of sovereignty (expressed through state ownership of resources) and that the state would create a bargaining space to reconcile policy goals with the interests of firms participating in the domestic energy sector. Moreover, the IAP indicated that one of the specific areas where policy needed to be reconciled with the interests of business was related to adequate investment flows – a key Russian concern – to ensure energy availability.

Finally, the IAP also expressed support for the Russian goal of creating reciprocity between producers and consumers. Rather than focusing on the concept of asset swaps as articulated by Russia, the group underlined the significance of partnership and reciprocal access between firms. However, the similarity of the concepts is difficult to miss:

[T]he supply of adequate and timely energy resources is a matter of extensive interdependence and common interest in all parts of the supply chain.

....[T]his strongly suggests that all interests will be supported by a partnership approach at both the national and international level.

As commercial companies the IAP members are greatly aware of the benefits of partnership and consistently seek to develop the capabilities, knowledge and skills that allow them to contribute to effective partnership in all their areas of activity.

It is important that international mechanisms of cooperation are in place to support such partnership on the basis of the common interest in securing adequate and timely energy supply.

Reciprocal access to natural resource production and markets may be a valuable tool in extending mechanisms of cooperation to the mutual benefit of all parties. The IAP members suggest that the Energy Charter process could play a valuable role in examining the potential application of the

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1019 For example, presentation by Dr. Maria Belova, IAS, UC Berkeley, July 2007.

1020 "Communication from the IAP," December 7, 2007.

reciprocity concept and pointing towards those approaches most likely to support the objectives set out in this paper.<sup>1021</sup>

Thus, without using the term “asset swap,” the group endorsed the main policy that Russia was promoting: reciprocal access to natural resources in exchange for access to markets.

At the same time, we cannot say that in supporting many of Russia’s claims the IAP had abandoned the interests of the EU. Most likely, the group was aiming to balance its findings in a way that supported both parties. For example, the IAP noted the tension between energy security and competition/consumer interests. Rather than taking a position, the group argued that the principles needed to be reconciled:

The Industry Advisory Panel of the Energy Charter seems to have adopted a similarly cautious and balanced approach to reciprocity ...issues regarding reciprocity and the designation of some sectors as strategic may serve mainly to address concerns about security of supply, while not necessarily addressing parallel concerns about competition and consumer protection. Therefore, these two layers of concern need to be carefully integrated in a balanced way when developing strategies and policies in the energy sector.<sup>1022</sup>

The significance of the IAP discussion was not so much that they took one position over the other. Rather, it was important because the group supported and therefore legitimized many of Russia’s claims and goals, giving them status equal to many neo-liberal claims and goals within the context of the discussion.

At the same time, support from the IAP probably also reflected a more fundamental factor coming from outside of the ECH context. Concerning certain issues related to the creation of a single, competitive European natural gas market, the policy of Gazprom converges with the preferences of many national energy companies in key European states (such as Germany, Italy, and France) and therefore enjoys strong support. This can be seen in the context of the EU debate on the question of unbundling for vertically integrated companies. This was a major controversy when the EU’s third energy packet was being developed between 2007 and 2009.<sup>1023</sup>

The EC, which considered breaking up vertically integrated companies as a necessary condition to promote competition on the European market, proposed a variety of options to do this.<sup>1024</sup> One option was “ownership unbundling,” which is the strongest form of unbundling. According to this variant, a company that produced gas would not be able to also own transmission infrastructure; to comply with ownership unbundling, it would have to divest itself of the transmission system. The EC draft also created restrictions on ownership of transmission networks by actors from outside the EU; these provisions have come to be known as the Gazprom clause and were included in the final packet. Therefore, both EU energy companies and Gazprom were threatened with loss of ownership of transmission assets within the EU. It is not surprising then that Gazprom and national energy would become allies against the EC on certain questions. This was seen during the 2008 European Gas Conference in Vienna when a “high-ranking representative of a key European gas company (commenting in front of high-

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1021 Ibid.

1022 Note from the Secretariat, Reciprocity in Terms of Access for Investors and Reciprocity in Access to Markets (Investment Group Meeting, October 20, 2008), Brussels, September 1, 2008.

1023 Wim Groenendijk, “Unbundling Under the Third Energy Package,” May 17, 2009, University of Utrecht, accessed June 6, 2011, <http://www.energypolicyblog.com/2009/05/17/unbundling-under-the-third-energy-package/>.

1024 Ibid.



ranking representatives of DG competition and DG Trade and Energy) took the view that ‘ownership unbundling’ as proposed by the Commission in the draft third liberalisation package would be clear and direct ‘expropriation.’”<sup>1025</sup>

The convergence of many interests between Gazprom and several of its counterparts means that on certain questions, European business actors are sympathetic to Russian policy. There is also some indication that Russia is spearheading these coalitions. In discussing the politics of the creation of an EU gas market, Konoplyanik has stated that:

[T]he most important question is whether this model will be workable or not. It is for this reason that it might be helpful for non-EU experts to give their opinion .... By not being part of the EU, in particular Russia and Gazprom representatives, we are actually more free to speak openly on these issues than some EU business structures and member-states. They are much more dependent on the political forces of their countries and Brussels than we are.

So, we are able to talk more openly about our concerns and to give a critical assessment of the legal model that is being developed for the future gas market....In contrast to EU companies, that have no choice but to accept this model, we have the choice to accept it or take another sovereign decision.<sup>1026</sup>

The main point is that the even-handedness of the IAP communication may mask the fact that there is significant support for the Russian position among European businesses. Moreover, in certain cases EU energy companies may actually prefer Russia’s vision for organizing international markets to the EC one but may not be able to say so publicly for political reasons.

#### *The EU response: rejecting changes to principles*

Clearly, the reaction of the EU, the members of which came to compose an absolute majority of the regime during this time, was critical. In fact, adapting the regime appeared to be very much a Russia-EU bilateral affair despite the multilateral nature of the ECH. The summary record of the November 2006 Charter Conference recorded that: “[w]ith regard to the Treaty itself, the Chairman concluded that it would be prudent to await the results of the EU-Russia discussions before making any formal assessment of ways in which it could be adapted or amended.”<sup>1027</sup> The EU contested Russia’s attempt to revise the concept of energy security as conventionally understood (security of supply). This can be seen in a paper distributed by the EU two weeks before the October 2008 meeting of the SG. In the paper, entitled “Contribution of the European Community on enhancing the efficiency and effectiveness of the Energy Charter process for the Ad Hoc Strategy Group Meeting of 17 October 2008,” the EU acknowledged the importance of investment and indeed noted that the ECT’s provisions in this area were its greatest accomplishment:

The Treaty’s most significant value added...lies in its investment promotion and protection provisions. Virtually any and all of the challenges we face in the energy world today require investment for their resolution....

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1025 Konoplyanik, “A Common Russia.”

1026 “The 3rd Energy Package and the concerns of non-EU gas producers: An interview with Dr. Andrey Konoplyanik,” *Eurasia Energy Observer*, February 12, 2011, accessed June 6, 2011, <http://www.konoplyanik.ru/ru/publications/articles/476-1.pdf>.

1027 Note from the Secretariat, “Summary Record of the 17th Meeting of the Energy Charter Conference, November 20, 2006,” Brussels, January 8, 2007.

The European Community notes that the key importance of the investment climate in the energy sector was repeatedly referred to by delegations in the Ad Hoc meeting of 12 June and is also the first item cited in the paper submitted by the Russian Federation....<sup>1028</sup> (emphasis in original)

However, the EU also stated very clearly that it did not accept that energy security was related to security of demand, nor did it agree with the concept that predictable and stable markets were important:

[T]he desire by...supplying countries for security of demand...is expressed in the paper by the Russian Federation, as is the concept of predictable and stable energy markets. The European Community can only share the desire for security of energy supply and this is one of our fundamental energy objectives, along with the need for sustainable energy supplies at reasonable cost.<sup>1029</sup>

The paper also gives an indication of how the EC thought about the concerns raised by Russia on reassuring investors:

The European Community understands the need for investors in energy supply to be assured of stable access to markets for their production which can be secured through normal contractual arrangements including long term supply and transportation contracts, though it is also a fundamental belief of the Community, and set out in the Energy Charter Treaty, that this should be in a context of *open and competitive markets, which gives the greatest efficiency*. Current energy prices also indicate the strength of demand compared to supply, though excessively high prices will attenuate demand through the response of consumers. The European Community also notes that exchanges of data on supply and demand forecasts can also contribute to a greater sense of security of supply and of demand.<sup>1030</sup>

Therefore, in EC thinking, security for investors could not be subordinated to the goal of competitive markets that produced efficiency. Moreover, price signals are considered efficient and effective. It is assumed that consumers will respond to high prices with substitution. Although the importance of LTCs is acknowledged, the tension between consumers' responding to price and long term commitments to suppliers is not acknowledged. Finally, there is no mention of a potential state role in demand management.

In terms of access to resources, infrastructure, and markets, the paper only notes that the states "need to reflect more deeply on such issues and their implications and use the Energy Charter as a forum to help try to develop greater mutual understanding on these questions." Rather than propose action, the paper suggested continued discussion and exchange of views. There is no mention of the legitimacy of asset swaps.

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1028 European Commission DG Energy and Transport, "Contribution of the European Community on Enhancing the Efficiency and Effectiveness of the Energy Charter Process," Ad Hoc Strategy Group Meeting, Brussels, October 17, 2008.

1029 Ibid.

1030 Ibid.

## **The failure of adaptation: the problem of anarchy**

### *Sources of EU reluctance: preliminary examination*

Since the EU comprises the largest bloc of states within the ECH, to understand the failure of Russia's attempts I examine this other key actor. The EU proved to be especially skeptical of Russia's initiative from the very beginning. The EU resisted Russia's first official call (at the November 2006 Charter Conference) to modify the regime/Treaty within the ECH context. As we shall see, when Russia proposed to make the SG a permanent group and change the budget to do so, the EU resisted this proposal. At the same time, it allowed discussions to continue on an ad hoc basis and also agreed that a special chairman should be selected to replace the secretary general as the chair of this group. The EU also allowed for a staff member from the Secretariat to be appointed to coordinate the group's work with the other organs of the ECH. Thus, while not being a formal working group, the SG did acquire some of the functional trappings of one.

Finally, the EU continued to participate in informal discussions with Russian experts on the transit protocol. These discussions led to considerable progress and most of the substantive issues were resolved. However, the discussions never made it to the political level, and this was largely due to EU resistance. In 2006, when there was an opportunity to come to a political agreement on the TP in the context of the grand bargain, the EU balked, and one possible reason was that it did not trust Russia to keep its end of the bargain.<sup>1031</sup>

The pattern of behavior on the part of the EU was two-fold. Formally, the EU refused to acknowledge official "consultations," did not agree to the creation of a working group on strategy, and filibustered the process by demanding concrete criticisms and proposals. It also downplayed the possibility of changing the regime while highlighting the fact that Russia was not a full blown contracting party and did not have the right to initiate such a process and also emphasizing that any such process would be long and arduous. At the same time, the EU allowed for informal, ad hoc consultations to proceed on both strategy and transit, which meant that most of Russia's grievances were being heard. However, despite progress, the TP process did not move beyond the expert level. The EU was allowing debate and even the emergence of some new consensus on certain important issues (for example, transit) while blocking any moves that might actually accommodate Russia politically.

Finally, the EU expressed very clearly that it did not support amending the ECT. It felt that the Treaty provided a good base for meeting the new challenges and argued that new negotiations would be complex and lengthy. However, acknowledging that some of the views and concerns raised were legitimate, it suggested future contemplation on how to address them within the context of the regime in its present form. Similarly, it felt that creating new instruments within the regime was not necessary.

The most obvious explanation for the EU's reluctance has to do with its interests. The ECH was an EU initiative and, due to Russia's weakness in the 1990s, reflected its interests. This is certainly part of the reason behind EU reluctance to adapt the regime, but, the EU and Russia came to significant agreement during negotiations on the draft TP that also reflected

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1031 Interviews in Brussels, fall 2006.

Russia's interests and concerns. Therefore, under certain circumstances, the regime can be modified to accommodate Russia. The TP process was unique for two reasons. First, it was already ongoing at the initiative of other states (initiated by Azerbaijan in 1998; negotiations began in 2000) and consistent with regime rules for adaptation. Second, during the extended TP process (in 2003, negotiations were suspended in favor of bilateral informal consultations between the EU and Russia), the parties identified new problems and solutions. In fact, informal consultations are the vehicle for producing consensus within the regime, and in the case of the TP this has been effective.

My argument is that part of the reason the EU was unwilling to adapt the regime in the ways Russia demanded during 2006 and 2008 was due to Russia's tactics, which disregarded important procedural norms<sup>1032</sup> within the regime. The violation was two-fold. First, Russia's initiative had a "political" rather "legal" character, thereby violating the regime's procedural norms of *legality*. Second, Russia's initiative did not prioritize creating a *cognitive consensus* concerning the need to adapt the regime. These violations reveal more fundamental aspects of Russia's approach to interstate relations, which not only departed from its approach under Yeltsin but also from the approach of other ECH states. As a result, the initiative broke an important consensus within the regime about state behavior.

The tension between Russian tactics and the EU reaction reflects an inherently different view of cooperation in international anarchy. For the EU, law is an opportunity to marginalize state power and bring about cooperative relations between states in a post-anarchic world. From the Russian perspective, you cannot overcome anarchy or state power, but this does not necessarily mean states cannot cooperate. The key factor is whether states are able to accommodate one another's changing interests politically. Law is not unimportant, but it is a secondary factor. Obviously, the two perspectives are incompatible, since the Russian approach is exactly what the EU is trying to overcome. We may surmise that Russian use of state power creates anxiety for the EU, and in energy the reaction (for example, after the first Russo-Ukrainian gas war) has been to pressure Russia to ratify the Treaty. This is consistent with the value of using law to displace power and conflict and would also explain why Russia's non-ratification has been such a concern for the EU.

I have not done research on the sources of EU foreign policy, so this claim is speculative for the moment. However, there is some evidence concerning the special importance to the EU of law and the significance of following procedural norms to adapt the regime. The remainder of this chapter explores this question.

### *Formal rules for adapting the ECH*

Before delving into the regime's procedural norms and Russia's violations, it is necessary to go over the relevant formal decision-making procedures concerning regime adaptation, which are primarily elaborated in Part VII of the ECT, "Structure and Institutions." The main decision-making body of the ECH is the Charter Conference,<sup>1033</sup> which is made up of one representative from each contracting party. Article 34 actually provides for the possibility of regime adaptation

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1032 According to Finlayson et al., "guidelines regarding how states should...use decision-making mechanisms." "The GATT and the Regulation of Trade Barriers."

1033 Konoplyanik, "Energy Charter Treaty and Its Role in International Energy," 548.

through periodic reviews to evaluate the functionality of the Treaty (article 34.7) and make changes if necessary. Should it decide that changes are necessary, the Conference can authorize negotiations of declarations (34.3.i), protocols (34.3.h), or amendments to the Treaty (34.3.l). According to Konoplyanik, “[d]iscussions of questions relating to adapting the Energy Charter process to new realities on energy markets is an integral part of the charter process and takes place every five years.”<sup>1034</sup>

A review had taken place in 2004, and the next one was scheduled for 2009. However, the Charter Conference does not have to wait for a review to take action. Additionally, article 42.1 states that “Any Contracting Party may propose amendments to this Treaty.”<sup>1035</sup>

Article 36 establishes the rules for voting. Amending the Treaty requires unanimity of present and voting CPs.<sup>1036</sup> Most other decisions, including those related to the review process, require a three-fourths majority of present and voting CPs. With the exception of budgetary matters, no decision is valid “unless it has the support of a simple majority of the Contracting Parties.”

#### *Procedural norms: legalism within the ECH*

In proposing to adapt the Treaty, Russia was not in violation of the Treaty’s formal provisions for doing so. The problem was in its tactics, which violated procedural norms. The first such norm was the norm of legalism.

As a regime, the ECH is very legally oriented. The most obvious expression of this is that the centerpiece of the regime is the Treaty. In the words of Andrei Konoplyanik, the ECT is “its own sort of constitution for the Charter process.”<sup>1037</sup> The significance of the Treaty within the context of the larger regime can also be seen in the text “An Introduction to the Energy Charter Treaty,” which accompanies the actual agreement on the Secretariat’s website. In the section “Why an Energy Charter?”, after noting the regime’s original political and economic goals (overcome divisions in Europe; energy for investment), the narrative states that:

There was therefore a *recognised need* to ensure that a *commonly accepted foundation* was established for developing energy cooperation between the states of the Eurasian continent. On the basis of these considerations, the Energy Charter process was born.

More than a decade later, the role of the Charter’s legally-binding foundation,

*the Energy Charter Treaty*, remains very significant.<sup>1038</sup> (emphasis added)

Thus, the narrative by the Secretariat establishes that the foundation of the regime was the Treaty, it was a legal foundation, and it aimed to promote interstate cooperation in energy. This

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1034 Ibid.

1035 “The Energy Charter Treaty and Related Documents,” 88.

1036 With the exception of amendments that affect the Secretariat, the Conference itself, and the list of states that are entitled to transitional measures (Annex T).

1037 Andrei Konoplyanik, “Russia—EU Partnership and Cooperation Agreement and the Energy Charter,” *Political Journal* 6-7, 183-184 (April 2008): 42. Konoplyanik was still general secretary at the time.

1038 “The Energy Charter Treaty and Related Documents,” 13. The text of the Treaty is published with various other documents in the 225-page book.

is further evidenced by article 2 of the Treaty, which articulates the “Purpose of the Treaty” and states that: “This Treaty establishes a legal framework in order to promote long-term cooperation in the energy field.”<sup>1039</sup> In short, the Treaty was at the heart of the ECH regime; it established a foundation for cooperation, and this foundation was inherently legal.

In focusing on the legal aspects of interstate relations, the Treaty was in many respects a milestone in international politics. According to Bamberger et al., “[t]he Energy Charter Treaty is, together with NAFTA, the major multilateral treaty *pioneering the extensive use of legal methods* increasingly characteristic of global economic regulation.” (emphasis added)<sup>1040</sup> Because of its remarkable legal character, the ECT (with NAFTA) was at the forefront of a new strategy for international economic cooperation and governance that emerged in the 1990s. The breakthrough character of the ECH was very much connected to the fact that it was first and foremost a legal regime that aimed to depoliticize energy relations as much as possible.

This depoliticization can be seen in the substantive contents of the Treaty. One of the Treaty’s most important innovations is that it gives investors the legal right to take a state into arbitration (that is binding on the state) for, among other things, expropriation. If the investor prevails, it can claim damages as determined by the arbitrators.

Imbued by the philosophy of economic liberalism...it *breaks away* from the pattern of multilateral trade agreements by *making Governments directly accountable to aggrieved investors before non-national tribunals* for important duties specified in the Treaty....it is arguably the *most innovative* of the modern international economic treaties.

One should not forget that the *initiative underlying the Treaty* was to create an East-West *European legal framework*.<sup>1041</sup> (emphasis added)

It is clear that the strategy was to legally constrain states with respect to relations with investors. The text that accompanies the Treaty boasts that:

The fundamental aim of the Energy Charter Treaty is to strengthen the rule of law on energy issues, by *creating a level playing field of rules to be observed by all participating governments*, thus minimising the risks associated with energy-related investments and trade.<sup>1042</sup> (emphasis added)

In the areas in which these provisions apply, the Treaty reduces state sovereignty to “legal sovereignty.” As we have already seen, this is consistent with the neo-liberal perspective: the state’s primary role is making and enforcing domestic and international laws that constitute the business environment for firms; by the same token, these laws and treaties were also supposed to constrain the behavior of states and reduce political risk for firms.

The remarkably strong provisions on protecting investors clearly aimed to substitute law for politics to the advantage of private business. However, legally constraining states to displace politics went beyond protecting firms. Law was also to serve as a central element in interstate relations. This must not be overlooked. Therefore, the Treaty’s provisions on disputes between states and investors had significance not just for a state’s relations with investors but also with other states. Duchesne has remarked on how investor protections relate to interstate relations:

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1039 “The Energy Charter Treaty and Related Documents,” 44.

1040 Bamberger et al., “The Energy Charter Treaty in 2000,” 208.

1041 Ibid.

1042 “The Energy Charter Treaty and Related Documents,” 14.

[T]hanks to a rapidly expanding network of bilateral investment treaties, as well as significant multilateral treaties like the North American Free Trade Agreement (NAFTA) and the Energy Charter Treaty, as well as numerous national investment laws and countless more individual contracts, many private foreign investors now have unprecedented access to international tribunals for the direct arbitration of investment disputes with host governments.

[O]ne of the primary purposes for giving private investors a right of direct access to international arbitration is to depoliticize the dispute resolution process, with the twin objectives of reducing the potential for inter-state friction and assuring potential investors that future private claims cannot be compromised or even eliminated in the name of political expediency.<sup>1043</sup> (emphasis added)

The EU believed that legally protecting investors would promote economic activity. Just as significant, this was also connected to a broader, legal model for interstate cooperation. According to this legal model, disputes between firms and states would no longer burden relations between states. Rather, they would be resolved in international courts, and this would reduce international “friction.” In this way, law was a vehicle to “depoliticize” the energy sphere. The substitution of law for politics is very important. At the heart of the strategy was the idea that displacing politics with law would promote interstate cooperation and even security in the energy sphere. As noted by the Secretariat:

The Energy Charter Treaty provides a multilateral *framework for energy cooperation that is unique under international law*, and the strategic value of these rules is likely to increase in the context of efforts to *build a legal foundation for global energy security*.<sup>1044</sup> (emphasis added)

The significance of law also affected dynamics within the regime. It meant that the nitty-gritty of negotiations focused on the iterative drafting of legal texts, with various states and the Secretariat proposing alternative wording that would be suitable to a large number of states. It also meant that there was a premium on precise language: “[t]he wish for precise legal definitions of “the exploitation and trade with energy materials and products” turned out to be a very demanding exercise.”<sup>1045</sup> The prominence of legal considerations also meant that considerable attention was devoted to developing provisions that did not violate the existing international commitments of the states. The importance of this factor when the Treaty was being developed was emphasized by Andersen,

The relationship between the Basic Agreement and participating countries’ commitments in other agreements soon came to dominate the discussions in Working group II....

By spring 1992 the result was a comprehensive and complicated draft....alternative formulations on “trade and investment promotion and protection” was discussed on the basis of GATT reference. The chairman took the view that a choice between alternative approaches could not be decided before detailed legal texts were available. The US delegation agreed to work out such a text over the summer.

There was a need for a clear and consistent legal text which did not affect existing commitments for participating countries. This opened up the use of established concepts and language from international agreements on trade and economic co-operation.

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1043 Matthew S. Duchesne, “The Continuous-Nationality-of-Claims Principle: Its Historical Development and Current Relevance to Investor-State Investment Disputes,” *George Washington International Law Review* 36, 4 (January 1, 2004): 783.

1044 “The Energy Charter Treaty and Related Documents,” 13.

1045 Andersen, “East of Market—West of State,” 25.

The decision to accept GATT by reference in the fall 1992 was a very important simplification.<sup>1046</sup>

Making sure that the ECT was not in conflict with GATT was a major preoccupation that took considerable time and effort. In the end, the group decided that the easiest way forward was to import GATT wholesale by referring to it in the Treaty and then specifying what exceptions/differences applied within the ECH regime. This was much easier than developing the right legal language from scratch.

The concern for precision and consistency had implications not only for the pace of negotiations, but also for the types of definitions and concepts that the Treaty could contain. According to Andersen,

[D]emands for consistency, internally and in relation to other international agreements, became important disciplining factors.

...Eventually [this] model [became] reinforcing. It created new demands for consistency and compromises that were reached became vulnerable to changes later on.

...Embedded ideas, in the form of established concepts and rules, were important. The GATT by reference approach was an example of a binding logic. Formulations building on this logic were not only more legitimate, rules could also hold implications [for the future].<sup>1047</sup>

The legal character of the regime meant that much attention was paid to making sure that concepts and definitions within the regime were precise and consistent, both internally and with other agreements. In particular, the intimate connection to GATT meant that issues that emerged during negotiations had to be articulated in terms of ideas that were embedded in a pre-existing context, and this shaped what language was legitimate during negotiations. At the same time, this also created potential constraints down the road; any subsequent changes or additions had to be consistent with what came previously. Ignoring this factor threatened the very legal logic of the agreement and could lead to the unraveling of the entire regime.

Despite the fact that states had different interests, they were able to operate within this framework because of a pre-consensus on the neo-liberal approach:

[M]arket principles and established agreements on international economic conduct [were] the *only common set of values and language, embedded in international legal definitions and rules*. Negotiating energy issues within such a perspective served, in many ways, to de-politicise a number of issues that could have been difficult to deal with as energy policy.<sup>1048</sup> (emphasis added)

As Andersen notes, this pre-consensus on the neo-liberal approach (significance of market principles and law) affected relations between states during the regime building phase by depoliticizing them. In other words, questions that had the potential to lead to political conflicts were dealt with in technical terms, and solutions consisted in finding the right language or adding an annex or declaration.

However, it is also clear that within this context, states were constrained in terms of the tactics they could use to make demands. This presented them with specific strategic choices:

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1046 Ibid., 25, 32-34.

1047 Ibid., 55, 57.

1048 Ibid., 57.



In such a situation exceptions for vital interests may be sought in two ways. One strategy is to support the main perspective and views, but at the same time carefully carve out holes that provide exceptions. This approach opens up for compromises.<sup>1049</sup>

On the one hand, states could go with the flow and try to carve out legal niches that create exceptions through technical devices that are foreseen by the ECH process.<sup>1050</sup> This was the strategy used to deal with the explosive issue of the uranium trade, an unsettled question between the EU and Russia until the very end of negotiations that threatened to prevent an agreement in 1994. According to Andersen,

[E]ven Russia and the EU had problems of finding acceptable formulations concerning trade with uranium which would not undermine general GATT obligations in the last stage. It was hard to find a way out, even if it was clear that a final text had to satisfy these key actors....The solution was to postpone decisions in important areas.<sup>1051</sup>

As we have seen, the uranium question was ultimately never resolved to Russia's satisfaction and re-emerged more than a decade later. The key point here was that the issue was dealt with in technical, rather than political, terms and finally resolved through a last-minute declaration that postponed the problem to salvage the larger ECT agreement.

The other choice was to challenge the dominant approach. As we saw in chapter 4, this was the strategy chosen by Norway:

Another main strategy was to try to limit the dominance of the market model, by challenging basic assumptions of this model. To achieve exceptions in this way is very difficult, especially as negotiations reach a mature stage. Exceptions on this basis can easily create uncertainty about other parts of the agreement. The Norwegian strategy had elements of this latter strategy, especially on the issue of sovereignty.<sup>1052</sup>

The problem with challenging the main assumptions of the agreement directly was not only that it went against the conventional wisdom held by a large number of states, but there was also the technical problem of how to reconcile significant changes with what came earlier to maintain the conceptual integrity of the document. This imperative is an artifact of the legal character of the regime: the Treaty has to be precise and consistent.

In summary, the ECH regime is first and foremost a *legal* regime, at the heart of which is a treaty that is groundbreaking in its focus on binding legal provisions in the area of investment protection. This reflects the philosophy underlying the creation of the regime to substitute law for politics to depoliticize relations between states and investors and other states. Finally, the legal character shaped not only the substance of the agreement but also the dynamics of negotiations. In particular, the latter became exceedingly textually oriented. The primary focus of negotiators' attention was the wording of the agreement, and there was a premium on precision and consistency.

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1049 Ibid.

1050 Examples of technical devices include: making declarations—these are not legally binding, but they are significant because they might be examined by international courts during dispute resolution to understand intentions, context, etc.; creating an annex that provides for exceptions; using soft language (endeavor to do) rather than hard language (shall do).

1051 Ibid., 57.

1052 Ibid., 58.

The legal character of the regime facilitated compromise by depoliticizing difficult issues, which could be dealt with through technical devices within the regime or postponement. However, it also created a constraint for states in terms of what demands they could make and the tactics they could use to advance their interests. The procedural norm was to look for incremental technical solutions, prioritize the wording, which had to be precise and consistent, or postpone questions to avoid jeopardizing the larger regime.

Perhaps the most significant point is that, due to the rigors of legality, from the perspective of states the bargaining process was constrained. Once negotiations on the Treaty were closed and it came into effect, the process for modifying the regime became even more difficult since the heart of the regime was the Treaty, which had now become a part of the international legal fabric. Thus, ECH decision-making processes were characterized by a particular type of internal path dependency that was a special product of the regime's legal orientation. To stray from these norms was to go against the grain of dynamics within the regime and risk being seen as "political" within the ECH context.

*Russia's call for adapting the ECT: being "political"*

This section looks at one example of Russian diplomacy to understand how its tactics violated the procedural norms of the ECH. Within the ECH context, Russia was beginning to "call on other member states to reform [the Treaty] to new conditions."<sup>1053</sup> To preview the argument, Russia's violation was to call for changing the Treaty in general terms. This was a problem because the states were accustomed to precise incremental changes within the context of the regime that left the Treaty largely intact. By calling for "changing the Treaty," Russia was suggesting transformation of the regime and thereby disregarding the special significance of law (which the Treaty had become) within this legally oriented regime.

At the 2006 Energy Charter Conference, the Russian delegation declared that the Treaty, though still important, needed to be updated to reflect the circumstances that had changed since the time it was initially crafted. Deputy Minister of Industry and Energy Ivan Materov, who was re-elected vice-chairman of the Conference, called on participating states to begin negotiations on reforming the ECT and remarked that the provision of a higher level of energy cooperation demanded changes to the very mechanisms through which the Treaty operated.<sup>1054</sup> I have not been able to find a transcript of Materov's full remarks; however, the position of the Russian delegation can be gleaned from a summary of the proceedings:

[T]he delegation of the Russian Federation commented ...that the Treaty was drafted in the early 1990s, and... the provisions are a result of trade-offs between the negotiating parties and their wish to find a balance of interest. However...much has changed since the Treaty was concluded, creating the need to adapt and update its provisions. The approach embodied in the original agreement – access to upstream energy resources in exchange for energy investment – had lost validity at a time when the main current challenge was to encourage mutual investment among participating states...the Treaty needs to reflect a new balance of interest and to include reciprocal obligations all along the energy chain.

.... This delegation urged more attention to the interest of companies from producer states, for example in relation to transparency in downstream markets, including the EU.

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1053 Interviews in Brussels. fall 2006.

1054 Yershov, *Global Energy Security and Russia's Interests*, 203.

....This delegation also commented on the enlargement of the European Union and the conclusion of the Energy Community Treaty, which meant that three-quarters of the Energy Charter constituency now fell within the legislative reach of the European Union. This has also had an effect on the balance of the Treaty, both in terms of voting and also in terms of substance....

In concluding, the delegation of the Russian Federation underlined that the Energy Charter Treaty retains importance for Russia as the only document establishing international rules of the game for the energy sector. In order to ensure that this document reflect current realities, this delegation called on other parties to discuss a reform of this instrument, and indicated its readiness to participate in this process at expert level and at political level.<sup>1055</sup>

From Russia's perspective, the world had changed since the Treaty was created. Not only had energy markets shifted to favor sellers over buyers, but Russia and Europe had changed as well. As a result of these changes, new interests and challenges had emerged.

For example, the dominant formula according to which the initial Treaty was crafted, "Western investments for access to Eastern resources," was outdated. Now investments flowed in both directions. European companies wanted to invest in Russian natural resources. However, now Russian companies wanted to invest in European infrastructure and markets, but they faced barriers to doing so. From the Russian perspective, since the Western flow of investment was a relatively recent development,<sup>1056</sup> it was not adequately addressed by the Treaty. Russia was suggesting that changes were needed to facilitate "the ability of companies from producer countries to be able to invest in downstream markets, including the EU,"<sup>1057</sup> and it was proposing to adapt the Treaty to embody "reciprocal obligations all along the energy chain." To strike a balance of interests in this new setting, it was necessary to change the Treaty, which reflected the period in which it was created. By implication, not to do so would be to ignore Russia's interests.

By arguing that the world had changed and as a result the ECT needed to be changed, Russia was making a major demand that violated the norms of legality, which prescribed that states make incremental, specific, and technical changes cognizant of what had come previously within the regime.

The difference in approaches can be seen in the exchange between the EU and Russia that followed the Russian presentation:

The delegation of the European Union recalled that it has ongoing discussions with the Russian Federation on the draft Transit Protocol, but is not discussing amendments to the Energy Charter Treaty. Any additional process aimed at amending the Treaty would certainly be a lengthy one, and this group of delegations requested clarification from the Russian side as to what sort of amendments it might be seeking.<sup>1058</sup>

In response, Russia stated that:

[A] first specific priority was to complete the Transit Protocol. This delegation said that its remarks regarding the possibility to adapt or amend the Energy Charter Treaty should be seen as a

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1055 Note from the Secretariat, Summary Record of the 17th Meeting of the Energy Charter Conference, 6.

1056 Actually, Gazprom had been trying to invest downstream since 1991. That spring, despite lobbying by the Soviet government, Gazprom was not allowed to participate in the privatization of the East German natural gas company.

1057 Note from the Secretariat, Summary Record of the 17th Meeting of the Energy Charter Conference, 6.

1058 Note from the Secretariat, Summary Record of the 17th Meeting of the Energy Charter Conference.

*general observation rather than a specific request*, but that this was a discussion that should begin in order to make the Energy Charter more effective.<sup>1059</sup> (emphasis added)

From the EU response, it is clear that they saw modification to the Treaty in specific, technical, and incremental terms. With its reference to the draft TP, the EU was noting that the ECT was already in the process of being adapted through an additional legal agreement, which was provided for in the Treaty. Beyond that, the EU wanted clarification: What did Russia have in mind? A new protocol? A series of amendments?

By contrast, for Russia, the specifics were less important than the idea of changing the regime to accommodate the new situation and its new interests. The difference in the two approaches is a question of incremental change within the regime (adaptation) and major change of the regime (transformation). However, because incremental change had become institutionalized into the regime through the norms and practices of decision making, the disagreement is also one about process.

In response to Russia's initiative, the 2006 Conference decided to convene an additional group – the SG – to discuss strategic issues related to the Charter. Summaries of the discussions and recommendations would then be conveyed to the Charter Conference, which met at the end of each year. This was a compromise solution since the group was ad hoc and would discuss strategy rather than begin negotiations as Russia wanted.

At the first meeting of the SG the following April, Russia again raised the issue of modifying the agreement. According to the summary record of the proceedings,

While recognising that the Treaty has played an important role, this statement asserted that the Treaty needs to be adapted in the face of new challenges, and called on other members to discuss reform of the Treaty.

...[T]he Energy Charter Treaty was negotiated and signed in a different economic and energy environment, when conditions were broadly in favour of consumers of energy, and when the former communist countries were faced with a shortage of funds for investment. While energy remains subject to market principles, the balance has shifted from a buyers' market to a sellers' market. Seen against this background, the Treaty was like a photograph from the past; it is a framework that has been used and from which all have benefited, but which *now requires modification both in terms of mechanism and of philosophy*. This delegation felt that *the Treaty should reflect the new balance between producers and consumers, and between security of supply and security of demand*, in which, for example, *support for liberalisation was accompanied by recognition of the importance of long-term contracts as a guarantee of energy security*.<sup>1060</sup> (emphasis added)

Again, Russia pointed to the fact that circumstances had changed since the Treaty was concluded and that it needed to be adapted to re-establish a balance of interests. Furthermore, not only was Russia proposing the need for new mechanisms (that is, rules), but also a new philosophy that entailed new concepts. One new concept in particular included a modified understanding of energy security that included security of demand and acknowledgement of the importance of a variety of market mechanisms (types of contracts). Again, these are political demands that do not necessarily acknowledge the special nature of international law and prioritize consistency with what came previously.

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1059 Ibid.

1060 Secretariat, Summary Record of the Meeting, Ad Hoc Strategy Group, April 23, 2007.

The summary documents reveal that the reaction to the substance of Russia's initiative was mixed. However, no delegation agreed that the Treaty needed a major overhaul, as Russia was suggesting. Moreover, all the proposals that were made to meet Russian concerns reflected that the other states were looking for change that was of an incremental, technical character. The other states wanted within-regime adaptation, not major transformation.

One delegation<sup>1061</sup> argued that the process of reform in the East was indeed significant, and so it preferred the Charter process to become a forum for policy discussions. Another delegation agreed that “the time is right to take stock of strategic steps for implementation of the Charter Treaty” and argued that specific provisions needed to be “developed further.” As examples, it raised several questions that were already being negotiated in the draft TP. It also noted that:

There is a need for the Charter to reflect geopolitical changes and the importance of the Caspian region for energy security, and this delegation argued that – while there is *no need to re-write the Treaty* – there may be the need to revisit certain issues and provisions.

This delegation urged attention to transit risks for energy exporters, and welcomed in this context the work on the *Charter's Model Agreements*. With regard to investment, this delegation suggested a focus not only on issues of the investment climate but also on investment policies, supply-demand scenarios, and the impact of industrialised country policies and company activities on the accessibility of financial resources.<sup>1062</sup> (emphasis added)

In pointing to geopolitics, this delegation made explicit what was implicit in Russia's statements: the balance of power had changed since the 1990s. It also pointed to the problem of transit risk, which was a Russian concern as well. To deal with this, it referred to the Charter Model Agreements, which were non-binding documents that already existed within the regime. This was the type of technical, incremental solution that could generate broad consensus (partly because it was non-binding) to which the states had become accustomed.

Further, it pointed to issues related to investment that needed to be addressed. Here, its comments are on par with those Russia was making: the investment regime was inadequate. Although it agreed that “revisiting” the Treaty's provisions was merited, it also made clear that reform would be limited. Thus, its ambitions were modest; even when part of the regime was clearly inadequate, this needed to be addressed incrementally through the tools that the regime offered, not by “rewriting” the Treaty.

The most conservative reply pointed to the need for specific written proposals and consensus:

One delegation said that it can acknowledge some relatively minor issues in relation to the Treaty, but noted that if there are more substantial concerns from other delegations then these should be *put in writing*. Modifying or adapting the Treaty would be a long-term undertaking, and it was important to gauge opinion on this issue and to see whether there were pragmatic solutions to the problems identified.<sup>1063</sup> (emphasis added)

Another delegation suggested that the group refer to the political declaration that preceded the Treaty:

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1061 This document did not reveal the names of states. However, the comments make it obvious when the delegation represents Russia. It is not possible to divine which other states are speaking.

1062 Ibid.

1063 Ibid.

In looking for possible areas of cooperation, one delegation referred back to the 1991 Energy Charter, which enumerated areas of potential cooperation among the signatories including gas, coal, electricity, technology transfer, nuclear issues, emergencies and the transfrontier consequences of accidents.<sup>1064</sup>

This comment is interesting because it shows that at least one delegation was willing to look beyond the Treaty to the political declaration that preceded it. In fact, as we saw in Chapter 3, the political declaration had taken a back seat to the legal agreement before the former was even signed in 1991. However, it pointed to an instrument that already existed within the regime. Ultimately, change had to be consistent with what came previously. By contrast, for Russia, a different political declaration and one that was outside the ECH regime (the 2006 G8 statements) had become a more important reference point.

Finally, the summary comments of the secretary general are perhaps the most revealing:

[T]he Secretary General noted that one delegation in particular, supported to a degree by others, was in favour of launching a new reading of the Treaty, with a view to its modification and adaptation. He emphasised that this was not a minor matter, and that, before member countries can react, they need to have a *clear understanding of the ambitions and wishes of the countries concerned*. The starting point for this debate must therefore be clarity on current positions, in order that all delegations can react and so that there can be a proper assessment of the support for moving in any given direction. A second stage would be a discussion on procedure, and *the means by which any shared concerns can be reflected in the text of legal agreements or in the activities of the Charter*.

The Secretary General concluded by recalling that the Secretariat has considerable flexibility in the Charter process to put emphasis on different aspects of the Treaty, but *that legal modifications would be a different undertaking and would require a careful assessment*.<sup>1065</sup> (emphasis added)

In outlining how to proceed, the secretary general opened a window for understanding the norms of the decision-making processes within the regime. Adaptation requires specific arguments and consensus. Procedure is important and also requires consensus. Moreover, the instruments of change have to be within the context of the regime. There is some leeway for accommodation, but solutions that touch on the legal substance of the regime have a special place. Ultimately, changing the legal text – the Treaty – could not be taken lightly.

In 2009, the secretary general spoke publicly about the possibilities of reforming the ECH regime to accommodate Russia. Again, the necessity to preserve the integrity of the Treaty as much as possible was obvious. According to Yershov,

The GenSec [General Secretary] acknowledged the necessity to take a “fresh look at the ECT in order to try, without putting into doubt the value of the existing text, to fortify the document, by for example, giving it new goals and directions.” Acknowledging the reluctance to fundamentally change the ECT, Mernier nevertheless admitted that the Treaty “must and can be adapted to the changing world.” Possible paths, in the opinion of Mernier, could be the adoption of additional protocols, declarations, interpretations, and others.<sup>1066</sup>

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1064 Ibid.

1065 Ibid.

1066 Yershov, “The Energy Charter Treaty and the National Interests of Russia (part two),” 7.

The difficulty of changing the Treaty and the preference for alternative solutions have also been noted by Konoplyanik:

The Energy Charter framework contains a number of different facilities:

- (1) the Charter as a policy forum: transparency, reporting, discussions, etc.;
- (2) non-binding instruments: guidelines, benchmarking, recommendations, policy coordination, model agreements, declarations;
- (3) legally binding instruments: protocols, amendments to the Treaty, association agreements.

All these instruments are at the disposal of member countries, although negotiations and implementation become more complex as they become more binding. Thus Treaty amendments are not the only instruments to adapt the current Treaty to the realities of the changing world.<sup>1067</sup>

The foregoing has shown that the norms of process within the regime demanded incremental, technical solutions to accommodate states while preserving the body of law embodied in the Treaty largely intact. Russia's "sin" was to make general political demands that implied radically transforming the Treaty. In so doing, it was disregarding the special legal character of the ECH regime, the status that this gave the Treaty in that context, and the norms of state behavior that this implied.

#### *Sequencing of action: the importance of generating consensus*

Russia's second violation of procedural norms was that it disregarded the appropriate sequencing of action that other states expected. Sequencing was particularly important because it created an opportunity for states to generate consensus based on compromise. This allowed initiatives to move forward, albeit in a compromised form. One example of this is that Russia called for changing the Treaty before generating a consensus that the Treaty needed to be changed.

Before any change could be made to the Treaty, a broad consensus was required. Amendments to the Treaty formally require unanimous consent among the states, a very high threshold, indeed. However, the Treaty also normatively prescribes consensus for any action: "[t]he Contracting Parties shall make every effort to reach agreement by consensus on any other matter requiring their decision under this Treaty. If agreement cannot be reached by consensus, paragraphs (2) to (5) shall apply."<sup>1068</sup> Voting rules that do not require unanimous consent do exist for certain issues; however, states were supposed to strive for full consensus. Creating consensus meant feeling out the positions of other states and mobilizing support through persuasion and relations with allies.

Russia was not opposed to consensus or compromise; in fact, it insisted that reciprocity was at the heart of its initiative. However, adapting the ECH regime was an urgent goal; Russia was looking for instruments to promote its foreign energy policy goals (and the commercial

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<sup>1067</sup> Konoplyanik, "A Common Russia-EU Energy Space."

<sup>1068</sup> Article 36.1, The Energy Charter Treaty and Related Documents, 85.

interests of its energy companies, most notably Gazprom) in a challenging and quickly changing environment.<sup>1069</sup>

Russia wanted to begin a process to adapt the Treaty immediately. Its diplomats and experts did try to promote change according to the established norms. Its delegations attended meetings, made proposals, and argued their case to generate a consensus. However, its demands were urgent, and so it called for change before a consensus had emerged. From the perspective of other states, it did not engage in the due diligence necessary to generate consensus and violated the procedural norms concerning sequencing (make your case to generate consensus, create support, and then call for change backed by a large constituency). The responses of other states to Russia's initiative have been described by Yershov: "[a]nother [response] is that first you have to identify all the new problems and risks which world energy has encountered, and then make decisions about changing the ECT."<sup>1070</sup>

Yershov also laid out what he saw as the most promising way for Russia to change the agreement. First, Russia should raise its demands during the regular five-year review in 2009, which would create a legitimate context for discussions about adapting the agreement. However, for the initiative to be successful, Russia would still have to build support:

This requires serious preparatory work on the part of the Russian delegation, which will have to be armed with convincing arguments to advance constructive proposals. It will be necessary to bring on board in advance our allies who are members of the ECT to fortify the Russian position.<sup>1071</sup>

Konoplyanik, who was deputy secretary general during the height of Russia's efforts to transform the regime, has written at length about the necessity to convince other parties of the legitimacy of Russia's demands for updating the agreement:

The position of a host of other countries (the EU in particular) is that first, they do not want to talk about, in advance, without discussions, the possibility of introducing changes and amendments into the ECT as this might predetermine the outcome of future negotiations. The necessity of this kind of change has to be proven. Everyone understands that at the base of discussions lie realities... that have been legitimately identified by Russia. Discussions will give an opportunity to understand which new risks are emerging on different markets and how it might be possible to address them through collective efforts.

And only after achieving a consensus on this question will it be possible to begin discussions about what concrete instruments from the package available to ECT member states (both legally binding and non-binding) are most suitable to the multilateral society for the minimization of concrete risks, that have appeared on the markets of ECT member states.<sup>1072</sup>

From the perspective of the procedural norms of decision making, Russia was putting the cart before the horse; it was calling for change to the Treaty before it had made sufficient arguments to convince other parties that any changes were in fact necessary. Moreover, it was proposing the most radical measures possible within the ECH context (changing the Treaty), when many other measures were potentially available for addressing these concerns:

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1069 In this respect, contemporary developments related to the expansion of the EU, which I will discuss shortly, were critical.

1070 *Investments in Russia* 1 (2009): 5.

1071 *Investments in Russia* 6 (2009): 8.

1072 Konoplyanik, "Energy Charter: On Understanding and Trust."



In the opinion of many countries, it would be counterproductive, before the new risks have been identified and as a minimum matched up with this or that article of the Treaty, to today predetermine in a conference decisions the use of the most radical instrument – introducing changes into the ECT itself. But this is exactly how the other states interpret the proposal from the Russian side.<sup>1073</sup>

Ultimately, the norms for adapting the regime dictated that a dissatisfied state had to begin a lengthy process whereby it convinced the other states of the validity of its concerns and accepted solutions that did not change the entire Treaty.

The entire multilateral society of the Charter must by all means consider the well substantiated criticisms of the ECT by the Russian side. If the Russian side is able to convince the entire multilateral society of the Charter of their validity, it will be necessary for all the countries to find together practical means to address them without reviewing the entire ECT, which is a sort of constitution for the Charter process. The ECT itself provides for a number of possibilities for this.<sup>1074</sup>

By contrast, Russia just came in and made demands to change the Treaty, and this was illegitimate from the perspective of state behavior within the regime:

The member states of the Energy Charter come to the conclusion that for Russia the outcome of discussions about rewriting the ECT is a foregone result, even though Russia has not even presented to the other countries an exhaustive list of the shortcomings that it feels the ECT contains.<sup>1075</sup>

Another example of Russia's jumping the gun on change was related to the status of the SG. Since the Conference only met annually, the SG was an important arena for debating the need to reform the ECH. After the first meeting (April 2007), as a direction forward, Secretary General Ambassador André Mernier, who was the chair, proposed an additional meeting, asked for written proposals, and underlined that the focus should be on policy rather than legal questions. The ultimate goal was to have both an understanding of the issues at stake and ways to resolve them.

In August, in advance of the second, supplemental meeting of the SG, Mernier wrote to all the members and observers of the ECH that, pending the outcome of the discussion on "The response of the Energy Charter to new challenges and opportunities on international energy markets," he planned to propose to the annual Charter Conference, which was scheduled to meet in Istanbul on December 7, the adoption of a "Political Declaration on the Energy Charter in a New International Energy Environment."<sup>1076</sup>

Such a political declaration was consistent with the incremental approach within the regime. A party (in this case the secretary general) would propose a text. The other parties would examine the text, communicate objections, and propose alternatives. Where agreement was lacking, a position paper would be circulated to convince others of a particular perspective.

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1073 Ibid.

1074 Konoplyanik, "Russia-EU Partnership and Cooperation Agreement and the Energy Charter."

1075 Ibid.

1076 Ultimately, the secretary general did not propose such a declaration to the Istanbul conference. As we saw earlier, the Istanbul conference also had to consider the Russian procedural proposal to create a new working group and adapt the budget. The Russian proposal was not accepted. It is not clear if the secretary general refrained from presenting his declaration because he was pre-empted by the Russian proposal or because there would not have been enough support for it among the other states.

This too would solicit a response from other states. The parties would then play with different formulations of the wording to find a compromise that accommodated as many states as possible (ideally, all of them). Although the initiator's formulation is diluted and goals are compromised, consensus can emerge and a declaration is made. The declaration then becomes the reference point for the next incremental step, which may have more legal significance: beginning a protocol or making an amendment.

The supplemental meeting of the SG was held on November 19, 2007, in Brussels. During the meeting, Russia proposed a written statement to be adopted as a declaration by the Charter Conference. The statement proposed to begin consultation on updating the ECT, transform the SG into a permanent working body of the Conference that would coordinate consultations, and amend the 2008 budget to support this change. As a justification for the initiative, the statement declared that:

Bearing in mind a radical nature of changes in the energy sector, which have taken place after the Treaty's signature,

Desiring to find the most adequate ways to meet new challenges and threats to world energy today,

Wishing to improve the Treaty efficiency in the new conditions and optimize its mechanisms with a view to addressing a common task of improving security of energy supply,

Proceeding from the need to take into account interests and opinions, and to ensure a balance of interests of all participants of the Treaty.<sup>1077</sup>

Moreover, the delegation "underlined its aim at this stage to reach a common understanding on the principle of holding consultations, and to initiate the process of holding such consultations."<sup>1078</sup> So, not only was Russia still calling for major changes to the ECT, it was taking concrete steps in that direction: creating a group for negotiations and changing the budget to do so.

Russian diplomacy within the ECH context was also coordinated with public statements coming from the political level. During an interview in November with the magazine *Itogi*, Russian Minister of Industry and Energy Khristenko again pointed to the need to modify the ECT: "[w]e are ready to ratify the charter, but in a new version that answers contemporary realities."<sup>1079</sup>

Again, the reactions varied in level of sympathy for Russia's substantive claims, but Russia's wish to take immediate action was not reciprocated. The other states' reactions reveal a strong preference for taking an incremental, within-regime approach to adaptation. In addition, there was strong resistance to actually modifying the Treaty.

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1077 Russian Delegation, Proposal on Conference Decisions, Ad Hoc Strategy Group, November 19, 2007, Brussels.

1078 Secretariat, Summary Record of the Meeting, Ad Hoc Strategy Group, November 19, 2007, Brussels, November 22, 2007.

1079 "Who is left on the pipeline? Interview with Minister of Industry and Energy of the RF, Viktor Khristenko," *Itogi*, November 1, 2007, accessed on June 3, 2011, <http://v2009.minprom.gov.ru/appearance/interview/74/print>.

One delegation<sup>1080</sup> agreed that the “efficiency of the Treaty [Transit] provisions ... [were] a matter of concern since Charter principles are not always observed by all member countries” and suggested that the conclusion of the TP be prioritized. This delegation also agreed that the situation had changed, but that investment issues needed to be considered “not only from the perspective of external investors, but also based on the needs and requirements of host governments.” Ultimately, it recognized arguments in favor of strengthening some of the provisions in the ECT, but noted that “it was too early to draw any conclusions on substance, and that any proposals would require careful consideration in capitals.” Still another delegation noted that finalizing the Transit Protocol would “create a platform for consideration of other issues.”<sup>1081</sup>

Another delegation noted that some of the interpretation or clarification issues raised by Russia could be addressed without amending the Treaty. It also argued that forming a permanent standing body would “require careful consideration,” and it did not see the need to “re-open the draft budget for 2008.” This position on the budget was supported by another delegation.<sup>1082</sup>

Another delegation insisted that Russia would have to submit “complete and detailed proposals” for consultations to be held. As a first step, it suggested that Russia “state in writing which Treaty articles it sees as incomplete or as causing difficulties, including explanations and possible ideas for how to move things forward.” After careful consideration, it would become clear whether it was possible to address “legitimate concerns...[without] amend[ing]... the Treaty.” On this point, it was supported by a number of other delegations that expressed their support for the ECT as is, and claimed that it was “premature to mention the possibility of amendment in a Conference decision.” Concerning a Conference decision in December, the delegation noted that it was ready for consultations; however, any decision should not prejudge the outcome of consultations. At the same time, it recalled that it had previously expressed its general satisfaction with the ECT. Moreover, it may be possible to address the concerns without amending the treaty, which would be “difficult and time-consuming.”<sup>1083</sup>

The most critical reaction was from a delegation that contested the analysis of new challenges and suggested that the interpretation of challenges shaped what sort of remedies were to be sought:

[One] delegation referred back to the analysis of new challenges, and suggested that conclusions on substance would depend to a large degree on this analysis. A focus on energy security, such as that suggested by the Russian Federation, would lead to the strengthening of certain provisions, but other challenges can also be identified, such as the need for efficient and competitive markets, which would lead to different proposals for example on mandatory third-party access, and the need to combat climate change, which could lead to stronger provisions on energy efficiency.<sup>1084</sup>

Overall, although some states were sympathetic to Russia’s call for reform, no state actively supported Russia on actually beginning a process to change the Treaty. In fact, a “sizeable constituency” felt that given what a “struggle it would be to agree on a common framework” for adaptation, the group should be grateful for the document that already

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1080 The summary document only mentions specific states when the issue raised is specific to that state.

1081 Secretariat, Summary Record of the Meeting, Ad Hoc Strategy Group, November 19, 2007.

1082 Ibid.

1083 Ibid.

1084 Ibid.

existed.<sup>1085</sup> Ultimately, the ECH regime members' position was very conservative, and this was significant since Russia's call for reform was urgent. Thus, while Russia wanted negotiations to begin immediately – it was calling for the creation of a working group and a change in the following year's budget to do so – the other states wanted proposals and informal discussions. From Russia's perspective, the other states were filibustering its initiative.

At the end of the discussion, the secretary general, who was chairman of the SG, stated that “this was an important proposal and presentation from the Russian Federation, which would require thorough consideration”<sup>1086</sup> and promised to try to find a way forward at the Istanbul Conference. Several days later, the Secretariat sent a memo that summarized the work of the SG, mentioned the Russian written proposal, and referred members to the actual document. However, rather than transmit Russia's request, it proposed that the conference approve a “conclusion” that “welcomed the discussion... on new challenges and risks in international energy markets” and requested that the SG continue consultations in 2008 that “identify those challenges which the Treaty and Energy Charter process can most efficiently address, to consider how these challenges can influence the development of the Energy Charter, and to report back to the next meeting of the Conference on the outcome of its discussions.” Moreover, this work in 2008 would take into account the regular five-year review scheduled for 2009. Therefore, the secretary general was proposing a compromise since there was no consensus on implementing Russia's proposal for creating a permanent group and beginning negotiations.

The 18<sup>th</sup> meeting of the Energy Charter Conference was held in Istanbul on December 7, 2007. According to the summary documents, the secretary general communicated to the Conference Russia's wish for an examination of the Charter “to ensure that its work corresponded to the current reality of the energy sector” and the concerns that it raised during the November SG meeting regarding new security challenges as well as ambiguities in the Treaty. He also noted that, while there were no specific proposals concerning possible changes to the Treaty, Russia had proposed a procedural change, “that another Group should coordinate consultations on this subject.” Finally, he communicated the positions of the other delegations: there was strong reluctance to begin a process to amend the Treaty, but there seemed to be a general readiness to “review specific initiatives from the Russian delegation.” He also recommended that Russia submit specific proposals in writing. At the same time, he pointed out that debate within the SG needed to be carefully structured “particularly in view of the caution of various delegations concerning the commencement of new legal negotiations, especially while the Transit Protocol is still being negotiated.”<sup>1087</sup> Finally, he commented that new steps have to be taken on the basis of the important existing ECH foundation. The secretary general's position was a synthesis of all the views within the group; the modus operandi was to work by consensus through compromise.

In terms of what actions to take moving forward, he underlined that the conference was asked to make a decision concerning procedure rather than substance and noted that “while it was too early to predict the outcome of this debate, it was important to take a constructive approach.” He also suggested that since the SG was no longer in its start-up phase and had

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1085 Interview in Brussels, fall 2006.

1086 Secretariat, Summary Record of the Meeting, Ad Hoc Strategy Group, November 19, 2007.

1087 Note from the Secretariat, Summary Record of the 18th Meeting of the Energy Charter Conference, December 7, 2007, Brussels, March 17, 2008.

“demonstrated its potential,” the Conference should replace him with a chairman from among the member states “as with other Groups of the Energy Charter.”<sup>1088</sup> It seems that the secretary general was trying to strike a delicate balance between Russia’s wish to begin a discussion on changing the Treaty (by creating a new group that would begin consultations) and the obvious reluctance of many other members to make such a commitment.

The discussion following his presentation saw comments from several participants. The EU “expressed doubts whether the Ad Hoc Strategy Group should be made permanent at some point in the future.” However, since the SG had been successful it supported the idea of replacing the chairman “as is the normal practice with Groups under the Charter process.” Japan and Ukraine stated a preference for calling the work in the SG “discussions” rather than “consultations” to distinguish this work from negotiations on the TP. Kazakhstan and Azerbaijan also noted the need to distinguish between these two processes.<sup>1089</sup>

At the conclusion of the Conference, there was general agreement concerning replacing the chairman. However, the proposed Russian declaration was not adopted, so the group did not become permanent nor did the budget change. Instead, the Conference agreed to reconvene the group and charged it with the task of “identify[ing] the new challenges in the energy sector” and “consider[ing] in which way the Energy Charter Process and its instruments can most efficiently respond to such challenges.”<sup>1090</sup>

Thus, the Russian proposal for a declaration and procedural changes had failed. A compromise emerged that would allow ad hoc discussions but with a dedicated chairman to replace the secretary general. However, the other consequence of Russia’s proposal appears to be that it pre-empted the secretary general’s proposal for a political declaration. The sequencing of Russian diplomacy was wrong. The modus operandi was to have a statement of principles and then initiate negotiations. Russia had skipped the first step, which was important for generating the necessary consensus to make negotiations possible.

### *Overcoming anarchy? law vs. politics*

To be fair, the rules and norms for adapting the regime created a very conservative arrangement. In a sense, the Charter Conference resembles a very conservative, domestic legislative body. It is even more conservative than the US Senate, where a 60-vote majority (out of 100) is sufficient to advance even the most controversial initiative. Even modifying the US Constitution does not require unanimous consent.

The decision-making design of the ECH means that the adaptation process has the potential to be lengthy and cumbersome. As changes become more significant, they are also likely to be more difficult and less feasible. Moreover, because all changes had to be consistent with a Treaty that could not be cardinally modified, it is likely that some of Russia’s demands simply could not be accommodated. If a change was inconsistent with the Treaty, it was out of the question no matter how much effort Russia expended in arguing for its merits.

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1088 Ibid.

1089 Ibid.

1090 Ad Hoc Strategy Group, Discussion paper reflecting contributions by delegates at the meeting of June 12, 2008—Meeting New Challenges in International Energy Markets, Brussels, June 12, 2008.

There is an irony here: in crafting a regime that “depoliticized” interstate relations in energy by replacing politics with law and consensus, the designers actually created a regime in which it would be difficult to accommodate a powerful state that was dissatisfied with the status quo. This points out an important divergence in states’ understanding of international relations and how to promote cooperation between states.

The bottom line with respect to Russia’s initiative to adapt the ECH regime is that Russia neglected the significance of the Treaty as a founding legal document for the regime and the importance attached to this by the other states and particularly the EU. Additionally, it was less concerned with process than outcome, and this affected the importance it attached to generating consensus. Russian delegates did make arguments and proposals and try to convince their counterparts of the merits of their case. However, these actions came after a strident call for change and never quite came to the level of precision and conceptual rigor that a piece of international law embedded in a larger system of international law required.

To boil it down, for Russia interests were more important than the sanctity of law and legal processes. This kind of approach created problems within this legally oriented regime. During a presentation at the conference “Energy Security and EU-Russia Relations,” the next to last point made by Tim Gould, a senior adviser at the Charter Secretariat, was that “Russia...need[s] to accept that there are benefits associated with binding commitments, due process and procedures.”<sup>1091</sup>

On the other hand, the EU’s response missed the fact that Russia felt it got a raw deal in the 1990s and wanted a new one. Times had changed, Russia’s position had changed, and so had its interests. The ECH and Treaty did not fulfill its needs, and so for cooperation to proceed they had to be changed. Russia was prepared to be accommodated through any number of legal or non-legal means. For Russia, the Treaty was an instrument of cooperation that was less important than the relationships and political agreement between the states. Adapting the regime meant concluding a political bargain with the other states and particularly with the EU, which comprised a majority of the members of the Conference. This is not to say that law is not important. However, the political deal comes first and is at the center of cooperation. Once states agree on a bargain, drafting the legal text merely consummates the deal. In any case, the text is not etched in stone. By contrast, for the EU, the Treaty and the rules – both substantive and procedural – that they established were the very essence of cooperation.

This divergence in approaches is indicative of profounder differences in thinking about interstate relations. For the EU, states could overcome anarchy and cooperate through contractual commitments that constrained their behavior. This is at the heart of the neo-liberal perspective, which sees laws as constraining the state with respect to both domestic and international society. Contractual commitment – law – is the only way to get beyond power politics and anarchy, which are dangerous.

For Russia, states cannot overcome anarchy. International politics is fundamentally based on power and interests that contracts cannot overcome. This was a lesson learned by many Russian elites during the 1990s.<sup>1092</sup> However, cooperation can occur through mutual accommodation. States are not locked in, in the sense of a contractual commitment. They are

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1091 PowerPoint document from personal collection.

1092 Interview with Sergei Karaganov in Moscow, spring 2009.

only constrained by power and recognition of other states' interests. Changes in power and interests mean that accommodation has to be dynamic for cooperation to prevail over conflict. Ultimately, whether cooperation occurs depends on the relationship between the states: can they accommodate each other? In the ECH context, Russia's call to adapt the ECT reflected a will to begin a discussion about how to perpetuate cooperation by giving Russia, which was now in a better situation than in the 1990s, a better deal. Legal texts and procedures were secondary to beginning a discussion that would culminate with a new cooperative bargain. For the other states, however, the Treaty in its current form was the very foundation of cooperation.

Finally, it is clear that the neo-liberal strategy from the 1990s – to legally constrain the state with respect to both firms and other states and displace power politics with law to promote cooperation – had failed. Regardless of the fate of the ECH regime, the transformed Russian state resisted the notion of sovereignty as only legal sovereignty. By contrast its predecessor under Yeltsin embraced this understanding which was at the heart of Russia's strategy to integrate into international society during the 1990s. When law came into conflict with its interests, as a sovereign state in the sense of Hobbes (an actor above which there is no authority, not even international legal authority), Russia decided that its interests prevailed.

## **Summary**

This chapter has examined the period from 2006 to 2008, when Russia began a serious effort to transform the ECH regime to accommodate its interests. Russian policy touched on almost every aspect of the regime. Ultimately, it was unsuccessful, and preliminary evidence suggests that part of the reason was related to Russia's tactics, which violated important procedural norms that reflected the EU vision for cooperation to overcome anarchy, a vision that Russia no longer shared. In short, Russia's proposal was too controversial, which is consistent with the expectation for a state with a mercantilist identity (and regime maker role identity, specifically). The next and last chapter examines the period from 2009 to 2010, when Russian policy became even more controversial with respect to the ECH.

## **CHAPTER TEN: REGIME CHANGE – THE 2009 RUSSO-UKRAINIAN GAS WAR, THE YUKOS CASE, AND RUSSIAN ECH POLICY (2009 TO 2010)**

### **Overview**

In the previous chapter, we saw that beginning in the fall of 2006 and through 2008, Russia pursued an ambitious initiative to adapt the ECH regime by trying to update the ECT. Many states were sympathetic to Russia's call to adapt the regime to reflect contemporary realities that differed significantly from the 1990s. Its initiative also found a sympathetic audience among business participants in the Charter regime (the IAP) and had a significant effect on the work of the Secretariat. In addition, Russia and the EU made significant progress during unofficial expert consultations on the draft TP. By coming to agreement on several questions related to the transit of natural gas, these talks were able to address many of Russia's most significant concerns (related to the commercial interests of Gazprom) pending a final, multilateral political agreement on the TP.

At the same time, Russia's call to begin immediate negotiations on revising the Treaty itself received no support from other states. This reaction was partly due to the central place of the Treaty within the regime and the path-dependent and cumulative character of international law. An additional reason for the reluctance expressed by other states was Russia's tactics, which violated several of the procedural norms that had emerged in the regime. In particular, Russia's call for adaptation was radical rather than incremental, the latter being the dominant *modus operandi* within the regime. Relatedly, Russia called for significant substantive changes before generating a cognitive consensus that such changes were really necessary. Finally, the EU was particularly resistant to modifying the principles of the regime to accommodate the expanded understanding of energy security that Russia was proposing. This was significant because, by then EU states made up a majority within the ECH conference. Overall, Russia's attempt to adapt the regime to suit its own interests was unsuccessful.

To formally change the Treaty required unanimous consent. Other instruments to adapt the regime also demanded very large majorities of states. Ultimately, from a procedural perspective, the decision-making rules made the ECH regime extremely conservative. Therefore, independently of Russia's tactics and the preferences of any particular ECH member state, Russia's call for adaptation of the ECH regime and the Treaty in particular faced practically insurmountable obstacles. We might conclude that Russia's call for adaptation was predestined to fail due to the very nature of the regime. At the same time, progress related to the draft TP suggests that adaptation is possible, but it is very difficult and time consuming. Certainly the time frame associated with adaptations of the order that Russia was proposing did not meet Russia's needs, which were urgent.

The years 2009 and 2010 saw two significant developments in Russian ECH policy. First, beginning in 2009, Russian policy shifted yet again. Starting in January, the Russian leadership became publicly extremely critical of the ECH. In addition, at this time Russia began arguing at the highest level of state that either the ECT needed to be significantly modified or a brand new document for governing the international trade of energy needed to be created to replace it.



In mid-April, during a visit to Helsinki, President Medvedev announced that he would distribute a document, “which defines issues of cooperation in the sphere of energy, including proposals on a transit agreement.”<sup>1093</sup> The following day, the presidential administration published a new document, the Conceptual Approach to the New Legal Framework for Energy Cooperation (Goals and Principles) on its website<sup>1094</sup>; I am calling this the “April Concept.” During an interview, Presidential Adviser A. Dvorkovich stated that the new document was being proposed as an alternative to the ECT. In this way, Russia was taking action to create a new, alternative framework, as the president had suggested in January.

By late 2010, the April Concept had evolved into the Draft Convention on International Energy Security. Russia began promoting its new framework in a variety of international venues including the OSCE, UN Economic Commission for Europe (UN ECE), bilateral relations with the EU, and the ECH. In principle, the ECH regime continued to be a viable setting for working with other states to create a new framework to govern international energy relations. However, it was by no means the only one.

In summary, this first development, what I am calling the Convention process, represented an important escalation in Russia’s policy to promote its interests in the energy sphere. During 2006 to 2008, Russia called on other member states to update, modify, or amend the Treaty to address contemporary realities that had changed significantly since the Treaty was developed. Russia was calling for regime transformation.

Beginning in January 2009, Russia asserted that if the Treaty was not changed, a totally new document would be needed. Moreover, this position was announced in a very public way by the president himself and later seconded by Prime Minister Putin. Previously, Russia had not gone so far as to propose scrapping the Treaty entirely. In addition, the ECH regime became one of several potential settings for energy cooperation as Russia began venue shopping to create support for its new initiative. Therefore, without repudiating the ECH regime entirely, Russia was sketching the outlines of a policy to replace the ECH regime rather than simply adapt it. The first development was that Russian policy aimed at regime *transformation* was gradually, but not yet irrevocably, turning into policy aimed at regime *change*.

The second development began at roughly the same time that the April Concept was unveiled. In April 2009, the Russian leadership began to publicly disavow that Russia had ever undertaken any obligations to the Treaty at all. This position reached its apogee on July 30, 2009, when the Russian government issued ordinance number 1055-r, terminating its provisional application (PA) of the ECT. Less than a month later, on August 24, 2009, Russia informed the Energy Charter depository, the government of Portugal, of its intention to not become a contracting party to the agreement. As provided for by the Treaty (Article 45.3.a), Russia’s PA of the Treaty – which had been in effect for over a decade – was formally terminated sixty days later, on October 20, 2009. According to Konoplyanik, the leading supporter of the ECH regime

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1093 “Russia's Medvedev offers to rewrite energy rules,” *AFP*, April 20, 2009, accessed December 9, 2011, <http://www.google.com/hostednews/afp/article/ALeqM5jAMWC32kFZY8-NxF9CvBtLfL2aRw>.

1094 Conceptual Approach to the New Legal Framework for Energy Cooperation (Goals and Principles), April 21, 2009, accessed on May 31, 2011, <http://archive.kremlin.ru/eng/text/docs/2009/04/215305.shtml>.

in Russia, this represented a “step backward”<sup>1095</sup> in Russian policy toward the regime. I will refer to this second development as the PA process.

This chapter examines the reasons for these two shifts in Russian ECH policy. The timing of events suggests that the two processes have separate origins. To preview the argument, the main factor that precipitated the Convention process (the creation of a new document to replace the ECT and the emergence of venue shopping to promote it) was the second Russo-Ukrainian gas war. This second and much more serious conflict with Ukraine provoked a very critical reaction toward the regime from Russia, which argued that the ECH was ineffective in preventing the crisis and needed to either be significantly modified or replaced. This culminated in the proposal of the April Concept and the later Convention, which Russia began promoting in a variety of international venues that included the ECH. Nevertheless, in the immediate aftermath of the gas war, Russia did not focus on its legal commitments under the ECT, and there was no suggestion that it was on the verge of terminating PA. This emerged toward the end of April, a few months after the gas war.

Why did Russia begin emphasizing that it was not legally bound by the Treaty and then suspend its provisional application of the ECT? This particular shift in Russian policy is related to a second endogenous factor within the ECH process: international arbitration over the Yukos case. The majority shareholders in Yukos had taken Russia to arbitration for expropriation as provided for by the ECT. Before the merits of the case could be evaluated, the panel had to decide a key procedural question: did the Yukos affair actually fall under its jurisdiction? In fact, Russia had argued that the panel did not have jurisdiction since it had never ratified the ECT. However, by the spring of 2009, it was becoming clear that the arbitration panel was preparing to give a ruling and that it was going to decide that the Yukos case did fall under its jurisdiction because Russia had been applying the Treaty on a provisional basis. In other words, the panel was going to reject Russia’s argument that it was not bound by the ECT because of its non-ratification. Therefore, Russia was going to lose this first critical stage of arbitration, and the fact that it had been applying the Treaty on a provisional basis was the pivotal factor behind this decision.

This outcome meant that the arbitration case could be considered on its merits and that Russia could be found liable for damages. With potential compensation estimated to be between \$30 and \$100 billion (depending on when expropriation is determined to have taken place), this is the largest damages claim in the history of international arbitration.<sup>1096</sup> Ultimately, Russia’s decision to suspend PA was related to this preliminary but significant decision against it in the Yukos arbitration.

At the same time, despite public pronouncements that it was not bound by the Treaty and its termination of PA, Russia continued to participate in the Energy Charter process. In fact, termination of PA meant that Russia’s status within the regime became identical to that of Norway, Iceland, and Australia: it had signed both the 1991 political declaration and the ECT but was not applying it on a provisional basis. This meant that Russia could continue to endeavor to adapt the ECH within the context of the regime. This is significant because it means that a

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1095 Andrei Konoplyanik, “Russia and the Energy Charter: a long and tortuous path toward each other,” *EKO - All Russia Economics Journal* 12 (2010): 114.

1096 Ibid., “Yukos Could Bankrupt;” Malskyy, “Energy Charter Treaty: a backup plan for investors?” Markiyani M. Malskyy is an attorney-at-law with Arzinger & Partners; Goldhaber, “A Lifetime of Litigation.”

revised ECH can still be the basis for cooperation between the EU and Russia and thus can still fulfill its original purpose. However, it appears that this is contingent on the regime being modified to Russia's satisfaction. At the same time, since Russia is promoting its Convention as a framework for cooperation in alternative settings, the ECH is no longer the only potential multilateral international instrument for governing energy relations between Russia and the EU.

The first goal of this chapter is to examine why, by 2010, the ECH regime that was supposed to integrate Russia and Europe in the energy sphere as a way to generate cooperative and peaceful post-Cold War relations had ultimately failed to fulfill its purpose. To the contrary, the ECH had not integrated Russia with Europe; Russia never ratified the ECT; and in 2009 it suspended its PA of the agreement. Russia was also proposing what was essentially a new arrangement and promoting it in multiple institutional venues. Most surprising was that energy relations between the EU and Russia were now worse than they had been between the USSR and Western European states during the Cold War.

The second goal is to show that Russia continued to behave as a regime maker. This is true even though the top leadership had changed and the new president appeared to have more liberal credentials than his predecessor. Moreover, the 2008 economic crisis hit Russia more severely than other states. Even though this created expectations that Russian policy would turn in a direction that resembled the Yeltsin approach from the 1990s, in fact, Russian ECH policy was not only characterized by continuities, it actually became more assertive. This supports the claim that, although leadership and external economic constraints are important, ultimately they are mediated by societal ideas about the state that become institutionalized into the state apparatus.

## **Organization of chapter**

The first section examines the second gas war between Russia and Ukraine in January 2009 and compares it to the first. It then examines the immediate Russian reaction to the crisis relative to the ECH. This analysis focuses on Russia's legal critique of the ECT and its political critique of states within the ECH as well as the leadership of the Secretariat. Examining these separately demonstrates the importance of the political aspect of the regime to Russia. The second section examines Russia's attempt to propose a new framework for energy cooperation. The third section explores Russia's termination of PA and the role played by the Yukos case. The section that follows examines the evolution of President Medvedev's Concept and also Russia's venue shopping. The last section examines developments within the ECH and in particular the attempt to modernize the regime after the second gas war.

## **The second Russo-Ukrainian gas war and Russian ECH policy**

### *The Russo-Ukrainian gas wars: 2006 vs. 2009*

The 2009 gas conflict between Russia and Ukraine was lengthier and therefore more consequential than the first conflict three years earlier. The 2006 conflict broke out on January 1, 2006, when Gazprom announced that it was reducing the amount of gas it was sending westward to the volumes contracted for by European customers only (in other words, no gas for

Ukraine). On the first day of the conflict, European customers experienced a drop in pipeline pressure and non-delivery. According to Stern,

The fall in volumes delivered to European Union countries caused an outcry all over Europe. By January 2, Hungary was reported to have lost up to 40% of its Russian supplies; Austrian, Slovakian and Romanian supplies were said to be down by one third, France 25-30% and Poland by 14%. Italy reported having lost 32 million cubic metres, around 25% of deliveries, during January 1-3. German deliveries were also affected but no further details are known.<sup>1097</sup>

Stern has attributed the gas shortfall in Europe to Ukraine's diversion of gas in transit (for EU customers) to make up for its own shortfall.<sup>1098</sup>

On January 2, Gazprom announced that it would pump additional gas volumes westward to "compensate for the Ukrainian withdrawals."<sup>1099</sup> A day later, gas delivery in Austria and Hungary was back to normal levels, although there were still shortfalls in other countries. On January 4, Gazprom and Naftogaz signed a five-year contract that ended the dispute. The outcry in Europe had created sufficient pressure for both parties to come back from the brink; reason prevailed, and the dispute was settled quickly. According to Konoplyanik,

Initially, a compromise looked almost impossible in view of the wide gap between the initial positions of both sides....<sup>1100</sup>

[The] solution had to be found first in the practice of the countries' mutual relations and on a tight schedule. The fact that the parties were able to find such a workable solution under very stressful conditions is to their enormous credit.<sup>1101</sup>

By that time, deliveries to Europe were already back to normal levels as far as can be ascertained. Stern has evaluated the overall effects of the crisis, which were relatively benign:

The dispute had lasted 4 days, three of which had resulted in shortfalls to European supplies.

...No EU country needed to interrupt supplies to customers as a result of the reduction of Russian supplies.<sup>1102</sup>

By contrast, the gas dispute in 2009 lasted much longer, and this contributed to its severity.<sup>1103</sup> After talks broke down between Gazprom and Naftogaz on December 31, 2008, Gazprom cut off shipment of gas to Ukraine (90 mcm) the following morning. At the same time, Gazprom also claimed that it had increased the amount of transit gas destined for European customers (300 mcm per day).<sup>1104</sup> However, several EU states reported a shortfall in delivered

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1097 Jonathan Stern, "The Russian-Ukrainian gas crisis of January 2006," *Oxford Institute for Energy Studies*, January 16, 2006, 8.

1098 Ibid.

1099 Ibid., 8-9.

1100 A. Konoplyanik, "Breaking with the past," *Petroleum Economist* (March 2006): 21.

1101 "The Gas Transportation System of Ukraine and Russia Has Always Been Unified (interview with A. Konoplyanik)," Conversation with Svetlana Dolinchuk, 24 December 2008, *Oil, Gas & Energy Law Intelligence* 7, 2 (May 2009): 2.

1102 Stern, "The Russian-Ukrainian gas crisis of January 2006," 9.

1103 The winter in 2009 was also colder than 2006, creating more demand for gas. At the same time, demand for gas was down overall due to the economic downturn in the wake of the 2008 global financial crisis.

1104 "Russia fully cuts gas to Ukraine, ups supplies to Europe," *RIA Novosti*, January 1, 2009, accessed December 9, 2011, <http://en.rian.ru/world/20090101/119302144.html>.

gas immediately.<sup>1105</sup> On January 5, Prime Minister Putin approved a Gazprom proposal to reduce the amount of gas to transit via Ukraine by the amount missing from the pipeline (65.3 mcm of gas). Future deliveries would also be reduced on a daily basis to compensate for missing gas.<sup>1106</sup> As a result, on January 7, all gas flows through Ukraine stopped.<sup>1107</sup>

The conflict was finally resolved at the political level on Sunday, January 18 after talks between Prime Ministers Putin and Timoschenko.<sup>1108</sup> Gas shipments to and through Ukraine were restarted two days later (January 20) after the two companies signed a gas supply agreement on January 19.<sup>1109</sup> Overall, the gas dispute lasted 18 days, and no shipments of Russian gas passed through Ukraine for 13 days.

The consequences of the conflict were severe and tragic. The states most affected were, not surprisingly, in Eastern Europe (which is more reliant on Russian natural gas than states in Western Europe), where both consumers and industry suffered. According to a report by the European Commission DG for Energy and Transport:

The event triggered emergency situations in most Eastern EU Member States, and led to the worst gas crisis ever experienced.

In countries most dependent on this gas flow, consumers had to rely on alternative means of heating their houses, such as electricity and, in places even, wood-burning. For industrial customers in Bulgaria, Romania, Hungary and Poland where major shortages occurred, demand simply had to be reduced.

... [T]he incident called into question the reliability of Russia and Ukraine as, respectively, supplier and transit countries, and inspired reflection on how better to assure EU external energy security.

... [M]ore action is [called for] with regard to the promotion of the rapid development of infrastructure for the EU's energy needs, by encouraging both diversity of energy sources and supply routes.<sup>1110</sup>

Bulgaria, Romania, and Greece were particularly badly hit:

[T]he largest falls in gas consumption in January were recorded in the Member States which were the worst affected by the gas dispute. In January 2009 Bulgaria, Romania and Greece experienced consumption reductions of 38%, 30% and 27% respectively. The corresponding reductions in natural gas imports were 54% for Bulgaria, 86% for Romania and 23% for Greece.<sup>1111</sup>

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1105 "Russia to cut Ukraine gas supply," *BBC News*, January 5, 2009, accessed December 9, 2011, <http://news.bbc.co.uk/2/hi/europe/7812368.stm>.

1106 Ibid.

1107 "FACTBOX—18 countries affected by Russia-Ukraine gas row," *Reuters*, January 7, 2009, accessed December 9, 2011, <http://www.reuters.com/article/2009/01/07/uk-russia-ukraine-gas-factbox-idUKTRE5062Q520090107?sp=true>

1108 "Gas to flow' after Moscow deal," *BBC News*, January 18, 2009, accessed December 9, 2011, <http://news.bbc.co.uk/2/hi/europe/7834796.stm>.

1109 "Russia and Ukraine sign gas deal," *BBC News*, January 19, 2009, accessed December 9, 2011, <http://news.bbc.co.uk/2/hi/europe/7836736.stm>.

1110 Market Observatory for Energy, European Commission, *Quarterly Report on European Gas Markets 2*, 1(January-March 2009): 18-19.

1111 Ibid., 2.

The crisis also took a significant human toll. For example, during the crisis, the Hungarian government reported that some forty people died as a result of heating systems that malfunctioned (due to a lack of gas pressure) amidst frigid temperatures.<sup>1112</sup> In Bulgaria, schools and other public buildings were closed due to lack of heat.<sup>1113</sup>

According to Commissioner Andris Piebalgs, the crisis had a profound effect on the European citizenry: “[The crisis] will be remembered...by many citizens who are using natural gas to heat their homes and who were deprived of their fuel of choice and convenience.”<sup>1114</sup> EC President Barroso called the crisis “unacceptable and incredible” and told the European parliament that failure to honor supply agreements would mean that Russia and Ukraine could no longer be considered dependable.<sup>1115</sup> In short, the gas war in 2009 was longer and more severe, and this had a significant effect on the EU and its estimation of Russia as a reliable energy partner.

### *The Russian reaction: the political bankruptcy of the ECH*

The second gas crisis also had a significant effect on Russian ECH policy. According to Yershov,

I would even put it this way: the January crisis *bankrupted Russia's trust in the ECT* as a valuable instrument for the regulation of international economic relations in the area of energy security.

It is equally well known that in Russia, both during the conflict and after its conclusion, the urgent need to develop a new Energy Charter or modify the old document was remarked on several occasions.<sup>1116</sup> (emphasis added)

This claim is also supported by Konoplyanik, who has given a more elaborate account of why the crisis changed Russia's position with respect to the ECH:

With the Russian-Ukrainian gas crisis in January 2009, there was an expectation that the Energy Charter would act. However, the Energy Charter was silent prior to and during the crisis. In my personal view, my country's leadership was very disappointed by the Energy Charter's passive role. They *criticised the ECT for lacking a mechanism* that would allow to inform about such emergencies [during or beforehand] in order to prevent them.<sup>1117</sup> (emphasis added)

Thus, Russia was dissatisfied with the ECT and the larger ECH regime because it did not play a productive role in preventing the crisis.

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1112 “Eastern Europe Faces Freezing Temperatures and Russian Gas Cut-Off,” *Voice of America News*, January 15, 2009, accessed December 9, 2011, <http://www.voanews.com/english/news/a-13-2009-01-15-voa5-68762507.html>.

1113 “EU warns of legal action over gas,” *BBC News*, January 14, 2009, accessed December 9, 2011, <http://news.bbc.co.uk/2/hi/europe/7827829.stm>.

1114 *Quarterly Report on European Gas Markets*, 1.

1115 Oleg Shchedrov and Yuri Kulikov, “EU premiers plead with Ukraine and Russia for gas,” *Reuters*, January 14, 2009.

1116 “The ECT can be preserved, but... (interview with Y. Yershov and A. Mernier),” *Heft' Rossii* 5 (2009): 88; see also Yershov, “Global Energy Security and New Recipes for Its ‘Treatment,’” 3.

1117 “The 3rd Energy Package and the concerns of non-EU gas producers: An interview with Dr. Andrey Konoplyanik,” *Eurasia Energy Observer*, February 12, 2011.

*Russia's legal critique of the ECT*

At one level, Russia's reaction represented disappointment with the substance of the Treaty as a legal document that prescribes action. From Russia's perspective, the Treaty lacked articles that would trigger action to effectively prevent this kind of crisis.<sup>1118</sup> In fact, the Treaty does not have a strong triggering mechanism to deal with transit conflicts. According to Article 7, conciliation within the Charter context only begins after "the exhaustion of all relevant contractual or other dispute resolution remedies previously agreed"<sup>1119</sup> between the parties. Articles 7a and 7b stipulate that conciliation is triggered only after a contracting party notifies the secretary general. That conciliation depended on the will of states and was not an automatic response to the crisis was for Russia a substantive flaw in the ECT.

A more general problem was that the ECT was not designed to deal with emergencies. Thus, even its strongest provisions – related to the protection of investments – which *do* have significant teeth can take many years to produce a result. By the same token, state-to-state arbitration under Article 26 (for which the draft TP does provide) can also be a lengthy procedure. I am calling this the legal critique of the ECT because it relates to missing (meaning, no automatic trigger) or inadequate (for example, dispute settlement is too lengthy) provisions in the Treaty as a body of law.

That the ECT as a legal document was not well equipped to deal with the crisis appears to be one interpretation that has prevailed within the Secretariat, which has understandably been put on the defensive by Russia's accusations. This can be seen in a Russian interview with Secretary General Andre Mernier:

Journalist: [A]n ...opinion has been expressed...about the ECT – it totally did not work during ...the Russo-Ukrainian dispute....

Mernier: [T]he Treaty, which today is almost fifteen years old, has never been ...applied for the rapid resolution of emergency situations.

Thus, it would be fundamentally unjustified to expect that the ECT can resolve problems for which it was not intended.<sup>1120</sup>

This point of view has also been expressed by ECT supporters in Russia such as Yershov.<sup>1121</sup>

*Russia's political critique of the ECH regime as a collection of states: inaction in the EU*

At a deeper level, Russia's disappointment with the ECT was also a political critique of the whole regime: not just the Treaty, but also the Secretariat and the member states. This grievance was specifically addressed to the EU members of the ECH and also the Secretariat for their behavior in the context of the crisis situation. According to Konoplyanik:

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1118 Yershov, "Global Energy Security," 3-4. Yershov notes that there are no mechanisms for fast action or effective sanctions to discourage transit states from interrupting the flow of energy materials through their territory.

1119 The Energy Charter Treaty and Related Documents, 49.

1120 "The ECT can be preserved," 86. While it may be true that the Treaty was not intended to deal with emergencies, the reader will recall from Chapter 3 that a major initial goal of Lubbers' 1990 initiative was to deal with an emergency: the economic crisis in the USSR, which was undermining Gorbachev politically and jeopardizing reforms in the USSR.

1121 Yershov, "Global Energy Security," 3.

Criticism of the ECT by the top Russian leadership ... is ultimately connected to...the Russo-Ukrainian gas crisis (January 2009). The first red flag concerning the ECT emerged at such a high level during the course of the Russian – Ukrainian gas crisis in January. The reason for the criticism was Ukraine’s violations of the transit provisions of the ECT, the lack of an adequate appraisal of this violation on the part of the European Union and the states that comprise it, and the inaction of the political leadership of the Secretariat of the Energy Charter.<sup>1122</sup>

The view in Moscow was that once the crisis started, Ukraine was in obvious violation of the Treaty’s Article 7 on transit. As a result, Russia expected EU members of the Charter regime to acknowledge this violation, intervene in the dispute, and compel Ukraine to ensure uninterrupted gas transit to Europe.

Russia would have preferred that EU states intervene before the conflict broke out. At a minimum, any EU state or the EU itself could have initiated the conciliatory procedure that exists within the regime after it was obvious that the parties could not come to an agreement on their own and that security of supply for consumer states was in jeopardy as a result. However, no state invoked this procedure. In the words of Mernier, “only member states have the right to initiate the procedure for the resolution of transit disputes provided for by the Treaty. However, in this concrete case, not one of the parties affected by the crisis relied on the procedure.”<sup>1123</sup> For Russia, the problem was not just the inadequate contents of the Treaty (the legal critique), but also that there was too little political will on the part of the EU to intervene in the dispute, acknowledge violations, and enforce the Treaty.

From the Russian perspective, the conflict between Gazprom and Naftogaz over payments, supply prices, and transit tariffs was old news. It was made particularly clear that the EU was not just a bystander after the first gas war in 2006 when EU states were affected, albeit minimally due to the short duration of the conflict. The EU response to the crisis at the time suggested that Europe understood its vital interests were at stake.

However, the conventional wisdom at the time was that Russia was “bullying” Ukraine after Yushchenko, a Ukrainian nationalist and market liberal who was portrayed as a “reformer” and “Westernizer” during and after the Orange Revolution, became president in 2005. According to Abdelal:

Gazprom’s preferred narrative, in which an irresponsible Ukrainian leadership unraveled existing contracts willy - nilly and then blackmailed Gazprom for a discount, found few sympathetic ears in the West. Anger and exasperation at the behavior of the Ukrainians and the unfairness of the Western reaction gripped Alexander Medvedev, Deputy Chairman of Gazprom and head of Gazprom Export, as he reflected on the conflict several months after the incident. Medvedev ardently emphasized “in the interest of truth” that “Europe was not switched off” and that “Ukrainians kept taking gas as much as they needed.” As for the decision itself, Medvedev posed a rhetorical question: “What should we have done if they had not come back to the talks before the New Year?”

Instead it was Ukraine’s narrative that dominated Western media and policy making circles: Gazprom, an instrument of the Russian state, was being used as a weapon to punish politically disloyal neighbors for making new friends in the West. Russia’s reputation as a

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1122 Andrei Konoplyanik, “Energy Charter: If You Destroy It, You Can’t Modernize It,” *EKO: All-Russia Economic Journal* 2, 440 (February 2011): 122 (part 2).

1123 “The ECT can be preserved,” 86.



reliable supplier of gas, a reputation built by the Soviet gas industry even during the Cold War, at the height of fears of mutual nuclear annihilation, was tarnished in a matter of days.<sup>1124</sup>

In this respect, Western reactions to the 2006 gas war were similar to those that prevailed during and in the immediate aftermath of Russia's war with Georgia in 2008. As a result, the lesson in Moscow was that it needed to do a better job of making its case and not allow its adversary to dominate international public discourse. In other words, it needed to be more PR savvy.

Negotiations over the terms of trade for 2009 started well before January.<sup>1125</sup> As early as the third week of November, Gazprom and President Putin announced that if a new agreement was not reached before 2009, gas prices for Ukraine would rise to \$400/mcm and that if interference with transit occurred, supplies to Ukraine would be cut off.<sup>1126</sup> Subsequently, Gazprom communicated to its EU partners and the media in early December that “the Ukrainian payments situation represented a serious threat to supply.”<sup>1127</sup> Several weeks later, Gazprom sent letters to EU leaders and the heads of gas importing states to warn them that “disruptions of Ukrainian transit were possible.”<sup>1128</sup> In assessing Gazprom's PR campaign, Pirani et al., argued that,

Gazprom's performance in the 2009 crisis compared well with its lamentable performance during the January 2006 crisis, where little was said publicly, and its (relatively coherent) commercial case for a higher price was drowned out by accusations that it was using energy as a political weapon against Ukraine's Orange Revolution and its president, who Moscow had desperately tried to prevent coming to power. The company handled the 2009 crisis much more professionally. *In mid-December 2008, as debts were mounting and warnings were being issued about the likelihood that supplies would be cut off, with potentially adverse consequences for European supplies, a Gazprom delegation headed by Alexander Medvedev (no relation to the president), one of the company's Deputy CEOs and head of Gazprom Export, toured European capitals – including Brussels. He explained the situation and warned of potential problems.* On December 29, as it was becoming clear that deliveries to Ukraine would probably be affected, Gazprom opened a website for the crisis – Ukraine facts – which carried daily reports of meetings, press conferences, and the company's version of events as they unfolded.<sup>1129</sup>

Additionally, although an “Early Warning Mechanism” was created after the 2006 crisis, the mechanism “was simply ignored” during the second crisis.<sup>1130</sup> The Secretariat was aware that negotiations were going poorly and issued a statement on December 23 recalling the principle of uninterrupted transit. According to Pirani et al., “This could be construed as a reminder to Ukraine of its obligations under the Energy Charter Treaty, which it has signed and – unlike Russia – ratified.”<sup>1131</sup> However, the EC made no attempts to intervene;<sup>1132</sup> rather, it waited until

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1124 Rawi Abdelal, “The Profits of Power: Commercial Realpolitik in Europe and Eurasia,” Working Paper 11-028, October 12, 2010, 21-22.

1125 For a detailed account, see: Simon Pirani, Jonathan Stern, and Katja Yafimava, “The Russo-Ukrainian gas dispute of January 2009: a comprehensive assessment,” *Oxford Institute for Energy Studies* (February 2009).

1126 *Ibid.*, 16.

1127 Abdelal, 24.

1128 *Ibid.*

1129 Pirani et al., “The Russo-Ukrainian gas dispute,” 31.

1130 Dr. Fraser Cameron, “The Politics of EU-Russia Energy Relations,” *The EU-Russia Centre Review, EU-Russia Energy Relations* 9 (June 2009): 21.

1131 Pirani et al., “The Russo-Ukrainian gas dispute,” 16.

1132 *Ibid.*

after the conflict had erupted to take action. Even then, the EU response was laconic. During the early stages of the dispute, EU Commission spokesman Ferran Tarradellas stated that there was no immediate danger to EU consumers or industry.<sup>1133</sup> It was also clear that the EU did not want to intervene in a dispute that it portrayed as bilateral. This is supported by media accounts of action behind the scenes in Europe; the BBC claimed that according to correspondents, “the EU is reluctant to get involved in what it describes as a commercial dispute.”<sup>1134</sup>

On January 6, after pipeline pressure in Europe had dropped and a day before all gas shipments through Ukraine stopped, an EC spokesman stated that:

[W]ithout prior warning and in clear contradiction with the reassurances given by the highest Russian and Ukrainian authorities to the European Union, gas supplies to some EU member states have been substantially cut - this situation is completely unacceptable.

The Czech EU presidency and the European Commission demand that gas supplies be restored immediately to the EU and that the two parties resume negotiations at once with a view to a definitive settlement of their *bilateral* commercial dispute.<sup>1135</sup> (emphasis added)

The claim that the gas shortfall was unexpected is inconsistent with the pattern of events leading up to the conflict. Moreover, the EU portrayed the dispute as bilateral despite the fact that the EU itself was predictably suffering collateral damage. Finally, the EU was not prepared to legitimate Russia’s position that it was Ukraine’s interruption of transit that precipitated the crisis in Europe.

Interestingly, during his presentation to the European parliament on January 14, a week after all gas stopped flowing through Ukraine, Commission President Barroso advised lawmakers that “If the agreement sponsored by the EU is not honored, the Commission will advise EU companies to take this matter to the courts.” Meanwhile, Putin stated on the same day that “In my view, European officials could do more to put pressure on the transit country to ensure European interests.”<sup>1136</sup> Again, the EU was emphasizing non-political procedures (such as the courts) for dealing with the crisis, while Russia was focusing on interests, power, and political action.

After the crisis became critical, the EU finally began working to broker a deal. Arrangements were made for international monitors to evaluate how much gas was going in the pipeline from Russia and leaving from Ukraine, something that could have been negotiated much earlier. But by that point, for Russia, it was too little, too late. European supply was interrupted with grave consequences, and Gazprom’s public reputation in Europe as a reliable supplier was badly damaged.

Despite working toward a practical solution to the conflict, the EU continued to blame both Russia and Ukraine and began issuing threats against both. On January 16, EC spokesman Johannes Laitenberger stated that:

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1133 “Russia to cut Ukraine gas supply.”

1134 Ibid.

1135 “European gas supplies disrupted,” *BBC News*, January 6, 2009.

1136 Shchedrov and Kulikov, “EU premiers plead with Ukraine and Russia for gas.”

If the gas is not flowing next week we will have to look point by point, at our relationship with Russia and Ukraine and whether we can continue to do business as usual under these circumstances.<sup>1137</sup>

In particular, the media reported that a series of sanctions was being considered against both parties:

A senior Commission official confirmed that the EU might halt talks on a new trade and aid partnership agreement with Russia as well as withdrawing support for Moscow's entry to the World Trade Organisation.

Ukraine's ambitions to join the EU and negotiations over an energy co-operation charter could also be a casualty of the dispute.<sup>1138</sup>

Russian proposals for resolving the crisis were also rebuffed.<sup>1139</sup> After the Russian prime minister proposed that a consortium of European companies pay for the gas Ukraine required to power its transit system (technical gas),<sup>1140</sup> an idea that European companies supported,<sup>1141</sup> it was “greeted with scorn in Brussels.”<sup>1142</sup> The EU replied that, “Next they'll be asking us to pump the gas and pay for the pipelines.”<sup>1143</sup> In fact, an agreement for an international consortium (that included Russia, Ukraine, and EU partners, specifically Germany) to manage the Ukrainian pipeline system (and thereby effectively pump the gas and pay for the pipelines) was put in place in 2002, although it was never implemented.<sup>1144</sup> Finally, when Russian President Medvedev proposed a trilateral summit in Moscow to resolve the issue, Czech Prime Minister Mirek Topolánek, holder of the EU's rotating presidency, stated that he would not be “summoned to Moscow”; instead, the EU pledged to send a “low ranking delegation.”<sup>1145</sup> At the same time, EU diplomats expressed concern that the summit was a delay tactic.<sup>1146</sup>

The combination of the EU's late response, its focus on the bilateral nature of the conflict, its rejection of various Russian attempts to resolve the crisis, and its refusal to recognize the merits of Russia's claims meant that from the Russian perspective, the EU was not cooperating to resolve the crisis.

To understand how the actions of EU states are connected to the Russian critique of the ECH regime, we can ask what good is a regime, the centerpiece of which is a Treaty that has the status of international law, if the states that are parties to it do not acknowledge when the treaty is violated, invoke its provisions when doing so is critical, and are incapable of enforcing its provisions, even when their own vital interests are at stake? For Russia, the ECH regime was

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1137 Bruno Waterfield, “Europe threatens Russia and Ukraine with sanctions over gas crisis,” *The Telegraph*, January 16, 2009.

1138 Ibid.

1139 European companies were putting pressure on Gazprom to resolve the crisis. Pirani et al., “The Russo-Ukrainian gas dispute,” 24.

1140 It appears that the idea originated at the Oxford Energy Institute. Ibid., 23, 24.

1141 Isabel Gorst, Chris Bryant, and Roman Olearchyk, “Eni leads push for gas consortium,” *Financial Times*, January 16, 2009.

1142 Waterfield, “Europe threatens Russia.”

1143 Ibid.

1144 Simon Pirani, “Ukraine's Gas Sector,” *Oxford Institute for Energy Studies* (June 2007) 73.

1145 Waterfield, “Europe threatens Russia.”

1146 Ibid.

bankrupt because the European states that composed it did not have the will to take political action to support it when doing so was most urgent.

Although he was not referring to EU states specifically, Konoplyanik has made explicit the significance of political will for the ECH to function effectively during critical moments:

[C]riticism of the Energy Charter was based on its inability to act as a “crisis management” vehicle. The Charter does possess some instruments to address “crisis management” (such as the conciliatory procedure for transit dispute settlement) but the parties never activated those procedures.

In order for the instruments of the “Energy Charter” to be implemented prior to or in the course of a crisis, three components need to be available:

- (1) the availability of relevant instruments of the “Energy Charter” and appropriate triggering procedures;
- (2) the *willingness* of the parties in dispute and/or touched by the consequences of the dispute to trigger and use the relevant instruments;
- (3) the competence, capability, readiness and willingness of the political leadership of the relevant administrative bodies of the “Energy Charter” to act accordingly in the given circumstances.<sup>1147</sup> (emphasis added)

Component one relates to the contents of the Treaty as a legal document that prescribes action in the context of the crisis; this was the subject of Russia’s legal critique. The second component points to political considerations: whether or not states are willing to use the instruments that are available, which we have discussed here. The third component refers to the reaction of the organization, which we examine in the next section.

*Russia’s political critique (part two): leadership, organizational incapacity, and the ECH regime*

As we just saw, Russia’s critique also concerned the ECH as an organization, namely the Secretariat. Russia expected the Secretariat to anticipate developments and intervene on its own initiative to prevent the crisis in advance. The Secretariat did speak out in December when negotiations were going poorly; however, as Mernier noted, the Treaty did not actually provide formally for the Secretariat to intervene forcefully in such a situation. Russia expected significant action from the Secretariat anyway given the gravity of the situation. According to Konoplyanik,

[T]he Secretary General denied the very possibility of advanced action on his part saying: “Only the Member States have the right to initiate a procedure under the dispute resolution mechanism of the Treaty. The Secretariat does not have this mandate.” This is correct, with the letter of the Treaty, if the crisis was not prevented and is already in place. But the political leadership of the Secretariat in line with both the spirit and letter of the Energy Charter also needs to take advanced proactive actions to do its best to prevent the crisis.<sup>1148</sup>

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1147 Andrei Konoplyanik, “A Common Russia—EU Energy Space: The New EU-Russia Partnership Agreement, Acquis Communautaire and the Energy Charter,” *Journal of Energy & Natural Resources Law* 27, 2 (2009): 288.

1148 Konoplyanik, “A Common Russia,” 288 fn. 85.

[The Secretary General also] stated that “The Treaty... has never had as its aim to resolve immediate crisis situations” ...[this is] quite correct, if we limit the Energy Charter only to its legal component and deny all other aspects of the Energy Charter process.<sup>1149</sup>

The instruments of the Charter are neutral by themselves. In order to put them into operation in conflict situations (such as the Russia–Ukraine gas crisis) either member states need to trigger the relevant procedures (most probably after the conflict has arisen), or the Secretary General needs to act preventively in order to help the parties to escape the conflict....And it is here that the political leadership of the Secretariat needs to be able to understand not only the consequences of its actions, but also of its inaction. By inaction the author means both no action at all and inadequate or untimely (late) action, such as when the relevant activity is undertaken in a (bureaucratically safe) reactive manner. Political leadership in the Secretariat is essential to ensure that the organisation takes adequate action in non-routine situations. This is why the member states accord the Secretary General absolute operational power so that he can effectively respond to non-routine situations, preferably, prior to their transformation into fully-fledged crises.<sup>1150</sup>

Thus, from the Russian perspective, the Secretariat – as the standing organization within the ECH – should have acted before the crisis broke out.

During non-routine situations, the role played by the secretary general is key. Because the Treaty does not provide for this formally, to take action in an extraordinary situation required a political decision on the part of the secretary general. However, the Secretariat responded with inaction, and Konoplyanik attributed this to the risk-averse character of its leadership, which was prepared to follow routines but do no more.

To understand how the Secretariat could have responded, we can examine the sequence of events during the crisis in 2006. At the time, Konoplyanik was still deputy secretary general. However, since there was a transition at the time from one secretary general (Dr. Ria Kemper) to another (Andre Mernier), Konoplyanik was fulfilling the duties of the secretary general’s office.<sup>1151</sup> According to Konoplyanik,

The [Secretariat] proposed its services in the capacity of third party in the settlement of a dispute. From December 20, the secretariat goes on vacation. In 2005, during this period discussions between Moscow and Kiev were getting tense...Nevertheless, the [Secretariat] was able to contribute its two cents worth. On the first working day, January 3, the new General Secretary sent letters to the relevant state agencies, the ministries of fuel and energy, in Ukraine and Russia, as well as to the management of “Gazprom” and “Naftogaz.” The letters indicated that the secretariat proposed to the sides, if they should want it, to use the transit dispute resolution procedure provided for in the ECT. In anticipation, even though we were on vacation, we did everything so that such a procedure could be instituted immediately. In particular, we came to an agreement with both the Ukrainian and Russian sides concerning the candidature of a potential conciliator....

...The General Secretary’s proposal turned out to be unnecessary since “Gazprom” and “Naftogaz” concluded a bilateral agreement on January 4.<sup>1152</sup>

Thus, when negotiations were not going well in late 2005, the Secretariat under Konoplyanik’s leadership took action. Even though they were on vacation, they worked informally with both

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1149 Ibid., 289 fn. 88.

1150 Ibid., 288-9.

1151 Svetlana Dolinchuk, “The Ukrainian and Russian Gas Transport System has always been one,” interview with Andrei Konoplyanik, *Economic News* 234, 997 (December 24, 2008): 3.

1152 Ibid.

parties to find a conciliator. According to Article 7 of the Treaty, this kind of work is supposed to happen after a state appeals to the Secretariat; thus, the decision to do so earlier on its own initiative was not routine and required a judgment call.<sup>1153</sup> Because of the Secretariat's action, dispute resolution was available at the earliest possible moment.

Ultimately, the Secretariat's intervention was very limited; in Konoplyanik's own words, it was worth "two cents," but because it created a contingency plan in case talks broke down, these efforts were useful. In the end, conciliation proved unnecessary. However, because the Secretariat worked with both states directly to find a conciliator just in case, the states could see the value of the ECH regime. Given that the question of transit between Ukraine and Russia was at the top of the agenda at the highest political level in both countries at the time, this was no small feat. By contrast, in 2009, the Secretariat did not take any initiative. According to Konoplyanik,

[T]he political leadership of the Secretariat did not even communicate the name of the proposed conciliator (the same George Verberg accepted by both parties in 2005) to the parties in dispute until 9 January, e.g., only after transit to the European Union was fully broken on 7 January. This is only one example of delayed and inadequate reaction of the political leadership of the Secretariat which provided an opportunity for Russia to criticise the "Energy Charter" organisation as a whole.<sup>1154</sup>

In the end, the dispute was settled outside the Charter context entirely. This did not go unnoticed in Moscow.

In conclusion, a small deviation from the letter of the law due to a judgment call by a single individual in 2006 yielded a large political dividend for the ECH regime as a whole.<sup>1155</sup> When the same action was not forthcoming in 2009 when it turned out to be absolutely necessary, the value of the regime in the eyes of the Russian leadership went to nil. In the words of Yershov, the trust of the Russian leadership in the ECT went "bankrupt."

### **The Russian response: a new framework**

As I have argued, the 2009 European gas crisis left the Russian political leadership utterly disillusioned with the efficacy of the ECH regime and Treaty, particularly concerning its ability to resolve emergency situations. Even before this episode, Russia had been calling on the ECH community to reform the Treaty. The denouement of the gas war served to intensify this policy, which was now being promoted at the highest levels of state.

This became clear, for example, during a nationally televised<sup>1156</sup> discussion between President Medvedev and Gazprom CEO Alexei Miller, which took place on January 20, 2009, one day after Gazprom concluded a contractual agreement with its Ukrainian counterpart:

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1153 ECT article 7b states that within 30 days of receipt of such a notification, the Secretary General, in consultation with the parties to the dispute and the other Contracting Parties concerned, shall appoint a conciliator.

1154 Konoplyanik, "A Common Russia," 289. For the Secretariat's announcement of Mr. Verberg's availability for conciliation, see [www.encharter.org/index.php?id=21&id\\_article=167&L=0](http://www.encharter.org/index.php?id=21&id_article=167&L=0) in *ibid*.

1155 Telephone interview with Konoplyanik, fall 2009.

1156 The meeting was broadcast on Channel 1. "Part 5. Medvedev: There is a need to create a new Energy Charter 20.01.09," accessed on June 22, 2011, <http://www.youtube.com/watch?v=W22DH8N88eE&feature=related>.

D. Medvedev:....Everyone has heard of the so called Energy Charter, which, when it was created, was to a significant extent oriented toward the defense of consumer interests, which is not bad. But we must not forget that sellers are participants in contractual relations in exactly the same way, and it is necessary to defend their interests to the same degree, as well as the interests of transit states.

In order for this to happen, we need new international mechanisms. I think that we could think about either the modification of the current version of the Energy Charter (if the participant states agree to this), or about the creation of a new multilateral document, which would address these goals in full measure. It would provide for procedural questions, technological questions, and legal questions related to the provision of payment for delivered gas, the fulfillment by transit states of their functions, and the prohibition of the kinds of problems that were unfortunately caused by Ukraine at the end of last year.

I think that the government of the Russian Federation, and our primary gas supplier OAO Gazprom need to think about what mechanism would be right in this respect to prepare and propose to all the participants of the international community. I see in this our special energy goal, given that Russia is the largest energy producer in the world.

As I have said....I will propose a series of ideas during the course of the meeting which will take place in London at the beginning of April and will be dedicated to overcoming the aftermath of the financial crisis, because the financial crisis could be exacerbated by other things for example like the conflict which has taken place, and during the course of other events, including the meeting of the heads of state of the “G8.” I ask that you become involved in this aim.

A. Miller: Concerning the blockade of the transit of Russian gas to Europe by Ukraine, concerning this situation which unfolded over the course of...several weeks, we can say that a new legal mechanism, which provides for the interests of consumer, transit, and producer states, is needed. Much blame, serious blame was and continues to be voiced with respect to the ECT. And we see that in a real, concrete situation, this mechanism, the mechanism of the Energy Charter, has failed in a serious way.<sup>1157</sup>

Even before the westward shipment of Russian gas through Ukraine had fully resumed, the Russian president was meeting with the head of Gazprom to consider alternative schemes to promote long term cooperation in the energy trade.

We can see that the significance of the position a state holds in a market – whether it is a producer, consumer, or transit state – is prominent in the president’s thinking. In this respect, the Charter is seen as serving the interests of consumer states rather than those of producer or transit states. As a result, a new arrangement – which promotes the interests of all states – is necessary. This was a general claim that Russia had been making in its attempts to modify the agreement. By 2009, it was a common refrain in Russian political circles.

It is clear, however, that the gas crisis, which is the focus of the discussion, played a significant role in Russia’s evaluation of the ECH regime. From the perspective of both the president and Miller, the crisis underlined the fact that the Energy Charter did not work and needs to be either modified or replaced. At the same time, Russia was not wed to a particular format. The approach was pragmatic: if the other ECH states agreed, a new agreement could be developed within the ECH context; if not, an alternative forum would suffice. In this connection,

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1157 “Meeting with the CEO of the Company ‘Gazprom’ Alexei Miller,” January 20, 2009, accessed December 9, 2011, <http://kremlin.ru/news/2894>.

the president proposed to promote the initiative in several prominent, high level venues and even made a causal link between energy security and the financial crisis.

Concerning the specifics of the new agreement, the president noted that the new mechanisms needed to deal specifically with the types of problems associated with the recent gas crisis. Among other things, Ukraine's failure to fulfill its transit obligations is seen not only in legal terms, but also in technological and procedural terms. Technological questions refer to the many arcane issues that emerged during the conflict.<sup>1158</sup> For example, restarting a gas pipeline network or changing the direction of gas flow is complex and time consuming. Another question is related to the gas fuel necessary to compress and transport gas through the pipeline; during the conflict this was referred to as "technical gas."

Procedural questions include more than just the sequence of events that lead to conciliation. They also include, for example, instruments to monitor gas flows (international monitors) to understand whether downstream pressure is falling because gas is being taken while in transit or because the supplier is sending inadequate volumes. These technological and procedural issues are specific to fuel and energy carriers that rely on network transport systems. Here, natural gas is exceptional since the vast majority of gas is still shipped through pipelines.

Since the interests of Gazprom are at stake, the president asks the CEO to "participate more actively" in the process together with the government. Thus, the division of labor that follows from the neo-liberal perspective – states make laws and treaties, firms conduct business – is blurred.

Finally, these were not isolated remarks by the president. Medvedev made similar comments again on March 1, 2009, during an interview with a Spanish journalist:

We have mentioned the gas crisis several times today. As a lawyer, I don't have any legal illusions, nevertheless, I think that there should be a solid legal basis for settling such issues. What do we have now in this area for example? We have an agreement with our Ukrainian friends, and the Ukrainian partners break it from time to time. And there is the Energy Charter, ratified by a number of countries, and signed, but not ratified by some, like the Russian Federation for example, some countries didn't sign it at all. It means that the issue has not been shaped legally. In relation to that, I have come up with an idea, which I first voiced at the Moscow summit during this gas conflict – let's draw up a new Energy Charter or a new version of the Energy Charter.<sup>1159</sup>

Prime Minister Putin was on the same page as the president. For example, at an early February press conference in Moscow with EC President Barroso, the prime minister said:

Let's work out uniform rules which everyone will be observing. This is why President Medvedev has proposed signing a new Energy Charter or reworking the existing treaty so that it corresponds to common interests and so that it is followed by everyone involved in the process.<sup>1160</sup>

In advance of this EU-Russia meeting, Russia's Ambassador to the EU Vladimir Chizov made similar remarks.<sup>1161</sup>

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1158 Earlier in the interview, President Medvedev pointed out that he was the chairman of the board of Gazprom for eight years and proceeded to demonstrate his detailed knowledge of the gas business.

1159 Interview of the president with the Spanish media, March 1, 2009, in Konoplyanik, "A Common Russia," accessed December 9, 2011, [http://archive.kremlin.ru/eng/speeches/2009/03/01/1002\\_type82914type82916\\_213434.shtml](http://archive.kremlin.ru/eng/speeches/2009/03/01/1002_type82914type82916_213434.shtml).

1160 "PM Putin says Russia, EU should abide by same rules," *BBC Monitoring Former Soviet Union*, February 6, 2009.



*The “Conceptual Approach to the New Legal Framework for Energy Cooperation”*

On April 20, 2009, during a visit to Helsinki, President Medvedev announced that he would distribute a new proposal for energy cooperation. At the time, the media reported that:

The announcement of the *ambitious* plan was the latest sign of *Moscow's increasingly assertive bids* to revive its influence in the world....

Medvedev described the proposals as a "basic document which *defines* issues of cooperation in the sphere of energy, including proposals on a transit agreement."

The most recent *energy “transit crisis” highlighted the need to work out a new framework* for cooperation in energy, said Medvedev. He was keen for the talks to start shortly, he added.

... Buoyed by *high oil and gas prices, Russia has been keen to assert its influence* in the world under the presidency of Medvedev's predecessor Vladimir Putin, calling to *rewrite the rules on energy and European security*.<sup>1162</sup> (emphasis added)

The following day, the presidential administration published a new document, the Conceptual Approach to the New Legal Framework for Energy Cooperation (Goals and Principles) on its website.<sup>1163</sup>

The document is short, organized by bullet points, and consists of three parts. Here, I examine the document to understand its significance for a number of key issues: Russia's policy toward the ECH and its approaches to energy security, state sovereignty, modes of cooperation in energy, and energy policy. The ultimate aim is to reconstruct Russia's new vision for international energy cooperation and energy market governance (the state management approach), with an eye to showing how much they had changed since the 1990s (when the neo-liberal approach dominated).

The main body of the text is composed of an introduction followed by an outline of the main principles embodied in the initiative. It begins by noting that the long term development of energy requires a model “adequate to the current conditions,” a familiar refrain from recent discussions on reforming the ECT. It also points out that,

The existing bilateral arrangements and multilateral legally binding norms governing international energy relations have failed to prevent and resolve conflict situations, which makes it necessary to efficiently improve the legal framework of the world trade in energy resources.

It would be advisable to elaborate a new universal international legally binding instrument, which, unlike the existing Energy Charter-based system, would include all major energy-producing (exporting) countries, countries of transit, and energy consumers (importers) as its Parties and cover all aspects of global energy cooperation.

Again, Russia was underlining the failure of the ECT to prevent the gas crisis. Moreover, it pointed to the fact that the Charter was not universal in terms of its membership or its scope. As a result, a new instrument was needed. Finally, it underlined that to be successful, the new system had to be “efficient (should include an efficient common implementation mechanism).”

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1161 The press reported that “Ahead of high-level EU-Russia meeting, Russia's EU ambassador says international energy treaty needs revision or replacement.” R. Jozwiak, “Chances of Russia ratifying energy charter are ‘minimal,’” *European Voice*, February 14, 2009, in Konoplyanik, “A Common Russia.”

1162 “Russia's Medvedev offers to rewrite energy rules.”

1163 Conceptual Approach to the New Legal Framework for Energy Cooperation.

The section, “Main Principles,” begins by stating that energy relations had to be guided by the “experience in implementation of the Energy Charter documents and approaches stipulated in the G8 Declaration and Plan of Action on Global Energy Security approved by the St. Petersburg Summit in 2006.” Thus, both the ECH and the G8 plan were reference points. However, experience of implementation of the ECH may also be a reference to, among other things, the ECT’s failure during the gas crisis.

The first set of principles relates to energy security. Thus, cooperation means the

Recognition of *indivisibility* of sustainable global energy security and interdependence of all world energy exchange participants;

*Mutual responsibility* of energy consuming and supplying countries, as well as of transit states for global energy security;

Recognition of security of supply (delivery) and *demand* (transparent and predictable marketing) as key aspects of global energy security.<sup>1164</sup> (emphasis added)

This was consistent with the principles for energy security that Russia had been promoting since 2006 in the ECH context. In addition to indivisibility and mutual responsibility, the importance of security of demand was emphasized. As we saw earlier, states played a key role in this respect.

The next principle concerns state sovereignty over national energy resources, which should be “unconditional.” This suggests a very different understanding of sovereignty than that which prevailed in the 1990s. The reader will recall that during negotiations and ratification hearings, the idea was that the state had sovereignty to create domestic laws and international treaties (that is, legal sovereignty). However, state sovereignty was ultimately subordinate to laws (both domestic and international) once they were adopted.

More importantly, sovereignty was constrained by the urgent need to create a “comfortable investment climate” for investors; this meant limiting state action. As we saw in Chapter 3, Konoplyanik argued for NT rather than MFN precisely because it constrained the state:

[S]uch an approach would hardly be attractive to foreign investors...the most favored nation regime grants the State more liberty in legal questions and in the admittance of investments. As a consequence of this a certain amount of doubt may arise for investors as to the stability of conditions for their business activities.<sup>1165</sup>

Clearly sovereignty – here, the state’s liberty to act – was subordinated to the needs of investors. In addition, Russia also expressed the intention to have stand still and rollback of exceptions to NT in the future, creating further constraints on state sovereignty. Ultimately, laws and treaties were deemed necessary as vehicles to minimize political risk for investors. In the 2009 document, however, sovereignty was construed as unconditional, an idea that was never raised by Russia during discussions on the ECH in the 1990s. The articulation of the principle of “unconditional” state sovereignty reflected that significant changes had occurred in Russian thinking about the state’s role in the energy economy.

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1164 Ibid.

1165 Konoplyanik, “The Energy Charter Treaty: A Russian Perspective,” (English edition), 174.

In terms of the modes of energy cooperation, the document calls for asset swaps. Again, the idea of substantive reciprocity is important. The Concept called for the “Promotion of mutual exchange of energy business assets within investment activities.” This issue had already been raised at the 2006 G8 and in the ECH context.

The document also revealed a very different attitude toward the place of energy policy in international energy cooperation than that which prevailed in the 1990s. It called for:

*Mandatory consultations on and coordination of energy policies* and related measures, including in the sphere of establishing a future energy balance structure, energy supply diversification, regulatory documents on energy production, trade, transit and consumption, planning and implementation of infrastructure projects which impact on global and regional energy security.<sup>1166</sup> (emphasis added)

Here again, Russia had come full circle. As we saw in Chapter 3, when negotiations on the ECH began in 1991, the Soviets emphasized the importance of coordinating energy policy. With the arrival of an independent Russia under Yeltsin, discussions on policy disappeared within the ECH context, and the focus was on creating an appropriate legal environment. Consistent with the neo-liberal perspective, policy was essentially reduced to creating the right kinds of laws within which firms would act. As a result, policy coordination between states was not necessary. By 2009, it had become mandatory. The intention was to rationalize energy use across states while also promoting energy security.

The main text is followed by two annexes. Annex 1 adumbrates “elements of the Transit agreement.” Several of the items were already reflected in the ECT or had been addressed during negotiations on the TP.<sup>1167</sup> This section was clearly influenced by the recent gas disputes with Ukraine. It states that:

The new system of documents should include as its *integral* part a new Agreement on the guarantees of transit of energy materials and products ... intrinsically incorporating a Treaty that establishes procedures to overcome *emergency situations* in this field.

The goal of the Agreement is to ensure a reliable and uninterrupted transit.

The Agreement shall determine:...

- Obligations of the Parties to the Agreement to ensure the fulfillment of transit requirements by their entities;
- Unacceptability of interruption or reduction of transit that is unprovided for in transit Treaties, or intervention in transit flows;
- Responsibility of Parties for losses incurred as a result of the nonfulfillment of requirements under the Agreement or transit Treaties...
- System of bodies (commissions formed on the basis of representation of the Parties and reputable international organizations) authorized to regulate emergency situations and acting on the principles of equitable participation of the Parties;

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1166 Conceptual Approach to the New Legal Framework for Energy Cooperation.

1167 For example, the principle of “Unacceptability of interruption or reduction of transit that is unprovided for in transit Treaties, or intervention in transit flows” is in the ECT. Another item, “Principles of establishing transit tariffs (objectivity, reasonableness, transparency, non-discrimination, cost justification, adequate tax regime)” was largely resolved in TP negotiations, with the exception of the tax regime.

- Mandatory response of the Parties to partners’ requests and obligations to ensure access of Parties’ experts and conflict regulation bodies to transit infrastructure.<sup>1168</sup> (emphasis added)

Therefore, the new system would not just be a legal framework but would also have an important political and organizational component vested with the authority to manage emergencies.

Interestingly, the annex also states a: “[p]reference of diplomatic over court channels to resolve conflicts with a possibility of dispute resolution in accordance with the UN Commission on International Trade Law (UNCITRAL) Arbitration Rules.”<sup>1169</sup> (emphasis added) ECT Article 7 gave priority to “the exhaustion of all relevant contractual or other dispute resolution remedies previously agreed.”<sup>1170</sup> The draft TP prioritizes conflict resolution “settled through diplomatic channels within a reasonable period of time,” and then refers to state-to-state arbitration in the ECT (Article 27), which states that “Contracting Parties shall endeavour to settle disputes ... through diplomatic channels.”<sup>1171</sup>

Comparison of the three approaches reveals a gradual and subtle evolution in language and also thinking about transit conflicts. Initially (the ECT in 1994), contractual relations were emphasized, although other remedies certainly did not preclude diplomacy. Later (the draft TP circa 2003), diplomacy was mentioned explicitly and prioritized. Finally, the latest approach (the 2009 Concept), not only focuses on diplomacy as in the draft TP, but it goes further by expressing a “preference for diplomacy,” which is explicitly juxtaposed to “court channels.” Russia had learned that legal solutions were not a panacea, particularly during transit emergencies.

Annex 2 is a List of Energy Materials and Products. This section is interesting because it starts, not surprisingly, with a detailed list of nuclear materials and ends with “Other types of energy,” including “Fuel wood, in logs, in billets, in twigs, in faggots or in similar forms” and “Charcoal (including charcoal from shells or nuts), whether or not agglomerated.”

What does this document tell us about Russia, its ECH policy, and its approach to international energy cooperation? Charter supporters in Russia have noted that the proposal did not add anything new to the already existing international arrangements for energy cooperation, particularly since key elements either already existed in the ECT, had already been proposed by Russia during the 2006 G8 summit, or had been submitted by the Russian delegation in the ECH context during its attempt to adapt the regime.<sup>1172</sup>

It is true that the Concept reveals important continuities with existing frameworks. It revealed that Russia still accepted the value of markets and embraced the principles of non-discrimination<sup>1173</sup> and transparency.<sup>1174</sup> This was particularly true as these principles applied to

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1168 Conceptual Approach to the New Legal Framework for Energy Cooperation.

1169 Ibid.

1170 The Energy Charter Treaty and Related Documents.

1171 Final Act of the Energy Charter Conference with Respect to the Energy Charter Protocol on Transit (draft), Brussels, October 31, 2003.

1172 Yershov, “Global Energy Security,” 4, 5; interviews in Moscow, 2008-9.

1173 One of the main principles was “Non-discriminatory access to international energy markets, their opening and increased competition on them.”

1174 For example, the concept includes the principle: “Transparency of all international energy market segments (production/export, transit, consumption/import).”

Russian firms doing business abroad. The Concept also duplicated many of the ideas put forward since 2006.

However, two points deserve our attention. First, although the Concept may only be marginally different from the work since 2006, it also reveals that Russia's vision for international energy cooperation has shifted significantly when compared to the 1990s.

For Russia in 2009, markets were not just organized to be favorable to individual investors. The structure of markets also had to respond to other demands such as substantive reciprocity (asset swaps), energy security (including predictable demand), rational use of resources (coordinated energy policy), and emergency situations (transit disputes).

Furthermore, all of these required significant political or economic action by states. As a result, markets no longer implied limiting state sovereignty to its legal dimension as much as possible. The state had become an important and legitimate political and economic actor, and this was not necessarily anathema to the effective functionality of markets.

The second point is that once again Russia was acting as a regime maker. Not only had it intensified its efforts to radically transform the ECT, it also made clear that if this was not possible, it was prepared to create a totally new and independent framework.

### **The structure of global energy markets, oil prices, and Russian ECH policy**

There is no question that Russia remained committed to cooperation and still wanted to attract foreign investment during this period. However, its foreign energy policy was motivated by an understanding of its own interests that was not a product of principles, norms, and rules proposed as universal by its powerful international partners. Russia had its own ideas about how things should be done.

This meant that Russia was no longer willing to just bargain on the margins of a pre-established, universally accepted framework for energy trade. Rather, it was working to create that very framework itself; it was clamoring for the driver's seat, something that only regime makers do. Moreover, it was prepared to do so even if that meant ruffling feathers when other powerful states disapproved. With the Concept, Russia was yet again proposing to create a new regime; it was a regime maker. That Russia was becoming a regime maker can also be seen in the context of negotiations on a new Partnership and Cooperation Agreement with the EU.<sup>1175</sup> In discussing this, President Medvedev could not have been blunter about the Russian state's new relationship with its European partner: “[w]e definitely should not look at the signing of the partnership agreement with Europe, with the European Union as *some kind of prize that Russia gets for its good behavior*, all parties are interested in such an agreement.”<sup>1176</sup> (emphasis added)

Thus, Russia very explicitly rejected its posture from the 1990s when it was a pupil of the West learning the norms, principles, and rules that the latter promoted.

Interestingly, this was happening after the 2008 global financial crisis, which hit Russia disproportionately both directly (for example, the fall of the Russian stock market) and indirectly

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1175 The new PCA is meant to replace the agreement signed in 1994, which went into effect in 1997 and formally expired after ten years. However, the old PCA is still generally applied pending the conclusion of a new treaty.

1176 Interview of the president with the Spanish media.

through the very dramatic fall in oil prices, which affected both private and state revenues. In the aftermath of the global crisis, the structure of global energy markets – whether the world had entered a new buyer’s market or whether a seller’s market persisted – was very much uncertain. Whether oil prices would partially recover was not immediately clear at the time.

As a result, some foreign participants in Russia’s energy sector expected it to revert to its open door policy from the 1990s; they soon realized that they were largely mistaken.<sup>1177</sup> This sentiment can be seen in a piece written as late as June 2009 by Dr. Fraser Cameron, the director of the EU-Russia Centre in Moscow:

The credit crunch has hit Russia harder than other emerging economies with Gazprom losing more than two-thirds of its market capitalisation since May. With oil prices down from a peak of \$147 a barrel in July 2008 to below \$40 in February 2009, the heavily oil-and-gas dependent Russian economy is highly vulnerable, especially since Russia needs Western technology to boost its energy extraction.<sup>1178</sup>

Based on this kind of perspective, we would expect Russia to become a regime taker as it was under Yeltsin. The Concept shows that Russia would continue to be a regime maker.

As it turned out, Russia showed that it had many levers even when oil prices were down and it faced financial adversity. For example, in late February 2009, Deputy Prime Minister Igor Sechin announced that the Russian state-owned oil company Rosneft’ and state-owned oil transit company Transneft had concluded a deal with China through which they would receive \$25 billion in loans (\$15 billion and \$10 billion, respectively) at 6 percent interest annually in exchange for a 20-year oil contract at a discounted price<sup>1179</sup> and future joint ventures in the upstream.<sup>1180</sup> The deal was especially important because, with credit payments pending in the near future, Rosneft’ was in serious financial straits.

This deal is interesting because it showed that Russia could acquire significant financing in a credit-scarce environment without accepting norms, principles, and rules from other states. Moreover, in acquiring the credit, it was prepared to drive a hard bargain to get very favorable terms.<sup>1181</sup> Also notable is that two different companies on the Russian side working cooperatively made the deal happen.

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1177 Interviews in Moscow, 2008-2009.

1178 Cameron, “The Politics of EU-Russia Energy Relations,” 26.

1179 “Russia industry: Rosneft and Transneft negotiate loan-supply agreements with China,” *Economist Intelligence Unit – ViewsWire*, February 27, 2009, 12. The bulk of Transneft’s loan would be used to build the Chinese section of the East Siberian-Pacific Ocean (ESPO) oil pipeline.

1180 John Helmer, “China loan turns Russian oil east,” *Asia Times*, February 24, 2009; “Rosneft President Sergey Bogdanchikov Joined Russian Delegation on a Visit to China,” Rosneft Information Division, April 23, 2009.

1181 The deal was based on an earlier five-year deal signed in 2005 whereby Rosneft received \$6 billion to acquire Yuganskneftgaz (previously owned by Yukos) in exchange for a long term oil contract. However, in 2007 Rosneft announced that it would not renew the contract because it was not satisfied with the price. Although I have not found the contract price, it has been reported that Russia prevailed in bargaining over the interest rate (which is fixed at 6% rather than variable or fixed at 7%). “Russian-Chinese loan negotiations need government approval—Transneft president,” *Interfax: China Business Newswire*, January 14, 2009 (reported Chinese proposal for variable rate); “Russia industry: Rosneft and Transneft negotiate,” 12 (reported 6% fixed). According to one account: “An industry source said Rosneft, as agreed earlier, was due to receive \$15 billion and Transneft \$10 billion. The interest rate was not disclosed but the source said it was ‘not very high’ because of high-level state involvement.” “China Makes 25mln Loan to Trans/Rosneft, Oil and Gas Eurasia,” *Moscow Times*, February 17, 2009; “China to lend

This kind of interfirm cooperation in international negotiations was unheard of during the 1990s when firms repeatedly defected by unilaterally pursuing their own interests.<sup>1182</sup> However, bargaining did not lead to a lose-lose-lose outcome<sup>1183</sup> in this case because bargaining on the Russian side happened under the auspices of state guidance. According to Bogdanchikov, “There was an instruction from the Russian Government to finalize the networking tariff for ESPO. Transneft and Federal Tariff Service are working on that. The currently discussed tariff range should bring a decision on the networking tariff that would ensure normal economics for the company.”<sup>1184</sup> In short, the state had the authority to make the firms cooperate to make a deal happen.

This episode demonstrates that international energy market conditions are not necessarily an accurate predictor of Russia’s foreign energy policy. It also shows that a state with high sovereignty that plays an important role in international economic transactions can create room for maneuver in order to raise international capital under difficult circumstances.

### **Termination of provisional application and the Yukos case**

We have seen that although the Concept was unveiled in late April, the idea behind this initiative emerged during<sup>1185</sup> the gas war in January 2009 in response to Moscow’s perceived failure of the ECT and ECH regime to prevent or resolve the conflict. The timing of the new initiative is important to be able to distinguish the process that led to it (the Convention process) from the process that culminated in Russia’s termination of PA of the ECT (the PA process), which started later.

Beginning in late April 2009, Russian policy had taken a new turn: Moscow began to disavow that it had ever committed to the ECT (which it signed, was applying on a provisional

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\$25bln to Russia's Rosneft, Transneft at 6% p.a.,” *RIA Novosti*, February 17, 2009 (reported that 7% was discussed but that this was reduced by 1%).

1182 What is the strategic dilemma in this situation? For Rosneft to supply oil to China, at a minimum, it has to be able to do so at a favorable transport tariff from Transneft. Each has an incentive to defect by negotiating the highest (Transneft) or lowest (Rosneft) rate possible. Moreover, because of Rosneft’s financial difficulties at the time, Transneft could have played hardball. As was pointed out to me during several interviews, because of these dynamics, it is not a foregone conclusion that a deal will be made. Once we add the fact that bargaining also included a third party (another state), the situation becomes even more complex and cooperation more difficult. However, bargaining did not lead to a lose-lose outcome (no credit from China, Rosneft defaults, Transneft does not build a new pipeline) because it happened under the auspices of state guidance. The state had the authority to make the firms cooperate to make a deal happen. According to Bogdanchikov, “There was an instruction from the Russian Government to finalize the networking tariff for ESPO. Transneft and Federal Tariff Service are working on that. The currently discussed tariff range should bring a decision on the networking tariff that would ensure normal economics for the company.” “Rosneft President Sergey Bogdanchikov Joined Russian Delegation on a Visit to China.” Interviews in Moscow, fall 2007, 2008-2009.

1183 For example, if the deal fell through, this would mean no credit would be forthcoming from China, Rosneft would likely default on its credit payments, an oil contract would not be concluded with China, the proposed joint ventures would not materialize, and Transneft would not build a new pipeline. Both firms and states lose.

1184 “Rosneft President Sergey Bogdanchikov Joined Russian Delegation.” It is also clear that both states played key roles to make the deal happen. Thus, on January 19, Transneft President Tokarev announced that, “The negotiations for credit between Russia and China have reached the level that requires government approval.” “Russian-Chinese loan negotiations.”

1185 According to President Medvedev, “I have come up with an idea, which I first voiced at the Moscow summit during this gas conflict.” Interview of the president with the Spanish media.

basis, but had never ratified) at all. According to Konoplyanik, “[w]ith regard to the Energy Charter and other documents [the president] said “we have not ratified these documents and do not regard ourselves bound by these decisions.”<sup>1186</sup> This shift can also be discerned in the comments made by Presidential Assistant Arkady Dvorkovich during an interview at the time that the Concept was released:

Today a document which concerns conceptual approaches to a new legal base for international energy cooperation will be handed over to our colleagues in the G-8, other countries in the G-20, CIS countries, international organizations, [and] our neighbors.

We have stated many times that we are not satisfied with the Energy Charter and the documents that comprise the Energy Charter system in its current form, and that we consider that a new international legal base is necessary. Now we have a subject for discussion; it is a fully concrete proposal... As the President said, we are ready for intensive negotiations with our partners, first and foremost the EU (these are our closest energy partners), concerning these documents already in the coming weeks in any number of different formats

Russia signed the Energy Charter, but did not ratify it. This signifies that that we do not consider ourselves bound by the obligations of the Energy Charter. Concerning the Energy Charter Treaty, we also do not consider ourselves bound by the obligations in this agreement....the point is that we are proposing a full blown, new legal basis for future energy cooperation.

...[T]hese documents also never covered for example nuclear materials, but this question is really of significant interest to us...this problem cannot be solved but for a new agreement, so we will propose to our partners to work on this with maximum intensity.

... [W]e are not quitting [the Energy Charter]. In fact, these documents do not apply to us.

...In fact, these documents are being offered as an alternative to the Energy Charter, although of course, the legal formulation can vary; it can be changes to the Energy Charter, and the preparation of a new document in connection with the fact that we are proposing to change many principles, to add many principles, and also in connection with the fact that the Energy Charter today does not include many very important players in the world market... Therefore, probably a new document is ultimately needed, but we are open to dialogue in any legal form.<sup>1187</sup> (emphasis added)

At the end of the month, Prime Minister Putin stated that:

The Energy Charter ...has regrettably not played its expected role. The Russian Federation has always said we do not consider ourselves bound by this document, because we have not ratified it. Today we can say in no uncertain terms that we find it pointless to even retain our signature on the Charter.<sup>1188</sup>

Thus, as the Concept was being made public, Russian policy was changing again: not only was Russia prepared to replace the ECT with a new document, it no longer considered itself bound by the agreement at all.

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1186 A. Konoplyanik, “Why Is Russia Opting out of the Charter,” *International Affairs* 56, 2 (2010): 85. Also, Dr. Andrey A. Konoplyanik, “Russia-EU common energy space: how to create it best—and how it correlates with Russian initiative on new international energy order,” presentation at the 5th Europe-Russia Economic Forum, Bucharest, Romania, May 25-27, 2009, 17.

1187 “Answers by Presidential Aide Arkady Dvorkovich to Journalists’ Questions,” April 21, 2009, accessed December 9, 2011, [http://news.kremlin.ru/ref\\_notes/186/print](http://news.kremlin.ru/ref_notes/186/print) .

1188 Konoplyanik, “Why is Russia Opting out of the Charter,” 86.



The total repudiation of its commitment to the Treaty appears to be connected with developments related to the Yukos arbitration case. In November 2004, GML (formerly the Group Menatep Limited), which owned 60 percent of Yukos,<sup>1189</sup> filed suit against the Russian state for expropriation, and the lawsuit was officially registered in 2005.<sup>1190</sup> The substance of the case related to discriminatory measures and expropriation and is based on ECT Article 13, “Expropriation.”<sup>1191</sup> The legal basis for taking the dispute with the Russian state into arbitration was Article 26 of the ECT, “Settlement of Disputes between an Investor and a Contracting Party.” The latter gives investors the right to take states to binding international arbitration over disputes related to their investments. Investors also have a choice of forum for arbitration.

Subsequently, a tribunal panel was constituted at the Permanent Court of Arbitration in The Hague<sup>1192</sup> under the auspices of the United Nations Commission on International Trade Law (UNCITRAL.)<sup>1193</sup> During proceedings, in which it was participating, Russia argued that the panel did not have jurisdiction in the case because Russia never ratified the ECT. Since the ECT was the basis for the whole suit, the panel had to decide this procedural question before it could consider the merits of the case. Obviously, this first ruling was critical.

By spring 2009, it was becoming clear that a ruling by the panel was imminent. Thus, on April 28, a week after President Medvedev’s Concept was made public, the press reported that: “[a]n international tribunal sitting under the auspices of the Permanent Court of Arbitration in The Hague is expected to give its decision soon in GML’s case brought against the Russian government.”<sup>1194</sup> Konoplyanik has also connected the PA process to the Yukos case:

I have heard it said that the Energy Charter created an opportunity for the shareholders of “Yukos” to file suit against Russia on the basis of the ECT and that it is necessary to exclude this case and analogous cases in the future by “quitting the ECT.”....

...[T]he sum of the property related damages being made by the “Yukos” shareholders keeps growing: first \$30 billion, then \$50, and now it is already \$100 billion. Evidently, the “Magic of numbers,” ultimately had a negative influence on the decision related to the fate of the ECT in Russia....

However, termination of provisional application of the ECT will not help Russia in the suit....However, it is this very illusion that could have become one of the primary motives behind the decision about termination [of PA]. However, termination of provisional application is not

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1189 GML owned 60% of Yukos. “Interview with Tim Osborne, CEO of GML (Ex-Yukos Shareholder): Russia Bound by Energy Charter Treaty”; 70% of GML is owned by L. Nevzlin, to whom Khodorkovsky’s shares were transferred. Goldhaber, “A Lifetime of Litigation.”

1190 Andrei Konoplyanik, “Russia’s Termination of Provisional Application of the ECT and ‘the Yukos Case’: Comments on the Results of the procedural Decision of the Arbitrage Court in The Haag,” *Oil, Gas, and Law*, January 2010, 48.

1191 Konoplyanik, “Energy Charter: If You Destroy It,” 132.

1192 “EU/Russia: New Energy Charter Not Necessary, Say Yukos Shareholders,” *Europolitics New Neighbours*, April 28, 2009.

1193 Konoplyanik, “Energy Charter: If You Destroy It,” 132; ECT Article 26.4.b states that: “(4) In the event that an Investor chooses to submit the dispute for resolution under subparagraph (2)(c), the Investor shall further provide its consent in writing for the dispute to be submitted to:.... (b) a sole arbitrator or ad hoc arbitration tribunal established under the Arbitration Rules of the United Nations Commission on International Trade Law (hereinafter referred to as ‘UNCITRAL’),” 73. Thus arbitration is by the Permanent Court of Arbitration in The Hague (ad hoc arbitration tribunal), established under UNCITRAL rules for arbitration.

1194 “EU/Russia: New Energy Charter Not Necessary”; see also “Energy: Decision Imminent on Russia’s Yukos Obligations,” *Europolitics*, August 26, 2009.

retroactive, and Russia...will be bound by the investment provisions of the Treaty and the dispute settlement procedure for the next twenty years (2029). That is why the outcome of the “Yukos” case depends not on termination of provisional application, but on the lawsuit as it unfolds during the arbitration proceedings.<sup>1195</sup>

Finally, once the decision by the arbitration panel against Russia was made public in early December 2009, the media reported that Russian state lawyers argued that the tribunal did not have jurisdiction because by then Russia had suspended PA.<sup>1196</sup> The evidence suggests that the PA process was related to developments in the Yukos arbitration. Specifically, once it became obvious that the tribunal would not accept Russian arguments about non-ratification and was going to claim jurisdiction based on Russia’s PA of the ECT, Russia suspended PA. From this perspective, the PA process was a tactical maneuver related to the Yukos arbitration.

In any case, an interagency meeting headed by Deputy Prime Minister Igor Sechin (in charge of the fuel and energy sector) was held on June 29, 2009, at which it was announced that Russia would suspend PA of the ECT.<sup>1197</sup> On July 30, 2009, the Russian government issued order number 1055-r, stating its intent to not become a participant of the ECT and instructing the Ministry of Foreign Affairs to take appropriate action. Less than a month later, on August 24, 2009, the Ministry of Foreign Affairs informed the Energy Charter depository, the government of Portugal, of its intention to not become a participant in the ECT. As provided for by Article 45.3.a of the Treaty, Russia’s provisional application of the Treaty – which had been in effect for over a decade – was formally terminated sixty days later, on October 20, 2009.<sup>1198</sup>

### *The future of the Yukos case*

For Konoplyanik, the decision to suspend PA as a reaction to the arbitration proceedings did not make sense. From a legal standpoint, he is of course right. According to ECT Article 45.3.b, a state that has suspended PA is still committed to uphold its investment obligations (for investments made during the period of its PA) for twenty years after PA was suspended.<sup>1199</sup> The Treaty is very clear on this, and it is difficult to imagine that any legal tribunal would accept an argument to the contrary. In practice, Russia’s arguments during deliberations by the arbitration panel in 2009 (that the tribunal did not have jurisdiction over the case because Russia had suspended its PA) were rejected.

However, now the tribunal must decide a second question related to the nature of PA. When a state ratifies the ECT, the Treaty becomes a part of its domestic law in its entirety and in principle trumps pre-existing domestic statutes that may contradict it. Ultimately, it is the Treaty’s status as domestic law (which it becomes after ratification) that creates legal rights and

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1195 Konoplyanik, “Energy Charter: If You Destroy It,” 131-2.

1196 “Yukos Shareholders Claim Victory,” *Europolitics*, December 1, 2009.

1197 Konoplyanik, “Energy Charter: If You Destroy It,” 124.

1198 Konoplyanik, “Russia’s Termination of Provisional Application,” 45; also “Why Is Russia Opting Out,” 86.

1199 Article 42.3.b states that: “In the event that a signatory terminates provisional application under subparagraph (a), the obligation of the signatory under paragraph (1) to apply Parts III and V with respect to any Investments made in its Area during such provisional application by Investors of other signatories shall nevertheless remain in effect with respect to those Investments for twenty years following the effective date of termination, except as otherwise provided in subparagraph (c),” *The Energy Charter Treaty and Related Documents*, 90.

obligation that may be invoked in international arbitration. However, Article 45.1 on “Provisional Application” states that:

Each signatory agrees to apply this Treaty provisionally pending its entry into force for such signatory in accordance with Article 44, *to the extent that such provisional application is not inconsistent with its constitution, laws or regulations.*<sup>1200</sup> (emphasis added)

As a result, under provisional application, the Treaty has the status of domestic law (and creates legal rights and obligations) only insofar as it is consistent with already extant domestic statutes. When it does contradict pre-existing domestic laws, the domestic statutes prevail.

Therefore, the tribunal must now decide to what extent the Treaty was (in)consistent with Russian laws. Insofar as parts of the Treaty were inconsistent with a part of Russian law, those parts of the Treaty are not applicable to Russia. Finally, in those areas of non-applicability, the international tribunal may not have jurisdiction. The key issue will be whether or not the Yukos case falls under such areas of non-applicability. If it does, then the arbitration could be dismissed due to lack of jurisdiction. According to Konoplyanik,

Substantiation of the extent to which the ECT was used by Russia until the present time within the context of provisional application of the Treaty will be the subject of contention by the lawyers for both sides (the firm Shearman & Sterling LLP representing the plaintiff; the firm Cleary, Gottlieb, Steen, & Hamilton LLP representing the defendant)....

Into what zone does the suit by Yukos fall into in this situation? Those articles of the ECT that are not applicable to Russia while it has not ratified the agreement? Or to the contrary, those that were in force by virtue of provisional application. Or perhaps part of the case will be in one zone, while part will be in the other. Or it may turn out that the case is outside the ECT framework entirely.<sup>1201</sup>

As if this was not complicated enough, Russian law has been changing since its PA began. Thus, whether a provision is applicable in Russia may also be variable over time.<sup>1202</sup>

Given that it took roughly five years for the tribunal to decide the relatively straightforward question concerning whether PA by a state gave the tribunal jurisdiction over a case when the state in question had not ratified the Treaty, we should not expect a decision on the second question very soon. After all, to make a determination, the panel will have to examine the entire (evolving) body of Russian law.

Finally, as a totally hypothetical exercise, it is worth considering what might happen if the tribunal ultimately rules in favor of the plaintiffs. First of all, if such an outcome appears likely, Russia may very well decide to settle the case without a judgment for a smaller amount. This does not seem likely given the posture of the current political leadership toward the Yukos question; however, it is possible, particularly with the passage of time and the advent of new leadership. This could also be attractive to the plaintiff given the difficulties and uncertainties associated with collecting international arbitration awards.

However, if a settlement is elusive, the Treaty has substantial teeth related to enforcement of arbitration awards. According to ECT Article 26.8 on “Settlement of Disputes between an Investor and a Contracting Party,”

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1200 Ibid., 89.

1201 Konoplyanik, “Energy Charter: If You Destroy It,” 133.

1202 Ibid.

The awards of arbitration... shall be final and binding upon the parties to the dispute....Each Contracting Party shall carry out without delay any such award and shall make provision for the effective enforcement in its Area of such awards.<sup>1203</sup>

Whatever award the Tribunal made in case of a judgment favorable to the plaintiff would be final and binding on Russia. Should Russia ignore such a judgment, the other states within the ECH have committed to enforce the decision. Moreover, Article 26.5.b states that:

Any arbitration under this Article shall at the request of any party to the dispute be held in a state that is a party to the New York Convention. Claims submitted to arbitration hereunder shall be considered to arise out of a commercial relationship or transaction for the purposes of article I of that Convention.<sup>1204</sup>

Therefore, the plaintiff would also have recourse to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the New York Convention), which would create an additional opportunity to collect the Tribunal's award, even in states that are not contracting parties to the ECT (such as the United States or Canada). This was alluded to by the CEO of GML Tim Osborne: “[i]f there is a binding award then we expect Russia to meet it. If the Russian government does not, then there are other treaties that allow us to collect against Russian assets around the world.”<sup>1205</sup>

At the same time, should such a development become likely, we might expect Russia to take pre-emptive action to avoid paying damages. In addition to deploying legal tactics to prevent the execution of the award (one example would be to challenge jurisdiction as it did during the first stage of arbitration at the Permanent Court for Arbitration), Russia might develop organizational strategies to disguise state assets abroad. The plaintiff would then have to demonstrate that the assets to be seized belong to the Russian state. This could be both difficult and time consuming.

Finally, the decision to make an award on the order of the one sought by GML (between \$30 and \$100 billion by their own account) ultimately needs to be considered from a political perspective as well. After all, to effectively enforce the tribunal's decision to award damages, a state would have to freeze and confiscate Russian assets of that value located within its territory. It is hard to image that even the United States would confiscate Russian assets worth \$30 billion, let alone \$100 billion. It is more than likely that Russia would retaliate, leading to a commercial war. This could be a pivotal factor in the decision to execute the award.

In conclusion, given the complexity created by PA, we should not expect a quick resolution to the Yukos case under the ECT. However, should the case be settled in the plaintiff's favor, there would still be considerable practical and political hurdles to overcome before any payments could be collected.

### *Termination of PA and Russia's status within the ECH regime*

Russia's termination of PA attracted some public attention and was construed in a variety of ways. Russia had been applying the ECT on a provisional basis, and in 2009 it withdrew this

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1203 The Energy Charter Treaty and Related Documents, 74.

1204 Ibid., 73.

1205 “Tribunal To Decide if Russia Bound by Energy Charter Treaty,” *Europolitics*, July 15, 2009.

PA, something for which the Treaty provides. However, discussions in the media have been less than punctilious in representing Russia's actions. For example, in a letter to the editor of the *Financial Times* on August 18, 2009, Professor Emmanuel Gaillard, lead counsel for the plaintiff in the case, wrote:

Vladimir Putin, the prime minister, announced in July that Russia will *withdraw* from the Energy Charter Treaty....

This latest act of Russian unilateralism in no way means that Russia can walk away from its pre-existing legal obligations. Russia's *withdrawal* will have no impact on the Yukos case, nor will it affect the rights of other existing investors in Russia's energy sector....

Within this context, there should be little doubt that Russia's *withdrawal* from the ECT is anything more than a pre-emptive strategy.<sup>1206</sup> (emphasis added)

From a legal perspective, termination of PA (covered by ECT Article 45) is not the same thing as withdrawing from the Treaty (covered by ECT Article 47). In a critical letter to the editor of the same publication a week later, Konoplyanik responded:

Prof Gaillard [sic] makes a number of strongly worded political accusations against my country. I would like to make a few comments in this regard.

First, on July 30 Prime Minister Putin signed Government Ordinance N 1055-r that Russia is to terminate provisional application of the ECT, based on its Article 45 (3-a) (by stating its intention not to become an ECT contracting party). Prof Gaillard is a lawyer and he understands the difference between "withdrawing from the treaty" and "terminating its provisional application." As a result of Russia's decision my country will stay as a signatory to the ECT but now with a different status.<sup>1207</sup>

Termination of PA means that the state no longer intends to become a contracting party to the agreement. Withdrawal refers to abrogation of the agreement by a state after it has "entered into force for a contracting party,"<sup>1208</sup> in other words, after the state has ratified the Treaty. Absent PA and parliamentary ratification, the Treaty does not apply legally in Russia or to its nationals in other ECH states (for transactions that took place after the termination of PA went into effect). However, this is not irreversible. Russia signed the 1991 political declaration and the 1994 Treaty; this remains unchanged, and Russia can still unilaterally ratify the Treaty.<sup>1209</sup>

The termination of PA appears to have had minimal consequences for Russia's formal status as a member of the ECH regime. To date, five states have signed the Treaty but not ratified it: Russia, Belarus, Norway, Iceland, and Australia. Prior to the developments that transpired in the summer of 2009, two of these states were applying the Treaty on a provisional basis (Russia and Belarus), while the other three were not (they only signed the Treaty but no more). In reality, Russia left the group of ECH states that had signed the Treaty, begun applying it on a provisional basis, but not ratified it. After its PA was suspended, Russia joined Norway, Iceland, and Australia as states that had signed the Treaty but not ratified it and were not

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1206 Emmanuel Gaillard, "Russia cannot walk away from its legal obligations," Letters to the Editor, *Financial Times*, August 18, 2009.

1207 Andrei Konoplyanik, "Russia remains a signatory of the Energy Charter Treaty," Letters to the Editor, *Financial Times*, August 26, 2009, 6.

1208 The Energy Charter Treaty and Related Documents, Article 47 on Withdrawal, 91.

1209 Konoplyanik, "Energy Charter: If You Destroy It," 136.

applying it on a provisional basis. As a result, Belarus is the only ECH state that has signed the Treaty and applies it on a provisional basis but has yet to ratify it.

In fact, Russia is still a part of the ECH regime, can participate in the Conference, and can engage other states in activities within the regime. According to Konoplyanik,

Termination of provisional application of the ECT in principle does not prevent Russia from participating together with other countries [to reform the ECH regime]. For example, Norway, which also having signed the ECT does not apply the Treaty on a provisional basis, participates very actively in the Charter process.<sup>1210</sup>

Despite its extreme criticism of the ECT and ECH regime at the beginning of the year, it appears that Russia did not totally reject the ECH process after the presentation of the April Concept. According to Konoplyanik,

[W]hen the government order was issued, the scenario for reforming the Energy Charter process ...was being discussed informally with some of the key figures in this process, who were further discussing it with representatives of a number of European states, and won a strong support. *The Russian delegation took first steps in this direction on June 16 at the meeting of the Energy Charter ad hoc group on strategy.*<sup>1211</sup> (emphasis added)

Moreover, even after the termination of provisional application, Russia still did not burn all its bridges. To the contrary, it expressed that although it wanted to create a new framework, it was not rejecting the ECT entirely. During a press conference after the 24th EU-Russia summit in Stockholm on November 18, 2009, President Medvedev remarked:

We spoke about developing large scale economic projects, and this included questions about energy cooperation, the development of energy security, and the provision of energy security in Europe. In this respect, I believe that we found a normal mutual understanding, since without reaching agreement on these questions, it is impossible to imagine normal life-sustaining activity in Europe. And of course to a significant extent the provision of energy security will be connected with which legal instruments will be used by us.

I have brought the attention of our partners yet again to the energy initiative which was proposed by Russia in addition to the existing energy documents including the Energy Charter. I would like to say one more time, that relating to this theme, I believe it is necessary to continue the exchange of opinions, in order to create a high quality international basis for energy cooperation in the future.<sup>1212</sup> (emphasis added)

In the president's statement, there was no reference to which venues would be appropriate for developing a new framework. However, in promoting his initiative, he did strike a relatively favorable tone, noting that it was "in addition" to the ECH.

Finally, by the end of the year it was clear that Russia was still participating in the Charter process, it had not entirely rejected the ECT, and that the ECH could be a suitable venue for developing a new framework for energy cooperation. This is clear from the proceedings of the 21<sup>st</sup> Charter Conference in Rome on December 9, 2009, to which Russia sent a delegation, which made the following statement to the other participants:

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1210 Ibid., 135; Konoplyanik, "Why Is Russia Opting Out," 95.

1211 Ibid., 94.

1212 Press Conference on the Results of the 24th Russia-EU Summit, November 18, 2009, Stockholm, in *ibid.*, accessed December 9, 2011, <http://news.kremlin.ru/transcripts/6034/print>.

The Russian Federation has advocated the creation of a new architecture of energy cooperation, beginning with the G8 St. Petersburg Declaration and the Action Plan on global energy security. In April 2009, Russian President Dmitry Medvedev proposed a conceptual basis for a new international legal instrument. The delegate noted that in Russia's view the system of legal acts in the energy sector should be universal, equitable and non-discriminatory, as well as have an effective mechanism for their implementation and provide a procedure to meet emergency situations. *Russia is considering the possibility to update existing legal instruments addressing energy that could provide the basis for a new legal framework. This work will involve cooperation with various multilateral organisations concerned with energy issues. In Russia's view, one of the platforms for discussion on improving the international legal framework in the field of energy could be the Energy Charter Conference and its working bodies, as Russia considers the Energy Charter Treaty an important multilateral treaty in energy.*<sup>1213</sup> (emphasis added)

Again, Russia was pointing to new circumstances and calling for change. In addition, it was informing the other states that it was interested in updating legal instruments to provide a basis for a new framework. Moreover, it was prepared to do so in a variety of venues, of which the Energy Charter Conference was only one.

This was consistent with President Medvedev's statements from the beginning of the year: Russia was dissatisfied with the ECH regime and Treaty, wanted a new framework for energy cooperation, and was prepared to try to create one in another venue. However, it did not necessarily have a principled objection to the ECH setting or even the ECT. Work could proceed in that forum and based on that document provided other states were willing to accommodate Russia's interests. At the same time, Russia's engagement with the ECH was not necessarily an exclusive commitment.

### **Venue shopping and evolution of the Concept**

As already noted, the Conference at the end of 2009 saw Russia express its intention to promote its initiative in a variety of forums. During a speech, the Russian delegation mentioned specific venues for the first time:

Recent changes on the world energy arena, the emergence of new threats to the stability of energy markets and energy security have put on the agenda the need to significantly improve current regulatory framework of the energy cooperation.

...At present the Russian party is finalizing the "inventory" of legal instruments existing in the energy field. Considered is a possibility to update them taking into account current international realities, as well as elaboration of new comprehensive mechanisms taking into full account the whole range of issues related to energy transit and ensuring rights of exporting countries.

We are preparing proposals for giving substance to the new legal framework, on the format of international consultations and negotiations, on the ways and modalities of the development of broad international discussion on the Conceptual Approach. In a rough draft we have prepared a document tentatively entitled "Convention on international energy security" and a treaty on dealing with emergencies in transit of energy materials and products.

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1213 Summary Record of the 20th Meeting of the Energy Charter Conference, December 9, 2009, Note from the Secretariat (revised version 2), November 10, 2010, 12; see also Brief outline of the speech at the Energy Charter Conference Meeting, Rome, December 9, 2009, in Konoplyanik, "Energy Charter: If You Destroy It," 124.

At the same time we study the options of platforms for multilateral substantive work on elaborating new international legal tools. Among them there are the UN Economic Commission for Europe (UNECE), the International Energy Forum (IEF), and, possibly, the International Energy Agency (IEA).

In Russia's view, one of those platforms for discussion on improving the international legal framework in the field of energy could be the Energy Charter Conference and its working bodies.

Despite the termination of provisional application of the Energy Charter Treaty (ECT), Russia considers the ECT to be an important multilateral treaty in the energy field.<sup>1214</sup>

Once again, Russia was communicating that it was unsatisfied with the current system for energy cooperation and had serious plans to change it. However, Russia did not have a principled position on how this initiative related to the ECT and ECH regime. The delegation stated that one possibility was to update what already existed, and so it was creating an inventory of available instruments to this end. However, it was also considering "elaboration of new comprehensive mechanisms," and it was preparing a new Convention document and distributing a draft to other states.

In terms of platforms, Russia stated that the Conference was a possibility for interstate discussions despite its termination of PA. However, it was also studying other platforms: the UNECE, the IEF, and the IEA. By the end of 2009, the presidential initiative was evolving, and Russia's plans for promoting it were crystallizing. However, work within the ECH regime was not necessarily off the table.

Discussing energy cooperation with other states outside of the ECH setting was not a totally new phenomenon for Russia. Even when the Treaty was being developed, Russia engaged in bilateral discussions about energy with other states. Given the significance of the international energy trade to Russia and its centrality in global energy markets, this is not surprising.

Some important alternative settings for discussing energy relations were those available through EU-Russia bilateral relations. As we saw earlier, in 2001 President of the European Commission Romano Prodi proposed the "Energy Dialogue" to Russia. In 2005, Russia and the EU agreed to make the Dialogue an element of the Road Map to implement the Common European Economic Space.<sup>1215</sup> Interestingly, the impetus for including energy in a road map appears to have been Russia's exclusion from the European Neighborhood Policy (ENP). Developed by the EU in 2004,<sup>1216</sup> the goal of the ENP was to avoid "the emergence of new dividing lines between the enlarged EU and our neighbours... instead strengthening the prosperity, stability and security of all."<sup>1217</sup> Initially, it was destined for the EU's closest

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1214 Russian delegation, Brief outline of the speech at the Energy Charter Conference Meeting Rome, December 9, 2009 (unofficial translation).

1215 Opening words by Minister of Energy of the Russian Federation Sergey Ivanovich Shmatko at the Anniversary Conference of the EU-Russia Energy Dialogue in Brussels, November 22, 2010. The Common European Economic Space was first conceived in May 2001. The Road Map was created in May 2004. Christer Pursiainen, "The Ambiguity of the Common European Economic Space: A Strength or a Weakness?" unpublished paper by the Russian-European Centre for Economic Policy, accessed June 29, 2011, [http://www.recep.ru/files/documents/04\\_07\\_26\\_Economic\\_Space\\_En.pdf](http://www.recep.ru/files/documents/04_07_26_Economic_Space_En.pdf).

1216 "The Policy: What is the European Neighbourhood Policy?" accessed on June 29, 2011, [http://ec.europa.eu/world/enp/policy\\_en.htm](http://ec.europa.eu/world/enp/policy_en.htm).

1217 Ibid.



neighbors in Eastern Europe, North Africa, and the Levant<sup>1218</sup> and covered a wide array of issues, including the energy economy. A 2003 communication from the Commission to the European Parliament stated that: [e]nlargement gives new impetus to the effort of drawing closer to the 385 million inhabitants of the countries who will find themselves on the external land and sea border, namely Russia, the Western NIS and the Southern Mediterranean.”<sup>1219</sup> Later the former Soviet states in the Caucasus were also included.

A central component of the policy was the export of EU legislation (*acquis communautaire*) to its neighbors. The 2003 Commission communication just cited stated that:

The EU *acquis* offers a well-established model on which to establish functioning markets and common standards for industrial products, services, transport, *energy* and telecommunications networks, environmental and consumer protection, health, labour and minimum quality requirements....

In return for concrete progress demonstrating shared values and effective implementation of political, economic and institutional reforms, including in aligning legislation with the *acquis*, the EU’s neighbourhood should benefit from the prospect of closer economic integration with the EU. To this end, **Russia, the countries of the Western NIS and the Southern Mediterranean should be offered the prospect of a stake in the EU’s Internal Market and further integration and liberalisation to promote the free movement of – persons, goods, services and capital (four freedoms).**<sup>1220</sup> (emphasis added; bold in original)

As a reward for meeting EU benchmarks, neighboring states were offered closer relations. Thus, the ENP was an expression of the EU’s approach to integration developed during the 1990s: the EU would expand by exporting its values, institutions, political economic philosophy, and laws. States that performed well in these respects were offered a stake in the project.

However, as soon as the policy became public, Russia expressed concern to the EU about being included as a potential participant.<sup>1221</sup> The crux of Russia’s objection was that the policy envisioned the export of the EU’s *acquis* to its neighbors. However, unlike the 1990s, Russia was no longer satisfied with that kind of approach, particularly in energy. According to Konoplyanik,

EU international treaties with third states de facto function to expand the geographical area of the *acquis*...*The European Union has tried to use this approach with Russia.* The PCA of 1994 is based on a concept that is very close to the European Union’s concept of the harmonisation of legal systems since it establishes a soft obligation for the convergence of Russian law with European law. Article 55(1) of the PCA acknowledges that the convergence of legal systems is an important condition for the improvement of economic ties between Russia and the European Union. It then states that *Russia will endeavour gradually to achieve the compatibility of its legislation with that of the Community.* Thus, convergence in the PCA means the movement of

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1218 At present, the ENP includes 16 non-EU participants: Algeria, Armenia, Azerbaijan, Belarus, Egypt, Georgia, Israel, Jordan, Lebanon, Libya, Moldova, Morocco, Occupied Palestinian Territory, Syria, Tunisia, and Ukraine, Documents: Who participates, accessed December 9, 2011, [http://ec.europa.eu/world/enp/partners/index\\_en.htm](http://ec.europa.eu/world/enp/partners/index_en.htm) .

1219 “Wider Europe—Neighbourhood: A New Framework for Relations with our Eastern and Southern Neighbours,” Communication from the Commission to the Council and the European Parliament, COM (2003): 104 final, November 3, 2003, Brussels.

1220 Ibid.

1221 According to Konoplyanik, then Russian Deputy Prime Minister Victor Khristenko “expressed his concerns with respect to the European Neighbourhood Policy in a letter to the then CEC DG TREN Director General François Lamoureux immediately after publication of the policy which initially mentioned Russia as a possible recipient country.” Konoplyanik, “A Common Russia.”

Russian legislation towards EU legislation rather than a process of mutual movement of both parties towards each other's interests.

The Energy Charter Treaty served as the “training class” to implement the EU energy rules in non-EU states before they joined the Union....

While it is reasonable to expect EU candidates to submit to EU norms it is difficult (if not impossible) to find solid ground to implement the same approach with respect to Russia since Russia has not expressed an intention to become a member of the European Union. Moreover, it has been clearly stated by Russian officials that Russia would not want to implement the *acquis*.<sup>1222</sup> (emphasis added)

Thus, rejection of the ENP was an early signal that Russia was no longer a regime taker. Rather than adopt EU law, Russia wanted a separate arrangement in which both it and the EU would work together to create a new regime. As a result, Russia was excluded from the ENP. In 2004, the partners agreed to create a Road Map within the Common European Economic Space, and energy was included in the Road Map in 2005.

Another important bilateral venue was the PCA. As bilateral negotiations on a new PCA were getting underway in the fall of 2006,<sup>1223</sup> Russia proposed to the EU to add an energy chapter in the new agreement, which would then govern energy relations between the two states.<sup>1224</sup> The 1994 PCA did not have a chapter on energy. Rather, it referenced the Energy Charter and Treaty to which it gave priority in this sphere.<sup>1225</sup>

How such an arrangement would relate to the ECT was not entirely clear. At the time, Russia suggested that it could be based on “Energy Charter principles”<sup>1226</sup> or be a totally new agreement.<sup>1227</sup> According to one interview participant, Russia proposed to incorporate the draft TP, on which significant agreement already existed between Russia and the EU, into the new PCA. Strictly speaking, this would have been a violation of ECT Article 33.3, which explicitly states that only states that have signed the 1991 Charter and also become contracting parties

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1222 Konoplyanik, “A Common Russia,” 267, 265, 269.

1223 The agreement was signed in 1994, went into effect in 1997, and lasted ten years (until 2007). Thus, the states needed to begin negotiations to craft a new agreement. Until a new PCA was finalized, article 106 of the initial Treaty provided for automatic annual renewal “provided that neither Party gives the other Party written notice of denunciation of the Agreement at least six months before it expires.” Agreement on partnership and cooperation establishing a partnership between the European Communities and their Member States, of one part, and the Russian Federation, of the other Part, Official Journal L 327, November 28, 1997, accessed on June 28, 2011, [http://trade.ec.europa.eu/doclib/docs/2003/november/tradoc\\_114138.pdf](http://trade.ec.europa.eu/doclib/docs/2003/november/tradoc_114138.pdf).

1224 Konoplyanik, “A Common Russia,” 258, 269; “Energy Charter will Secure,” 44; interviews in Moscow, 2008-2009.

1225 Article 65, Energy, stated that: “Cooperation shall take place within the principles of the market economy and the European Energy Charter, against a background of the progressive integration of the energy markets in Europe.” Article 105 declared that: “In so far as matters covered by this Agreement are covered by the Energy Charter Treaty and Protocols thereto, such Treaty and Protocols shall upon entry into force apply to such matters but only to the extent that such application is provided for therein.” Agreement on partnership and cooperation.

1226 According to Konoplyanik, this referred to the Energy Charter political declaration from 1991. This would have left the ECT and its legal provisions in limbo. As a result, the EU and Russia would have created a political legal edifice for the energy trade that was parallel to the ECT but not necessarily consistent with it from a legal perspective. It appears that there was limited support within the EU for such an option. For a more detailed examination of this question, see Konoplyanik, “A Common Russia,” 269.

1227 *Ibid.*, 258, 261.

(signed and ratified the Treaty) can become parties to its protocols.<sup>1228</sup> Another alternative would have been to use the text from the draft TP without actually referring to the draft protocol document. However, it is not clear whether the EU would have accepted this kind of solution.

In any case, the energy process in the PCA did not go anywhere because before official negotiations could begin, Poland vetoed the Commission’s mandate to negotiate with Russia in late 2006 due to a trade dispute related to Russian imports of Polish meat. It was later joined by Lithuania as a result of a dispute related to the closure of the Druzhba pipeline. The veto was lifted in late spring of 2008,<sup>1229</sup> and negotiations were finally launched during the Khanty-Mansiysk bilateral summit in June 2008. However, they were suspended by the EU in September 2008 after the Russo-Georgian war. Although they were resumed in short order, as we have seen, the gas war with Ukraine soon after led Russia to develop a brand new initiative, which became the focal point of its diplomacy.

In any case, at the 2009 Conference, Russia was for the first time proposing to address the question of energy security in a much broader array of settings, which included the ECH regime and EU-Russia bilateral venues that dealt with energy, but other multilateral settings as well. During a special expert meeting at the OSCE on September 13, 2010, Theodore Shtilkind from the Russian Ministry of Energy made a presentation summarizing the contents of a draft Convention on Ensuring International Energy Security, which Russia was preparing to make public to “experts of all interested States and international organizations for discussion.” According to Shtilkind, this was the “first official report on the document.” In conjunction with the “High-level Conference marking the 10th anniversary of the EU-Russia Energy Dialogue,” which took place in December 2010, Russia presented for the first time the draft Convention on Ensuring International Energy Security,<sup>1230</sup> a more elaborate successor to the Concept.

Finally, after the Convention was unveiled in December 2010, Shtilkind made another presentation to explain the Russian initiative during the 21st annual session of the (UNECE Working Party on Gas, held on January 18 and 19, 2011.<sup>1231</sup> At the end of his presentation, Shtilkind concluded by stating that Russia was: “looking forward to receiving comments,

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1228 The Energy Charter Treaty and Related Documents, 82.

1229 European Parliament resolution of June 19, 2008, on the EU-Russia Summit of June 26-27, 2008, in Khanty-Mansiysk (2009/C 286 E/09), point H, Official Journal of the European Union, C 286 E/36 EN, November 27, 2009, accessed December 9, 2011, <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2009:286E:0035:0041:EN:PDF>.

1230 The Convention is a 29-page document that has ten parts and two annexes. The key point here is that the broader Russian initiative to transform the international framework for energy cooperation was evolving. Since the contents of the Concept have already been analyzed in detail, and as the Convention is essentially a more elaborate version of this earlier proposal, it is not necessary to examine the contents of it here. One important difference that is worth noting was that the Convention included a long list (Annex 2) of potential protocols (twelve) that Russia was recommending. These included sectoral protocols, protocols on particular issues (most notably a “Protocol on Long-Term Contract System in Energy Resources Trade” and a “Protocol on New Principles of Financial Arrangements in Hydrocarbon Trade”). For a summary of the document by the Ministry of Energy, see: Presentation by Mr. Theodore Shtilkind, Ministry of Energy of the Russian Federation, at the OSCE Special Expert Meeting on Assessing the OSCE’s Future Contribution to International Energy Security Co-Operation, PC.DEL/901/10, September 13, 2010. An unofficial copy of the Convention was accessed on June 29, 2011, [www.ua-energy.org/upload/files/Convention-engl1.pdf](http://www.ua-energy.org/upload/files/Convention-engl1.pdf).

1231 Theodore Shtilkind, Ministry of Energy of the Russian Federation, “On the draft Convention on Ensuring International Energy Security (current status),” PowerPoint presentation, 21st annual session of the UNECE Working Party on Gas, January 18-19, 2011.

opinions and constructive proposals which will be in due course considered and taken into account.”<sup>1232</sup> Thus, Russia had made its move and was waiting for other states to respond.

UNECE is one of five regional commissions of the United Nations, and its primary goal is “to promote pan-European economic integration.” To achieve this goal, it

provides analysis, policy advice and assistance to governments, it gives focus to the United Nations global mandates in the economic field, in cooperation with other global players and key stakeholders, notably the business community.

The UNECE also sets out norms, standards and conventions to facilitate international cooperation within and outside the region.<sup>1233</sup>

It specializes in a variety of issues including energy. UNECE is composed of 56 member states and includes all the former Soviet republics (including the states of Central Asia and the Caucasus), EU states, Norway, Turkey, Israel, United States, and Canada. Thus, membership is not geographically limited to Europe. Furthermore, all interested UN member states can participate in its work, and more than 70 international professional organizations and other non-governmental organizations take part in its activities. In fact, the membership of UNECE overlaps significantly with the ECH.<sup>1234</sup> Perhaps the most interesting difference is that UNECE does not include the EU, which is a member of the ECH. Finally, UNECE is also an observer to the ECH Conference. Therefore, an institutional link exists between the ECH and UNECE.

In conclusion, Russia’s April 2009 initiative was evolving textually and being presented in a variety of venues that included bilateral EU-RF forums but also multilateral settings such as the OSCE and UNECE. The ECH also saw activity related to the Russian proposals, and the concluding section of this chapter examines the most recent developments in this respect.

### *Russian participation in the ECH: just another venue?*

Russia presented a summary of its draft Convention to the SG on October 11, 2010. This was roughly a month after Shtilkind’s presentation at the OSCE. It is not clear whether this was a deliberate snub or if Russia was not prepared to make a presentation at the previous SG meeting, which was held on June 17, 2010. In any case, it was clear that the ECH did not necessarily have priority status among multilateral institutions when it came to Russia’s foreign energy diplomacy.

At least on the surface, the reception was favorable. In his year-end report to the ECH conference, the chairman of the SG noted that:

Delegations showed great interest in familiarizing with this document and in discussing its contents within the context of the modernization of the Energy Charter Process. The Chairman confirmed the availability of the Strategy Group for such a discussion, in view of its mandate to

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1232 Ibid.

1233 UNECE, Introducing CMS Training, accessed December 9, 2011, <http://www.unece.org/cms-training/home.html>

1234 Japan, Australia, and Mongolia are the only ECH Conference members that are not in UNECE. Andorra, Israel, Monaco, and San Marino are in UNECE but not in the ECH at all. Canada, Serbia, and the United States of America are in UNECE but are observers to the ECH Conference. Finally, a number of significant states, for example, China, Iran, Saudi Arabia, Egypt, Pakistan, and Venezuela, are observers to the ECH Conference but are not in UNECE.

participate in the process of consultations over possible enhanced legal frameworks for energy cooperation. A corresponding task could be formulated by the Conference.<sup>1235</sup>

The response suggests that the convention could also be a basis for discussions on reforming the ECH, including discussions of the regime's legal contents.

Russia also made a summary presentation of the Convention to the 2010 ECH Conference. According to summary documents,

The Russian Federation delegation thanked the Conference for the opportunity to present the Russian-proposed draft Energy Convention and briefed the Conference on the fundamental principles of the Russian Federation's proposal. The background of the proposal was outlined, stating that the existing agreements were not enough to safeguard energy security. The developments that had led President Medvedev to propose a new global energy agreement which would take into account a wide range of issues not covered by existing international instruments were discussed. The delegation informed the Conference that the outline of the draft Energy Convention prepared by Russian experts had already been presented to various fora, including the Energy Charter Strategy Group, OSCE, UNECE....The core areas covered by the draft Energy Convention were outlined, including the governing structure and the organisational matters. The delegation expressed the hope of engaging all interested parties in detailed discussions to enhance the global energy framework.<sup>1236</sup>

In this way, the delegation briefed the other states about the context and substantive contents of the Convention, pointed out that it had already been presented in other venues, including non-ECH settings, and expressed hope to engage a wide audience in discussions related to the proposal.

Despite Russia's participation in the SG and at the ECH Conference during 2009 and 2010, there is some evidence that its engagement has diminished since 2009. Konoplyanik has written that with the April Concept, the Russian document became the focal point of Russian activity. At the 2010 Conference, various states also noted Russia's diminished engagement. A summary of comments made by Philip Lowe, the director-general for Energy, European Commission, (representing EU Energy Commissioner Oettinger), states that:

Mr. Lowe highlighted the importance of Russia's participation in the Energy Charter Process. He expressed his hope that Russia's presence at the Conference meeting was a *signal of its renewed engagement* in the Energy Charter Process. Mr. Lowe reiterated that the EU was open to discuss Russia's views on enhanced legal frameworks for international energy cooperation.

The EU believed that the Energy Charter was the forum where such discussions should take place, in an open and constructive spirit. It was the EU's firm belief that Russia belonged to the EU's Energy Charter family.<sup>1237</sup> (emphasis added)

According to summary documents, similar sentiments were expressed by the delegation from Italy during a discussion of the Road Map at the 2010 ECH Conference:

Italy stressed the importance of the modernization process, of renewed engagement for enhanced cooperation, mechanisms for emergency responses, conclusion of the Transit Protocol and promoting transparency, credibility, competition and energy technology transfer. Also highlighted

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1235 21st Meeting of the Energy Charter Conference, November 24, 2010, Reports from the Energy Charter Groups, Report by the Chairman of the Strategy Group, November 8, 2010.

1236 Note from the Secretariat, Summary Record of the 21st Meeting of the Energy Charter Conference, November 24, 2010 in the Justus Lipsius Building (Council of the European Union) in Brussels, June 23, 2011.

1237 Ibid.

was the importance of discussing new proposals for international energy cooperation and *Russia's participation in the modernisation process.*<sup>1238</sup> (emphasis added)

Finally, after Russia's presentation on the Convention to the 2010 Conference, the Conference chairman also made remarks to a similar effect. According to summary documents,

The Conference Chairman thanked the Russian delegation for the presentation and expressed the shared view that the Energy Charter would be the forum used for discussing the Russian Federation proposals. He hoped for Russia's renewed engagement in the modernisation of the Energy Charter Process.<sup>1239</sup>

In addition, although political negotiations on the TP were restarted in 2010, it appears that Russia disengaged from this process. According to a summary of the proceedings of a meeting by the Trade and Transit group in October 2010,

[Some delegations] asked for a clarification of Russia's status in the negotiations on the dTP...[The chairman] looked forward to an active involvement of the Russian delegation in future meetings, since they had been absent from the previous meetings.<sup>1240</sup>

In 2010, Russia apparently stopped attending the trade and transit meetings. This appeared to be connected with Russia's work on its forthcoming proposal and provoked a debate within the group on how to proceed. Some states argued that the Russian initiative should not hamper negotiations:

Another issue addressed was the intention of the Russian Federation to present in the near future a draft "Convention on Ensuring International Energy Security" to cover also energy transit. Delegations confirmed their interest in familiarizing with the document, but some argued that the development of the dTP should not be dependent on the availability of the "Convention."<sup>1241</sup>

Others felt that the Convention, which touched on transit, should be included in negotiations: "Japan expressed its consent with involving Russia actively, and suggested mentioning the draft "Convention" along with the issue of compliance with EU law as issues to be discussed in 2011."<sup>1242</sup> The group chairman also proposed to wait for the Russian proposal:

The Chairman confirmed that the TTG was operating under the existing mandate, but there was an interest to find out about Russia's position. In this view, the "Convention" could be considered a new input, in line with the negotiation guidelines allowing parties to bring any issue that they deem vital for them.<sup>1243</sup>

What do we make of Russian behavior? Konoplyanik has argued that Russian engagement diminished due to a knee-jerk reaction from the bureaucracy after Russia's termination of PA.<sup>1244</sup> This is possible. However, we have seen that Russia did participate in some ECH meetings. At a minimum, it attended the 2009 and 2010 Conferences and two of the four SG meetings held in 2010. Therefore, Russian truancy appears to have been selective.

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1238 Ibid.

1239 Ibid.

1240 Note from the Secretariat, Summary Record of the Trade and Transit Group Meeting on October 12, 2010, March 7, 2011.

1241 Ibid., 4.

1242 Ibid.

1243 Ibid.

1244 Konoplyanik, "Why Is Russia Opting Out," 94.

One explanation is that Russia was protesting demands made by the EU concerning negotiations on the draft TP. This is the interpretation offered by Kazakhstan:

Kazakhstan noted that since the beginning of the negotiations of the dTP the ideology of the discussion had changed significantly and new conditions had been put on the table. *Following the conditions put forward by the EU and the discrepancies with Russia's position, it was now unclear whether Russia would participate in the negotiations.* If Russia now put forward new conditions, progress would be difficult to achieve. The delegation failed to understand how the EU would want to ensure the compatibility of the dTP with the *acquis*, which would be a huge endeavour. However, in view of no progress made since a year, a push would be necessary.<sup>1245</sup> (emphasis added)

As we saw earlier, the EU made its position on the REIO a precondition for political negotiations on the draft TP. This position categorically rejected the Russian proposal in Article 20.3, and apparently Russia refused to proceed with negotiations on these terms.

In addition, after Russia terminated its PA of the ECT in 2009, the EU declared that it was “analyzing... carefully” its agreement to the Understanding on Transit Tariffs in the draft TP “in light of recent developments” and that it would keep “its position open when carrying this through to formal negotiations.”<sup>1246</sup> This might also have contributed to Russian disengagement. In any case, the EU position on transit might explain why Russia participated in other meetings but not political negotiations on the draft TP.

Finally, Russia's selective engagement in the ECH, in contrast to its very active participation after late 2004 (particularly in discussions on the draft TP after Gazprom became involved) was consistent with the idea that the ECH was one of several options for Russia to reform the international system for energy cooperation. In other words, Russia was venue shopping as a tactical maneuver to compel ECH states to accommodate its interests. To do this effectively, Russia had to promote energy cooperation in alternative venues and also curtail its engagement in the ECH. Russia was doing both, and the tactic was not entirely unsuccessful. For example, during the February 2010 SG meeting, the EU “repeated its position with regard to the “Conceptual Approach” of President Medvedev, which could be discussed if the Russian Federation expressed their wish to do so and participated actively.”<sup>1247</sup>

In making participation a pre-condition for discussing the proposal, the EU was implicitly recognizing that it would discuss the Russian initiative.

Interestingly, Russia's diminished engagement during 2009 and 2010 did not prevent its initiatives from affecting debates and programs within the ECH regime. The next section examines this question in greater detail.

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1245 Note from the Secretariat, March 7, 2011.

1246 20th Meeting of the Energy Charter Conference, the Understanding related to Article 10 in the draft TP and ECT Article 7.3. See previous chapter.

1247 Note from the Secretariat, Summary Record of the (Ad Hoc) Strategy Group Meeting, February 19, 2010, February 25, 2010.



### **Russia’s influence on ECH regime evolution: debate over principles and “modernization”**

Developments within the ECH regime are still ongoing. As a result, rather than presenting a detailed analysis of these developments (from 2009 to 2010), this section presents an overview of key elements that emerged during this period.

The 2009 Russo-Ukrainian gas war had a significant effect on the ECH process.<sup>1248</sup> In particular, it created a stronger conviction among the states that indeed the regime needed to be significantly adapted in key respects. Whereas a cognitive consensus concerning the need to adapt the regime and improve the Treaty was largely lacking during 2006 to 2009, the gas crisis highlighted areas where the regime/Treaty were inadequate and created an impetus for work to make them more effective. This concerned first and foremost the shortcomings of the ECT when it came to emergency situations. In a report to the 2009 ECH Conference, the SG chairman noted that:

The Group Chairman reported that following the gas crisis of January 2009, the Ad Hoc Energy Charter Strategy Group (AHSWG) proved to be a suitable forum for discussing the situation and considering the question of whether the Energy Charter Process had a role to play and the right instruments to offer in such a situation. Doubts were expressed about whether arbitration under Article 27 ECT was sufficiently fast to overcome a crisis situation and restore gas flows, and whether the conciliation procedure under Article 7(7) was sufficiently clear and precise.

The AHSWG recommended that the Conference continue its work on further defining the role of the ECT with regard to crisis situations, with a focus on fast-track arbitration and on mediation by legal experts acting under the authority of the Energy Charter Conference.<sup>1249</sup>

Interestingly, discussions related to transit emergencies also took on a technical flavor, apparently in response to the numerous technical questions that the dispute raised (such as operational reliability, underground storage, and reverse flows).<sup>1250</sup> Therefore, adaptation processes inside the regime were to a certain extent overtaken by major external events that had a significant effect on member states’ policies directly.

At the February 2010 meeting of the SG, when the group discussed the emerging Road Map for Modernization of the Energy Charter process (discussed below), the EU expressed that:

As the reference in paragraph 3 to “possible enhanced legal frameworks for energy co-operation” seemed to hint at the “Conceptual Approach” of President Medvedev, it should be noted that while this initiative could be a matter of consideration during the discussion, there should not be an impression that this discussion was triggered by the “Conceptual Approach.”... The EU asked to reflect this view in the summary record, while not requesting a change in the text of the Terms of Reference.<sup>1251</sup>

The EU wanted the record to reflect that the discussion on reform was not precipitated by the April Concept. This is understandable: since what documents can be legitimately considered within the ECH context might be the subject of bargaining, the EU wanted the record to show that the modernization process was not connected to the Russian initiative. However, this belies

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1248 See, for example, Report by the Chairman of the Group on Trade and Transit (CC 371), November 10, 2010; Note from the Secretariat, 20th Meeting of the Energy Charter Conference.

1249 Ibid., 3.

1250 Ibid.

1251 Secretariat, Summary Record of the (Ad Hoc) Strategy Group Meeting on 19 February 2010, Brussels, 25 February 2010.



the fact that Russian initiatives had a very significant effect on discussions and activities within the ECH during this time.

In fact, the states definitely acknowledged the significance of the April initiative by President Medvedev, which became an important reference point for discussions within the ECH setting. The chair of the SG reported to the 2009 conference that:

Another topical issue covered by the Group was the “Conceptual Approach to the New Legal Framework for Energy Cooperation” presented by the Russian President Dmitry Medvedev in April 2009. The delegates to the Group considered this initiative relevant to the work of the Group and agreed to start an informal discussion, also in the context of the idea of modernising the Energy Charter Process.<sup>1252</sup>

States acknowledged the need to improve the ECH; however, they objected to the idea of a brand new framework. The proposal could be considered, but only as part of an adaptation process that takes place within the ECH regime.

Delegations expressed their readiness to engage in a constructive dialogue with Russia on the “Conceptual Approach.” Several delegations expressed the view that there was no need to negotiate an entirely new legal framework and that it was preferable to bring the discussion into the already existing Energy Charter Process, whose effectiveness could however be further improved, e.g., by the inclusion of more global players on energy markets, such as major producers and emerging economies, and by effective implementation mechanisms. The Charter Process could benefit from a continued discussion on these issues.<sup>1253</sup> (emphasis added)

Interestingly, several former Soviet states, notably Kazakhstan and Armenia, became more vocal in supporting the Russian initiative. For example,

The delegate of Kazakhstan highlighted the changing nature of world energy markets.... There have also been important political developments in the ECT area, notably the growth of the European Union, the expansion of the constituency of the ECT and the increase in the numbers of states signing the ECT and joining the WTO. *These changes raise questions about the current ECT, as underlined by the Conceptual Approach presented by the Russian President.* The delegate indicated that *the modernisation and adaptation of the ECT* are thus topical issues, and this is especially important in respect to mechanisms for preventing and managing crisis situations.<sup>1254</sup> (emphasis added)

Similarly, during the 2010 conference, the Armenian delegation:

referred to the energy security issues in Armenia and in the South Caucasus Region generally. The delegation briefed the conference on Armenia’s participation in regional projects, stressing the importance of discussing the Russian proposal within the modernisation process.<sup>1255</sup>

In addition, the question of energy security became very prominent during discussions. However, beyond the problem of energy emergencies (such as interstate disputes and the interruption of transit, which affected both security of supply and demand), there did not appear to be a consensus on how this was to be defined. The Russian definition, which included security of demand, was still not widely accepted. In addition, the significance of the ECH as a

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1252 Note from the Secretariat, 20th Meeting of the Energy Charter Conference, 3.

1253 Ibid., 3.

1254 Ibid., 13.

1255 Note from the Secretariat, Summary Record of the 21st Meeting of the Energy Charter Conference, 4.

policy forum also became more prominent. Previously, its importance as a law creating setting had been more salient.

That year (2009) saw a regular review of the ECH process, which included questionnaires completed by delegates and direct consultations. The review was headed by Professor Sergio Garribba, designated the special representative for the review, who presented his report to the 2009 Charter Conference. The review concluded that, “[w]hile the Energy Charter Treaty had had a positive impact on energy markets, investment, trade and transit, there was a need to modernise the Process with a view to the dynamic energy context.”<sup>1256</sup> Therefore, a consensus was emerging that the ECH needed to be more adaptable. Garribba also recommended making the (ad hoc) SG a permanent body “to address policy and horizontal issues, the modernisation of the Energy Charter Process, enlargement activities.” Here, horizontal issues referred to questions that are not part of the energy sphere per se, but are directly related, such as the financial crisis and the environment. Finally, Garribba argued that: “[t]he discussion on the ‘Conceptual Approach to the New Legal Framework for Energy Cooperation’ presented by President Dmitry Medvedev in April 2009 could be instrumental for re-launching the Energy Charter Process globally.”<sup>1257</sup>

The ECH conference adopted a Statement (the “Rome Statement”) at its 2009 meeting. The Rome Statement noted the importance of the principles and action plan established at the 2006 G8 Summit and Russia’s April 2009 initiative:

Whereas recalling the Principles on Global Energy Security and the Plan of Action as adopted by the G8 St. Petersburg Summit in July 2006;

Whereas recalling the Conceptual Approach to the New Legal Framework for Energy Cooperation as presented by the President of the Russian Federation Dmitry Medvedev in April 2009.<sup>1258</sup>

The statement also established the SG as a standing body of the ECH regime, as Russia had proposed unsuccessfully in late 2007.

### *The 2010 Road Map*

The SG met four times during 2009. By the end of the year, the group drafted a Road Map for the Modernization of the Energy Charter Process. The strategic document was intended to “orientate the work of the subsidiary bodies and the Secretariat towards 2014.”<sup>1259</sup> The Road Map was approved at the 21<sup>st</sup> meeting of the Energy Charter Conference.

This section examines this Road Map to understand the substantive goals of the adaptation process. This is a useful window for gleaning the influence of Russia’s attempts to adapt the ECH regime. It is clear that the document was influenced by Russian efforts. Like the Rome Statement, it referenced the 2006 G8 and the April Concept. Concerning the latter, it noted in the introduction that it was: “one important contribution in relation to possible enhanced legal frameworks for energy co-operation.”<sup>1260</sup> It also emphasized that:

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1256 Note from the Secretariat, Summary Record of the 20th Meeting of the Energy Charter Conference, 14.

1257 Ibid., 15.

1258 Note from the Secretariat, Summary Record of the 20th Meeting of the Energy Charter Conference, 26.

1259 Note from the Secretariat, Summary Record of the 21st Meeting of the Energy Charter Conference, 22.

1260 Ibid., 21.

[T]he *modernization of the Energy Charter Process and strengthening the Energy Charter Treaty* are the keys to ensure that their potential to promote long-term cooperation in the energy field as well as energy security is fully used, and are the right way to strengthen the Energy Charter's authority, to ensure the continued commitment of existing members and to make it more attractive for those major actors which are currently not part of its constituency.<sup>1261</sup> (emphasis added)

Thus, the ECH states were clearly acknowledging that the goal was to adapt not only the ECH process, but also the ECT as Russia had proposed earlier. This was necessary if the regime was to prove a durable instrument for promoting international energy cooperation and managing energy security. In fact, the authority of the regime depended on this.

The document is divided into seven parts. The first part (Area A) on the promotion of the ECH and the ECT demonstrates that the states agreed in principle on expanding the membership of the ECH regime. It recalled the Rome Statement, which called for “expansion ...of its geographical scope.” This appears to be influenced by Russia's call to expand the ECH membership and make the regime universal. However, as an action plan it declared an, “[o]penness towards the integration of key energy players (producers, consumers and transit countries) outside the existing constituency.”<sup>1262</sup> Moreover, expansion is to be “targeted.” This indicates there was nevertheless some caution about inviting states from outside the current constituency. Finally, in addition to an interest in expansion, there is also a focus on “consolidation,” which refers to the need for signatories to complete ratification. In this respect, it recommended: “[a]n analysis based on the experience with existing partners of what prevents them from undertaking the next step towards their full membership in the Energy Charter Treaty, and proposals on how to respond to their hesitation.”<sup>1263</sup> Given this lack of consensus on the details of expansion and its relationship to ratification, it is not surprising that no specific action plans emerge; the “outputs” relate to further study of which states/regions to engage and how to promote ratification.

The second part (Area B) on transit and cross-border trade dealt with transit generally. Again, the April Concept was referenced in connection with “smooth energy supply to international markets;” therefore, thinking about transit in general was influenced by the gas crisis and Russia's initiative. In terms of action, the states again declared the intention to finalize expeditiously the draft TP. It had already been agreed at the 2009 Conference to restart political negotiations on the document, and the Road Map also called for formal negotiations. A key concern here was to clarify “the relationship of the draft Transit Protocol with legislation applicable within Regional Economic Integration Organisations as well as possible obligations of states under other international treaties.” Here, Kazakhstan appeared to ally with Russia:

The delegation of Kazakhstan, while expressing support for an expeditious finalisation of the draft Transit Protocol, noted that further clarifications were necessary to assess its expected effectiveness in view of the limitation of its application within the EU due to Article 20 and urged a constructive approach to the negotiation of this Article.<sup>1264</sup>

Thus, although there was a clear sense of how to proceed, the question of the eventual TP's application within the EU remained unresolved.

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1261 Ibid., 22.

1262 Ibid., 23.

1263 Ibid.

1264 The Further Procedure Regarding the Draft Transit Protocol (CC 372).

The third part (Area C) on emergency responses demonstrates that the states agreed that the ECH needed to be adapted to deal with emergency situations. This was the question that reflected the greatest consensus. Clearly, the 2009 gas crisis had a decisive influence here. Moreover, it was clear that ECT provisions needed to be strengthened to address this question. Interestingly, the document noted that law and legal norms were not sufficient for preventing conflicts: “[c]onflict situations have occurred in energy relations irrespective of existing bilateral arrangements and multilateral legally binding norms governing international energy relations.”<sup>1265</sup> The document noted that the ECH had a two-pronged approach to deal with conflicts: law (the binding provisions of the ECT) and diplomacy (the “the multilateral forum of peers established by the Charter Conference and its subsidiary bodies.”)

In terms of action, the document recommended the development of “additional binding rules” through a Protocol that would “oblige [states] to support an accelerated process of state-to-state arbitration (fast-track arbitration) in cases of emergency.” Another recommendation is for a Conciliator to be able to “balance his position between the interests of energy producers, transit countries and consumers, based on applicable rules and obligations as well as common interests.” Finally, it notes that the Conference should consider measures to promote the implementation of the ECT, provide early warning mechanisms, and settle/prevent disputes. This appears to point to a more prominent role for the Secretariat.

Part 4 (Area D) on investment promotion and protection also referenced the April Concept and the 2006 G8. This part of the document is very ambiguous, probably reflecting a lack of consensus on what exactly the problem was and how to deal with it. This is probably an artifact of the fundamental disagreements between the EU and Russia that emerged as Russia began adapting the regime in late 2006.

While there is a general commitment to promote and protect investments through “a predictable, transparent and non-discriminatory legislative environment,” it is not clear how this can be realized in practice. There appear to be two main issues that need to be addressed.

First, the document noted cross-currents in patterns of international investment. On the one hand there was activity to “further liberalize investment regimes and to promote foreign investment in response to intensified competition for foreign direct investment (FDI).” This is related to the dominant neo-liberal regime principle from the 1990s (meaning private investors are in the driver’s seat) and reflects the general EU approach. At the same time, it pointed toward moves to “regulate and harness FDI in pursuit of broader policy objectives.” The latter reflected a very different principle in which states were in control to pursue broad policy goals. This principle is reminiscent of Norwegian arguments a decade earlier. It also reflects the Russian approach to investment in energy and also the EU approach to investment from Russia (that is, the EU often invokes energy security and competition goals when interfering with Russian investments in Europe). Thus, there is no single overriding principle to guide action. In fact, the tension between the two principles is the very problem that makes legal predictability, transparency, and non-discrimination so difficult to implement.

The second problem is the relationship between investment and energy security. The document linked investment to energy security, which is articulated as a common responsibility.

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1265 Note from the Secretariat, Summary Record of the 21st Meeting of the Energy Charter Conference, 24.

Here the solution appears to be “transparent, equitable, stable and effective legal and regulatory frameworks,” and the 2006 G8 is referenced in this respect:

In 2006 the G8 leaders committed to transparent, equitable, stable and effective legal and regulatory frameworks, including the obligation to uphold contracts, to generate sufficient, sustainable international investments upstream and downstream. They further committed to enhance global energy security through actions aimed at improving the investment climate in the energy sector.<sup>1266</sup>

The use of “equitable” appears to be an acknowledgement of the Russian demand for reciprocity between suppliers and consumers.

The meaning of “upholding contracts” is vague. It can refer both to renegotiation of agreements (Russia) or threats to existing LTCs (the EU). In any case, there is no mention of security of demand as a necessary condition for investment as put forward by Russia. Again, this reflects a tension between the principles of liberalization and state action to promote policy goals (managing demand to promote security of supply). As we saw in the previous chapter, this was an area of fundamental disagreement between Russia and the EU. Finally, effective legal and regulatory frameworks are key, but it is not clear what would make them effective. This is the very substance of the disagreement.

In terms of action, the Road Map calls for policy recommendations from the investment group based on analyses of ECH states’ exceptions to non-discrimination and the question of mutual exchanges of energy business assets within investment activities (that is, asset swaps). Therefore, there is no concrete action beyond further study of the problem with an eye towards eventually formulating policy.

However, the Road Map proposes an option to facilitate “direct investment contracts between foreign investors and the host country ...to ensure legal certainty” for major foreign investment projects. The benefit of “[s]uch contractual arrangements [is to] endow host countries with the possibility to negotiate specific aspects with foreign investors, for instance with regard to the transfer of know-how, investment and environmental standards.” This is reminiscent of the Soviet approach whereby the emerging international arrangement would actually stimulate investment directly for large projects, and the state would have a hand in determining the terms of investment beyond simply creating a general legal framework (through negotiated contracts, for example).

It is not clear why legal certainty would prevail from this approach. There is no mention of political guarantees, which underpinned the Soviet approach and lies at the heart of Russia’s proposal for asset swaps. However, the document does propose that such “[i]nvestment contracts can also lay the foundation for public-private partnerships.” This refers particularly to “development and deployment of low-carbon technologies or joint research activities.” It hinted at equal state-firm cooperation (partnership) in economic activities. Although it is in a limited sphere, this is significant because it points to the potential importance of the state in mobilizing investment (deployment of technology) when a particular policy goal is at state (efficiency and reduction of CO<sub>2</sub> emissions). In summary, regarding investment the Road Map does not list specific recommendations for action (such as finalize the TP or draft a protocol on emergency situations).

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1266 Ibid., 26.

The fifth section (Area E) on energy efficiency noted that this question was a “tool for achieving and reconciling different objectives” and linked the issue to “energy security, the environment, industrial competitiveness, and reliable and affordable access.” However, it also acknowledged that “energy efficiency is a cross cutting subject matter for many international organizations.” In fact, there appears to have been a consensus among the states that the issue should not be dealt with exclusively in the ECH context: “[m]ember states have requested that activities within the Charter be developed in partnership with other international organizations to ensure constructive synergies and avoidance of overlap.”<sup>1267</sup> As a result, most of the discussion focused on how the ECH could cooperate with other international organizations to deal with this issue.

Finally, part 6 (Area F) deals with the question of the ECH as a policy forum, as well as the issues of interdependence and energy security. The Road Map recalled that the 1991 political declaration foresaw “coordination of energy policies.” This appears to be a Soviet contribution, since policy coordination, as we saw earlier, was an important Soviet concern. Since then it had become an important Russian goal as witnessed by the Concept, which also called for mandatory consultations and coordination on policy.

As a specific objective, the Road Map noted that “Policy Dialogue within the Energy Charter Process shall be open-ended and be used actively to promote common objectives within a broad co-operative framework and to coordinate energy policies as appropriate.”

In connection with the question of interdependence and energy security, again the Russian influence can be discerned. It referenced both the G-8 summit and the Concept in this connection. It also implicitly mentioned both security of supply (“delivery”) and demand (“transparent and predictable marketing”) as “among the principles for co-operation in the sphere of energy” and linked this to Russia’s previous initiatives.

Overall, proposed action boiled down to discussion, exchange of information, and analytical work. There was no will to take concrete measures to actually coordinate policy or promote a particular policy for energy security premised on a single, common definition. However, as an output, the document does foresee the “participation of the Strategy Group in the process of consultations over possible enhanced legal frameworks for energy co-operation.” Therefore, there is a future possibility of informal discussion related to these questions with an eye to changing the legal contents of the regime. This is supported by another output related to the analytical work by the SG, which might include:

specify[ing] the concept of a common responsibility and endeavor of producers, transit and consumer countries to promote global energy security and investment, and with regard to possible instruments and actions to improve energy security in collaboration with other international organizations.

Interestingly, the same passage states that the work could:

address issues raised by member states, such as access to international markets, their opening and increased competition on them, transparency of international energy markets, sovereignty over resources and the role of governments in relation to investment decisions.

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1267 Ibid., 28.

Thus, there is no consensus yet over basic principles. The document presents a laundry list of different priorities presented by different states. This includes liberalization and competition (probably the EU) as well as sovereignty and the state's role in the investment decision-making process (probably Russia). So, discussions will continue, and this will form the context for the evolution of the regime. However, Russia's impact is considerable. The cognitive context for the development of ECH will no longer consist exclusively of neo-liberal principles. An active role for the state is also a part of the discussion.

The final section (Area G) is on management, finance, and legal affairs. Again, Russia's previous initiatives are referenced. The focus appears to be on making the Secretariat more effective and accountable as an internal organization. This needs to be seen in the context of the budgetary challenges faced by the organization given global economic conditions and the pursuit of fiscal austerity measures by many of the ECH member states.

## Summary

This chapter has examined the period from 2009 to 2010 to understand two important developments in Russian ECH policy. After the second gas war with Ukraine, Russia began a new initiative to shape energy cooperation according to its vision and interests. It was clear that Russia was no longer particularly attached to the ECH setting. Therefore, what was an attempt at regime transformation during 2006 to 2008 began to look increasingly like policy to change the regime. At the same time, Russia abrogated its PA of the ECT as a product of tribunal decisions related to the Yukos case that were not in its favor. Both of these indicate that Russia continued to act as a regime maker despite important factors – change in presidential leadership and the global economic crisis, which hit Russia disproportionately in terms of both its financial markets and energy prices – that would suggest otherwise.

In addition, we can see that ultimately, the ECH has not been successful in fulfilling its purpose of integrating Russia with the EU in the energy sphere and making this the basis for peace and cooperation in Europe. In fact, Russian and EU energy relations took a serious turn for the worse.

Although the most significant factors were the gas wars with Ukraine, the ECH was unable to prevent them even though transit (the issue that affected the EU) was one of the functional areas that the Treaty governed, specifically prohibiting the interruption of transit during conflicts. In addition, underneath the acrimony associated with the gas wars was tension related to Russia's non-ratification of the ECT.

The EU was disappointed and anxious that Russia had not ratified the Treaty. When Russia signed the Treaty in December 1994 and began PA, this was taken by the Europeans as an important commitment. From their perspective, fifteen years later it appeared as if Russia was renegeing on this commitment. Instead, Russia had failed to ratify it on two occasions and since then had been raising additional demands on which its ratification would be contingent. However, it was not just the commitment to the regime that was unfulfilled. For the Europeans it was also a commitment to cooperation that, as the gas wars with Ukraine highlighted, was beginning to look dubious. This created anxiety about energy security and mistrust about Russia's reliability as a partner.

Non-ratification was also a source of frustration for Russia, which had made clear that it would not ratify the agreement until certain conditions were met. However, as the EU's repeated insistence on ratification indicated, this had fallen on deaf ears. Moreover, when Russia tried to adapt the regime, its efforts were unsuccessful. From Moscow's perspective, Russia had gotten a bad deal in the 1990s, and when it tried to modify this deal, its partners were not prepared to accommodate its demands, even though Russia was offering attractive material incentives (asset swaps).

In addition, when opportunities emerged to prevent or attenuate the gas conflict with Ukraine within (and outside) the ECH process, the EU balked, even though this appeared to defy its own immediate interests in protecting the transit of gas to its consumers.

Finally, the very logic of the regime had come back to haunt Russia. The original goal of the regime was to encourage Western firms to invest in Russia to develop its energy sector. The neo-liberal logic of the Treaty was to protect private investors from political action so that the investment climate would be "comfortable" for firms. However, the rules of the ECT were now being used by the allies of a former oligarch (now in jail) to legally extract an extraordinary amount of money from the Russian state as compensation for the expropriation of energy assets acquired through what everyone agrees were very suspect means. Whether this was a violation of the Treaty's provisions remains to be decided by the international tribunal. However, from Russia's perspective this certainly was not in the spirit of the regime, which promised so much hope and generated unprecedented enthusiasm nearly two decades earlier.

At the same time, despite these difficulties, it is too early to close the door on the ECH. Russia's actions do not appear to be a principled rejection of the regime but rather a reaction to its inefficacy. From this perspective, the venue shopping of its proposal for an alternative framework is a tactical move to compel other ECH states to accommodate its interests. To the extent that President Medvedev's Concept is being taken seriously in discussions to adapt the regime, it has been successful. But ultimately whether Russia embraces the ECH regime will depend on tangible outcomes. Developments in the Road Map process do not inspire great hope. The only progress relates to a consensus over the most urgent questions that emerged due to the gas crisis. This may not be sufficient to bring Russia fully back into the fold. Moreover, the process is still painfully slow, and there is a danger that it may be again overtaken by major events outside the regime.



## **CONCLUSION: TO ADAPT OR NOT TO ADAPT?**

One of the main goals of this dissertation was to understand the development of the ECH regime and specifically why it has failed to fulfill its original purpose: to promote peace and security in Europe by integrating the USSR/Russia with Europe through cooperation based on complementarities in the energy sphere.

When the ECH was being developed, several conceivable institutional designs were possible. The main controversy during early negotiations concerned the role of the state in the energy economy. The USSR submitted a proposal that envisioned an important state role in promoting investment into the energy sector. Other European states that had an affinity for this type of arrangement were available as allies. Had the Soviet proposal survived, it is possible that, as part of a compromise, the ECH regime would have had a significant state-led component as well as a legal component that protected the interests of private firms.

More specifically, we can imagine that in an alternative world, a regime would have emerged that created a legal treaty that protected investments by firms but also provided a venue where states could work with firms directly to promote project level initiatives that were consistent with broader energy policy goals. Because states and firms would collaborate to move specific projects forward, they could address the challenges of specific energy initiatives and deploy a variety of state instruments to support them. This would have at least partially reconciled the need to offer guarantees to private actors through law (the neo-liberal concern) with the need for state participation to address broader policy concerns (the socialist market concern).

Such a compromise might not have suited all the early participants in the ECH process. In particular, the United States might have withdrawn in hopes of a better bilateral deal with the USSR. This is ultimately what the United States did in 1994 when it found that the compromises necessary for finalizing the ECT were not satisfactory. However, the evidence suggests that the European states and the USSR were eager to see the overall project succeed and willing to compromise. Under such circumstances, a regime with a mixed design that included both a strong legal component but also an important policy-focused state role would likely have emerged.

After the collapse of the USSR, Russia embraced the neo-liberal vision offered by the United States, United Kingdom, and European Commission. This sealed the design of the ECH by making a legal treaty that protected investors' rights: the ECT, the primary vehicle for promoting energy cooperation in Europe.

Nearly two decades later, the balance of power shifted in Russia's favor. Political consolidation by President Putin under the auspices of a relatively statist ideology that valorized state power meant that Russia became a more powerful state than under Yeltsin. We also cannot ignore the very significant shift in international energy markets (from a consumer market in the 1990s to a producer market after the turn of the century), which also contributed to Russian state power. However, as I have argued previously, the change in international energy markets alone was not decisive in shaping Russian policy. Moreover, the state was able to bring important, previously obstructionist actors (such as Gazprom) into the Russian ECH policy-making process.

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As a result, new Russian policy demands with respect to the regime surfaced, and Russia began attempting to adapt the ECH.

However, Russia's attempt at regime modification met significant resistance from the other states and ultimately faltered. Moreover, the controversies associated with the adaptation process contributed to the deterioration in EU-Russia energy relations, which were becoming more conflict-ridden. The EU was understandably frustrated that, after nearly two decades, Russia still had not ratified the agreement but was instead putting forward what appeared to be a never-ending list of new demands. Russia, on the other hand, was becoming increasingly irritated at the EU's persistent calls to ratify the ECT even though it had stated very clearly that ratification was out of the question until its interests were addressed. Finally, an international energy crisis (the second gas war between Russia and Ukraine in January 2009), which the ECH was able to neither prevent nor attenuate, compelled Russia to propose a new regime that it began shopping in alternative venues. By 2010, Russia was putting forward alternative arrangements to govern the international energy trade.

From this perspective, we can say that the ECH has failed to fulfill its original purpose. Not only had it not integrated Russia with Europe in the energy sphere, but it was also becoming a source of conflict between the two parties. Part of the reason that the regime has failed is that Russia was unable to adapt it to accommodate its new interests. From this perspective, regime success or failure is connected with whether states with changed interests are able to reach agreement with their partners to adapt international regimes to meet their new needs rather than replace them with alternative regimes. Therefore, the ECH experience is a window for understanding the factors associated with regime adaptation and success when the global balance of power shifts.

Understanding the circumstances in which regimes can succeed due to adaptation when the balance of power shifts is particularly important at the present historical juncture. Most students of world politics agree that during the 21<sup>st</sup> century, large, rapidly growing states (most notably China) will surpass the United States in overall economic power. This means the emergence of a multipolar world after an extended period of bipolarity and unipolarity. Moreover, 21<sup>st</sup> century multipolarity will not necessarily see the United States (briefly a unipolar power) alone at the head of the pack.

According to Hegemonic Stability theory, a significant change in the distribution of power (the relative decline of the current hegemon and the relative growth of a potentially new hegemon, or hegemonic pretender) is fertile ground for conflict. International regimes are an important part of the problem since they reflect the distribution of power and the constellation of state interests at the moment they are created. When the distribution of power changes, rising states may find that they are no longer satisfied with the international regime in its contemporary form. They are likely to argue (as Russia has) that the regime is a snapshot from the past that needs to be modified to address new circumstances. Declining powers are just as likely to insist (as has the EU) that the regime is perfectly adequate and that the rising power has already committed to it.

Although major changes in the distribution of power can lead to conflict, we know that this is not inevitable. The most obvious example comes from the turn of the 20<sup>th</sup> century when the United States eclipsed Britain as the hegemon. Rather than conflict, cooperation and ultimately an enduring, close partnership between the two states emerged. Changes in the

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distribution of power therefore have an indeterminate effect on whether conflict or cooperation prevails. This suggests that how the states interact with one another during the power transition may be decisive. In the context of international regimes, the ability of the parties to come to a mutual accommodation is key. It may determine not only whether the regime survives, but also whether conflict or cooperation will prevail among the most powerful states in the international system.

Therefore, the adaptation of the ECH is a valuable case for understanding what is likely to be an important challenge moving forward. With this in mind, this conclusion begins a discussion of the factors that may shape whether regime adaptation is successful.

### **Institutional features: law vs. politics**

After the Russian defection in 1991, the ECH took off on a neo-liberal track. This meant first and foremost that the centerpiece of the regime became a legally binding treaty. As a result, political relations among the states took a back seat to the legal elements of the ECH regime. States were still the main actors, but they met infrequently, and the focus of their attention was the legal evolution of the regime. One possible explanation for the failure of adaptation is related to the legal, as opposed to political, character of the regime.

As we have seen, the formal rules for adapting the regime as enshrined in the Treaty are quite conservative. Deploying new instruments within the regime that are relatively weak (such as declarations and decisions) still formally requires broad agreement among the states (three-quarters of contracting parties present and voting). Changes to the binding rules require unanimity. This makes adaptation difficult.

The difficulty of adaptation is exacerbated by the fact that the ECT is a body of law that fits within a broader international legal framework to which many states have committed, which introduces a whole set of peripheral considerations that make adaptation more difficult. In other words, not only would significant regime adaptation require creating a universal harmony of interest (all states have to agree) on substantive issues, but all the states also have to be confident that the modification does not contradict their obligations in a host of other contexts that may also involve non-ECH states. The states may come to a political agreement concerning the modification of a trade provision; however, since the ECT is explicitly embedded in other legal frameworks (most notably the WTO and the treaties of the EU), adaptation may be elusive because it touches on important issues outside the regime, implicating a new set of actors, institutional rules, and norms.

Since different regimes evolve at different speeds, it is possible that a substantive question is solved in a different setting with another set of actors first, and this constrains the solutions available when the issue involves two great powers within the regime. For example, it is possible that an issue is solved in the WTO before it emerges in the ECH. Once it is raised in the ECH, since most of the states are members of the WTO, they will be reluctant to adopt a measure that is not fully consistent with the provisions of the WTO. However, not all of the ECH states are members of the WTO. In particular, Russia still has not joined the global trade regime, and yet it would be constrained by the regime in terms of the solutions that are available within the ECH.

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A related problem is that the large number of states involved can make negotiations more complex and lengthy. This is not inevitable. It is possible to have a large number of states that all have similar interests and thus agree on how to adapt the regime. Obviously, the opposite is also true: you can have a small number of states (only two) that have diverging interests and find it very difficult to come to an agreement. However, if we assume that different states have different interests and bring different issues and concerns to negotiations, the more actors involved, the harder it may be to find an arrangement that includes everyone. When both great powers and small states are involved, unanimity means that small states can veto developments in great power relations. Although this is democratic, it may not be expedient. Since we are concerned about successful regime adaptation to accommodate a rising power in the context of a significant change in the distribution of power, this is not trivial. The inability of great powers to come to an agreement can exacerbate tensions, lead to conflict, and eventually spill over into other areas, including the realm of security.

From this perspective, the combination of legal forms of governance (that is, treaties) and broad multilateralism characterized by state equality leads to regimes that are potentially less adaptable than political arrangements dominated by powerful states (concerts). We can think of the latter as an ongoing bargain in which states can periodically renegotiate their agreements to take into account changed circumstances, whether a shift in the distribution of power, an unforeseen dilemma, or a new interest on the part of one of the state actors. Under political forms of governance, the obsolescent bargain is not a problem because the entire relationship is premised on the idea of a constant give and take. Thus, regimes based on political relations among the great powers rather than legal relations among states that are all equal appear to be more flexible and conducive to adaptation when the balance of power changes.

This difficulty is not restricted to the ECH; other contemporary regimes, most notably the WTO, are also underpinned by a legal rather than political logic. This is probably a result of the dominance of Western, legal, rational states in the international system. According to Haas,

It must be acknowledged that Western beliefs about procedure – budgetary, administrative, and parliamentary – hold a privileged position in international organizations. This hegemony of Western modes of problem solving results not only from the founding role Western governments played in designing most international organizations but also from the tendency of non-Western delegates, experts, and civil servants to be educated in Western ways and sympathetic, in principle, to Western modes of defining policy issues.<sup>1268</sup>

However, political forms of governance also have an important downside. For one thing, any given question is never really settled. This may be conducive to adaptation, but it also means that power becomes the main currency of international politics, which can lead to greater competition and eventually conflict among the great powers. For example, a declining power might accommodate a rising power out of weakness. However, since no deal is final, this creates an incentive to develop power with an eye towards renegotiating another day. In other words, the fact that adaptation is always possible can become a potential source of conflict in and of itself. Therefore, great power conflict may emerge due to institutional rigidities (which are a product of law and broad multilateralism characterized by state equality) that prevent adaptation. However, it may also obtain under political forms of governance in which the only constraint on

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1268 Ernst Haas, *When Knowledge Is Power*, (Berkeley; Los Angeles: University of California Press): 58.

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state action is power, which can lead to power competition that spirals out of control and also leads to conflict.

If the foregoing is true, the conclusion is that truly successful adaptation, which addresses the concerns of dissatisfied powers in a way that minimizes conflict, may not depend on the institutional features of any given regime. This suggests that we have to look elsewhere to understand how states are able to adapt a regime to respond to a significant change in the balance of power in a way that prevents conflict.

### **Institutional function and state interests: the failure of the “lock-in” strategy**

According to neo-liberal institutional theory, regimes serve important functions that are valuable for participant states. From this perspective, a regime will be successfully adapted if its ability to fulfill a function that states find valuable erodes. However, adaptation will be unsuccessful if participating states no longer have an interest in the function that the regime served.

The ECH fulfills many functions. Perhaps the most interesting function is related to the fact that the ECH was part of a strategy to lock in a particular state orientation in Russia with respect to the international economy. We have seen that the philosophy behind the ECH was to limit state domestic sovereignty in the energy sphere to create freedom and security for private economic actors. Within the ECH context, sovereignty came to mean legal sovereignty rather than sovereignty as conventionally understood in international relations theory and as practiced in international politics historically since the emergence of the modern state. At the same time, the ECH was also inspired by the idea of committing Russia to an open foreign economic policy. Although cited previously, Walde’s comments on this point are worth revisiting:

Russian negotiators, and Western supporters, may have partly viewed the Treaty as a way to *commit Russia’s volatile foreign investment policy to a market economy model*, and thus counterbalance the Russian pendulum swinging between nationalist xenophobia and Westernizing “open door” policies.<sup>1269</sup> (emphasis added)

Promoting open door policies in weaker states is not new to international political economy. Rather than using gunboat diplomacy, contemporary powers use international law to create hard commitments that can then be enforced by international courts. Moreover, locking in states through international agreements to tie the hands of future governments is a broader strategy that does not apply only to Russia or the energy sector.

The reason the ECH was a candidate for this type of approach to the Russian state in the 1990s was that everyone understood that Yeltsin’s Russia was a historical anomaly. The conventional wisdom at the time was that the last decade of the 20<sup>th</sup> century was a window of opportunity to transform Russia and craft it in an enduring Western liberal mode. This informed policy related to economic transformation (building capitalism) and regime change (transition to democracy) among liberals in both Moscow and Western capitals. The salient feature at the time was that Yeltsin had pro-Western and liberal credentials. For the Clinton administration, he was “our man in Moscow.”<sup>1270</sup>

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1269 Walde, “International Investment Under the 1994 Energy Charter Treaty,” 255-6.

1270 Goldgeier and McFaul, *Power and Purpose*.

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From the perspective of the “lock-in” function, the regime could not be adapted because after Putin replaced Yeltsin as head of state, Russia no longer had an interest in this function. In the 1990s, the government in Moscow and its partners in Europe embraced this particular approach for incorporating Russia into the international economy. However, under the new leadership, the convergence of interests between Russia and the EU disappeared. There is no question that the new leadership, which emphasized Russian power as an important resource in international politics, rejected the lock-in strategy for Russia. This was true from the very moment Putin came to power. Being locked in was no longer a part of Russian international economic strategy, and since the regime had been designed around this principle, Russia lost interest.

The failure of the lock-in function explanation is valuable and the state identity approach clarifies why by pointing our attention to Russia’s low state sovereignty under Yeltsin. The experience of the ECH contains an important (if somewhat obvious) cautionary tale concerning the lock-in strategy for states. In international relations, there is always a temptation to seek out like-minded allies in the governments of other states, particularly in those undergoing dramatic transformations. For example, in Afghanistan, the Western powers obviously prefer to deal with a potential government other than the Taliban, which for legitimate ethical reasons Western states find odious. It is tempting to take advantage of “windows of opportunity” while allies are incumbents in foreign governments to tie the hands of future governments that might be less amenable to the same arrangement.

It is not my aim to suggest that Western (or any) governments should not pursue their interests. However, it is worth considering whether legally locking in states while an ally is in government will be an effective strategy for shaping state interests and behavior over the long term. This is particularly relevant for great powers. From a state identity perspective, I have argued that high state sovereignty is associated with state capacity to follow through on international commitments. This means that when making an international deal, states should not just focus on who is in government. Policy makers would be well advised to consider the level of state sovereignty and the factors that underpin state sovereignty as well. In the Russian case, state sovereignty was underpinned by elite beliefs about the legitimacy of state power. Therefore, the state identity approach leads to an examination of whether an agreement with the key decision maker at a given moment in time is legitimate from a broader societal perspective. In particular, does it enjoy the support of a broad segment of political elites? Is the implied role of the state consistent with notions of legitimate state power as understood traditionally within the society? If the answer is yes, these are indicators of state sovereignty and a credible commitment. If not, states should temper their optimism about the longevity of the agreement.

In the case of Russia and the ECH, the strategy pursued by Yeltsin’s government and the Treaty that his government signed in 1994 enjoyed only the narrowest of elite support. Most importantly, the key relevant actors — Russia’s largest company, Gazprom, and the State Duma — were absolutely against it. More generally, the role for the Russian state that the agreement prescribed was not legitimate in the context of historical Russian views of state power. As a result, the Russian state that committed to the ECT was not sufficiently sovereign (it lacked sufficient authority and control) to ensure that Russia could fulfill its end of the bargain. In political (as opposed to legal) terms, EU states were literally making a deal with their allies, Yeltsin and his government, and not the Russian state. However, the deal created a state commitment that is legally enforceable. Just as importantly, it created expectations among EU

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states about future Russian behavior. These states would inevitably be disappointed once a different, more conventional (from a Russian historical perspective) government came to power. The downside then is that unfulfilled expectations can actually make adaptation even harder. Not only are there conflicts of interest to overcome, but the process can become shrouded in mistrust and hostility because of the failure of the previous agreement. In short, we should be less sanguine and more skeptical of our ability to undo “the pendulums” that shape the behavior of states and especially great powers.

This is relevant in a number of contemporary cases not related to Russian energy policy. In their attempt to diversify away from Russian sources of natural gas, European companies (encouraged by their governments) signed agreements in 2010 with officials in the Kurdistan Regional Government (KRG) in Iraq, which is believed to have enough gas resources to at least partially fill the projected capacity of the EU-supported Nabucco pipeline<sup>1271</sup> which can be seen in Figure 11-1. Obviously, ownership and management of gas resources in the region, not to mention export and investment policy, are still contested between the federal government and the KRG. It is far from clear that the KRG has the authority to honor its commitment while the domestic sovereignty of the Iraqi state has yet to be resolved. Not surprisingly, the agreement offended officials in Baghdad,<sup>1272</sup> and “Iraq’s Oil Ministry rejected the deal, declaring that the Kurdistan region has no authority to export gas.”<sup>1273</sup> The central government is concerned not only about revenues from energy exports, but also about the availability of gas for the domestic production of electricity, which it is planning to increase.<sup>1274</sup> According to Iraqi Deputy Prime Minister Hussein Shahrastani:

Connecting the Kurdistan region to that project—a European project—is impossible, because this gas is Iraqi gas and Iraqi oil and gas is only exported by the Iraqi national oil company. It’s not like any province or a region can just go ahead and export its oil and gas as they wish.<sup>1275</sup>

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1271 “Germany’s RWE Signs Kurdistan Gas Deal,” *Iraq Business News*, August 28, 2010, accessed on November 22, 2011, <http://www.iraq-businessnews.com/2010/08/28/germanys-rwe-signs-kurdistan-gas-deal/>.

1272 Ben Lando, “Kurds’ EU gas deal irks Baghdad on eve of U.S. transition,” *Iraq Oil Report*, September 1, 2010, accessed on November 22, 2011, <http://www.iraqoilreport.com/politics/oil-policy/kurds-eu-gas-deal-irks-baghdad-on-eve-of-u-s-transition-4943/>.

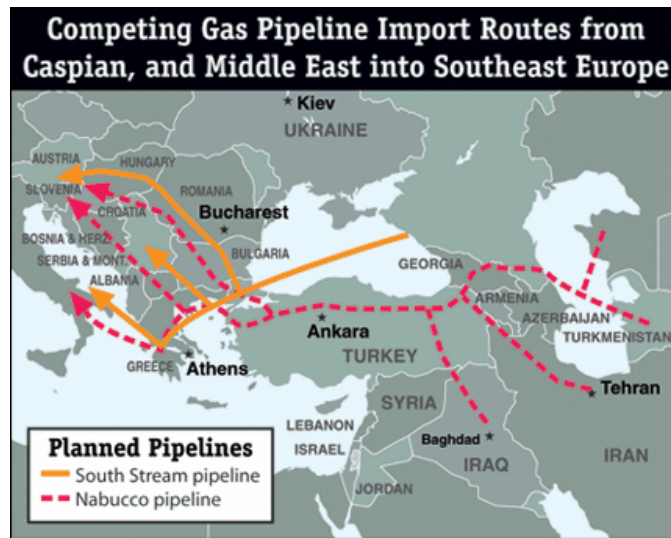
1273 Salam Saadi, “EU Energy Deal Sparks New Tensions Between Baghdad and Erbil,” *Rudaw*, June 6, 2011, accessed on November 22, 2011, <http://www.rudaw.net/english/kurds/3730.html>.

1274 Ibid.

1275 Ibid.

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**Figure 11-1 : The EU-sponsored Nabucco pipeline and the competing South Stream pipeline promoted by Russia**<sup>1276</sup>



Less than six months later the EU signed a second agreement, this time with the central government, that precluded the direct participation of the KRG. This created tension between Baghdad and Arbil (the capital of Iraqi Kurdistan) but also upset Turkey, which would be a central transit hub for the proposed pipeline and is also eager to find new sources of natural gas. It also created tension between the Kurds and the EU. According to an anonymous observer:

[T]he agreement will not last and if it does, it will harm the Nabucco pipeline.

“If [Baghdad] finds a way to transport gas to Europe, we wish them good luck,” said the observer, indicating that the Kurdistan region would not let such a plan materialize. “The Europeans have forgotten that the gas and oil is in Kurdistan and not in Baghdad. So it’s not going to happen if we’re against it.”<sup>1277</sup>

It is not clear why the agreement would actually harm the pipeline, but it is obvious that these interventions by EU actors are making the question of ownership and control of natural resources in the region more volatile than they already are.

Rather than following a grand lock-in strategy for Iraq as the West did with Yeltsin in Russia, the pattern of EU behavior suggests a more tactical logic. The most obvious explanation is that the EU is desperate for natural gas for its otherwise empty pipeline project and wants to be in on the ground floor for access no matter which actor ends up owning or exporting it. It is also possible, but seems less likely, that the EU is trying to play the Kurds and Baghdad off of each other for better terms. However, this would be shockingly short-sighted given the challenges of Iraqi security, the difficulties in central- regional relations in Iraq already, and the role that security plays in ensuring continued export flows.

In any case, there is a parallel to the Russian ECH experience under Yeltsin. If that case is at all instructive, it suggests that legal agreements (whether foreign contracts,

1276 David Wood, “Russia’s Gas Power Play,” *Energy Tribune*, August 17, 2007, accessed on November 22, 2011, <http://www.energytribune.com/articles.cfm/590/Russias-Gas-Power-Play>.

1277 Ibid.



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intergovernmental agreements, or domestic laws) are less important than resolving the question of control over resources in Iraq in a politically legitimate and therefore more enduring way. Only once you have a fairly broad elite consensus is it possible to infer that the governmental officials signing the documents actually represent a sovereign state that has authority and control over the issue and that the commitment has a likely chance of being honored.

### **Cognitive factors: ideological consensus**

The preceding explanations have been useful for thinking about great power transitions and regime adaptation. The institutional features perspective highlighted the difficulty of adapting legal regimes, especially when the regime is also broadly multilateral and grants political equality to all states regardless of power. However, we also saw that regimes that have a political logic and grant a special role to great powers, though perhaps easier to adapt, can also support great power conflict. By placing a premium on power, the process of ongoing adaptation can spiral out of control, with negative consequences.

The neo-liberal institutional approach, which focuses on state interests related to regime functions and specifically the interest in using the ECH as an instrument to lock in future Russian state behavior, brought to light that this may not be a successful strategy over the long term. The state identity perspective pointed our attention to the significance of state sovereignty and the factors that underpin it as a way to understand when the lock-in strategy is likely to succeed (broad societal support and legitimacy) or fail (transnational agreement with governmental allies in the absence of societal support and legitimacy).

A third perspective focuses on the significance of ideological consensus in supporting regime adaptation. According to Haas, the degree of ideological consensus is a feature of the environment in which regime adaptation occurs. It is significant because it combines with political goals to shape the decision-making style of the participating actors, the types of linkages that are possible, the character of bargaining, and problem definition.<sup>1278</sup> From this perspective, Russia and the EU could not adapt the ECH to address new challenges because the ideological consensus that existed under Yeltsin was no longer present.

This is certainly part of the explanation for the unsuccessful adaptation of the ECH. As we have seen, when Russia made demands related to addressing what it understood as common challenges (for example, unstable security of demand as a threat to investment in new resources and infrastructure and thus the availability of future energy supplies), the EU as a bloc was skeptical that Russia's demands addressed genuine problems with the regime. As a result, little to no progress was made in adapting the regime in these areas, and this positioned Russia to move away from the ECH after the second gas war with Ukraine in January 2009.

From this perspective, we might say that the evolution of the ECH was characterized by what Haas has called "turbulent nongrowth." According to Haas,

Turbulence characterizes an organization that finds itself in a setting of enormous social complexity. There are many actors professing many clashing interests; they have different perceptions as to why they find themselves in difficulties; and they cannot agree on who or what placed them in the condition...Each actor is tied into a network of interdependencies with other

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1278 Haas, *When Knowledge Is Power*, Ch. 5, especially 73, 76, and 79.

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actors who are as confused as the first. Yet each knows that some of the objectives sought by each cannot be obtained without cooperation from the other. A “turbulent field,” then, is a “policy space” in which this type of confusion dominates discussion and negotiation.

...[t]hese conditions add up to a number of impacts on international organizations that deserve the label “nongrowth.” The dominant coalition responsible for creating the organization loses control... Alternatively, the old coalition is completely displaced by contenders warring to become the next rulers, with no one group gaining a clear victory....

...[A]lthough attempts at institutionalization will multiply, one cannot expect them to be successful or permanent.<sup>1279</sup>

Although clearly many factors are at play, Haas nevertheless accentuates the significance of ideological consensus:

[I]n the turbulent nongrowth model...[k]nowledge *among* coalitions is not becoming more consensual; however, *within* some coalitions knowledge applicable to the organization’s mandate does command more and more agreement. Some politicians defend static and specific objectives while others advocate dynamic and interconnected ones; the two sets of politicians (and their associated experts) confront each other for control of the dominant coalition.<sup>1280</sup> (emphasis in original)

Haas developed these insights before the ECH was even created, but the description of the failed adaptation process is remarkably accurate. At the same time, the results of negotiations on the transit protocol approach what Haas has called “managed interdependence”:

Learning, as a form of bureaucratic behavior in and by international organizations, really means attempting to “manage interdependence.” The behavior implies “management” because those who lead the organization...want to take hold of a problem decisively. “Interdependence” is involved because the decision involves a cognitively more ambitious attempt at defining...the problem than had been attempted earlier.

...I stress that managed interdependence may be concerned with a few of the organization’s programs and operations, not its entire array of activities.

...Controversy is bound to remain lively. But it can also be expected that the controversy will not overtake every issue on the organization’s agenda. Pools of relative harmony within the broader turbulent sea ought also be envisaged.<sup>1281</sup>

Beginning in 2004, TP consultations saw Russia become more active in trying to deal with the evolving EU transit regime. Russia’s attempts were certainly more cognitively ambitious, bringing together disparate elements (the technical features of natural gas pipeline transit, competition, investment, and energy security) that had been understood previously as either separate or related in unproblematic ways. Finally, despite a lengthy process, negotiations saw progress and eventual agreement on what the transit problems were and how to address them. These consultations were isolated successes within a broader environment that remained turbulent.

How do we explain this pool of harmony in what was becoming an increasingly difficult environment? For Haas, cognitive agreement is a key feature of managed interdependence:

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1279 Ibid., 111-12.

1280 Ibid., 93.

1281 Ibid., 128-30.

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In this situation, epistemic communities come into their own. They are likely to furnish the studies and analyses that will lead to a different nesting of problems....If one or another epistemic community captures the high ground of a persuasive analysis, it will be introducing consensual knowledge into the bargaining. Transgovernmental processes will then spread the word....

...[t]he infusion of consensual knowledge ought to result in more substantive linkages taking place....

None of this can happen unless the relevant knowledge becomes more consensual than was previously the case.<sup>1282</sup>

However, the evidence from TP negotiations suggests that ideological consensus (consensual knowledge) was an *outcome* of successful bargaining, not the cause.

The approaches considered earlier also cannot account for this variation within the ECH process across issue areas. Consultations on the TP as well as bargaining related to Russia's other demands took place within the same institutional context: decision making by states in the Conference according to rules enshrined in the Treaty. The substance of state interests obviously differed by issue area; however, in no way was their more initial interstate harmony related to transit than in other areas. Therefore, the key question is why did a cognitive consensus emerge during TP negotiations while it remained elusive in other areas?

### **Role identity, expectations, and the evolution of international regimes**

To understand this variation, we have to look at the interaction between the EU and Russia during negotiations. In all cases, Russia was attempting to shape the rules of the ECH regime to promote its interests. Its behavior was increasingly assertive, ambitious, and concerted. Why did transit issues produce consensus on difficult and important substantive questions while disagreement prevailed in other areas?

The state identity approach helps us understand this variation by pointing to the importance of state role identity in interstate relations. As we have seen, under President Yeltsin Russia embraced the regime taker role identity. This was partly a deliberate strategy to signal to Western governments that it was a new kind of state, worthy of inclusion in international society. This created expectations among Russia's EU partners: Russia was a new state that was learning to follow the rules and respect international norms. Both sides agreed that Russia was trying to be a "normal" state, and both sides supported this project.

Because Russia embraced the overall philosophy promoted by the EU and thereby relinquished great power aspirations and behaviors, the threat of Russian power and the problem of geopolitics receded to the background for EU actors. As a result, the ECH became an area for economic cooperation. Negotiations saw disagreements, but all of these were contained within the economic realm. Furthermore, the EU was willing to make concessions motivated by the general belief that in so doing, it was supporting Yeltsin, reinforcing Russia's posture as a normal state, and thus promoting its own long term security goals. In other words, ECH cooperation under Yeltsin was based on a convergence of beliefs related to Russia's role in the international system; both sides agreed that Russia was trying to become a normal state that had

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1282 Ibid., 129-30, 135.

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shed great power ambitions and behaviors. Both parties also agreed that this was conducive to peace.

By 2006, the behaviors associated with Russia's new role identity were difficult to miss. The most obvious instance was the first gas war with Ukraine (January 2006), during which Russia demonstrated that it would not shy away from using its power during conflicts with other states. Not surprisingly, this raised concerns about security in the EU, which was becoming anxious that Russia was no longer trying to be a normal state, but rather was embracing great power tactics that were historically a threat to European states. From the EU's perspective, Russia was no longer becoming a normal state but instead was reverting to its old, dangerous self.

Viewed from this angle, the EU's tenacious attachment to the Treaty in particular becomes clear. The Treaty was a symbol of building peaceful and cooperative relations between the EU and a new Russia, which was premised on the shared idea of Russia as a normal state. This understanding was shattered in the EU by Russia's changed behavior. So, when Russia expressed that it wanted to radically change the Treaty, this reinforced the idea among Europeans that Russia no longer followed international rules and norms and was thus a threatening state. Not surprisingly, the EU balked at revising the agreement.

Overall, negotiations on economic questions became embedded in geopolitical concerns that, due to the previous shared understanding of Russia's becoming a normal state, had not been salient. Russia's changed behavior led to the "securitization" of energy relations inside the EU. This made compromise and accommodation difficult. Compelled to examine energy relations with Russia through the lens of geopolitics, the EU was reluctant to accommodate Russia's demands because this signaled weakness.

However, the TP negotiations began in 2000 when the consensus was still in effect. Thus, a process was created in which Russian experts and negotiators could persuade its EU partners of the challenges that the EU's changing transit regime posed for Russia's gas export business and energy security on the continent as a whole. Russia's role identity changed under Putin, but by then the TP process was already under way, and following the norms of the regime – consensus building, persuasion, incremental changes – was already built into TP negotiations. By continuing to participate in this process, Russia was behaving as a regime taker even though its role identity had changed.

Russia made bold demands related to transit, and in this respect its behavior during transit negotiations was also an expression of its new role identity. However, because negotiations were already under way, and because the structure of the negotiating process encouraged consensus building, persuasion, and incremental change, Russia's behavior was not perceived as threatening. To the contrary, even though Moscow was making bold demands, Russia's participation in negotiations on the TP was reminiscent of the Russian partner that the EU had embraced under Yeltsin. In short, the EU was able to accommodate Russian transit demands because, by continuing to participate in TP negotiations, Russia was behaving like a normal state that made demands but did not act "politically." As a result, the EU and Russia could find common ground and reach consensus.

In short, when a state adopts a particular role identity, this creates expectations about its behaviors among its partners. Whether regime adaptation is possible later depends on whether the state fulfills or violates these expectations, which shapes whether other states are inclined

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toward accommodation. If it fulfills these earlier expectations, accommodation and adaptation are more likely.

### **Ideological consensus, negotiating tactics, and international regime adaptation**

Russia under Yeltsin and the EU shared a geopolitical vision that aimed to banish the logic of great state power from the realm of economic cooperation. By de-emphasizing the security dilemma and fostering compromise and mutual accommodation, this consensus supported the development of the ECH regime in the 1990s and the creation of the TP process in 2000. Specifically, consensus over geopolitical questions opened the way for arriving at consensus on substantive economic questions. Consensual economic knowledge became nested in a shared understanding of high politics, and this led to regime success and managed interdependence.

After Russia's role identity changed, the consensus on geopolitics came apart. As Haas predicted, the lack of consensus made agreement on substantive questions difficult and successful regime adaptation elusive. Specifically, once the geopolitical consensus collapsed, concessions and accommodation, now viewed through the lens of security, became problematic. Regime adaptation became difficult, and managed interdependence gave way to turbulent nongrowth. Therefore, the ECH process supports Haas's argument that cognitive consensus is an important factor in the successful evolution and adaptation of international regimes.

However, the TP process allows us to qualify the relationship that Haas identified. Cognitive consensus on geopolitical questions may be sufficient for agreement on lower order substantive questions and thus for regime adaptation, but it may not be necessary. Once the cognitive consensus falls apart, lower order agreement on substantive questions is possible if states are able to interact "as if" the higher order consensus was still in place. Even though Russia had shed its regime taker identity, by continuing to participate in the TP process its behavior was perceived by the EU as if that consensus was still in place. In other words, by continuing with TP business as usual, Russia engaged in consensus building, persuasion, and incremental regime work. This was not a product of its new role identity but due to habit. However, these behaviors were sufficient to signal to the EU that, in the TP sphere, Russia was capable of being a normal power (that followed rules and norms) and could be accommodated safely in this limited way.

More generally, we can conclude that negotiating tactics are important for helping us understand how international regimes evolve and whether they can be successfully adapted. Negotiations always see conflicts of interest. The success of negotiations depends on whether states are able to overcome such conflicts of interest by accommodating one another through compromise. Whether states are motivated to compromise depends on how they view their partners. If a state's negotiating tactics reinforce concerns over security, other states may be reluctant to compromise since they fear sending signals of weakness. However, if a state's negotiating tactics are consistent with norms and rules, security does not become salient, and other states are more likely to be accommodating, making successful regime adaptation more likely. In short, negotiating tactics deserve greater attention from scholars of international relations because they are not only a means for states to achieve their goals, but also a signal to other actors about a state's identity.

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## APPENDIX A: MEMBERS OF THE ENERGY CHARTER REGIME

### MEMBERS OF THE ENERGY CHARTER CONFERENCE

Albania, Armenia, Australia\*, Austria, Azerbaijan, Belarus\*, Belgium, Bosnia and Herzegovina, Bulgaria, Croatia, Cyprus, Czech Republic, Denmark, Estonia, European Community (now part of the European Union) and Euratom, Finland, France, Georgia, Germany, Greece, Hungary, Iceland\*, Ireland, Italy, Japan, Kazakhstan, Kyrgyzstan, Latvia, Liechtenstein, Lithuania, Luxembourg, Malta, Moldova, Mongolia, the Netherlands, Norway\*, Poland, Portugal, Romania, Russian Federation, Slovakia, Slovenia, Spain, Sweden, Switzerland, Tajikistan, The former Yugoslav Republic of Macedonia, Turkey, Turkmenistan, Ukraine, United Kingdom, Uzbekistan

\* - denotes state in which ratification of the Energy Charter Treaty is still pending

^ - the Russian Federation signed the Energy Charter Treaty and was applying it provisionally until 18 October 2009 inclusive

### OBSERVERS TO THE ENERGY CHARTER CONFERENCE

Afghanistan\*\*, Algeria, Bahrain, Canada\*\*, China, Egypt\*, Indonesia\*\*, Iran, Jordan\*\*, Korea, Kuwait, Morocco, Nigeria, Oman, Pakistan\*\*, Palestinian National Authority, Qatar, Saudi Arabia, Serbia\*\*, Syria\*\*, Tunisia, United Arab Emirates, United States of America\*\*, Venezuela

#### **International Organisations with Observer Status:**

ASEAN, BASREC, BSEC, CIS Electric Power Council, EBRD, IEA, OECD, UN-ECE, World Bank, WTO

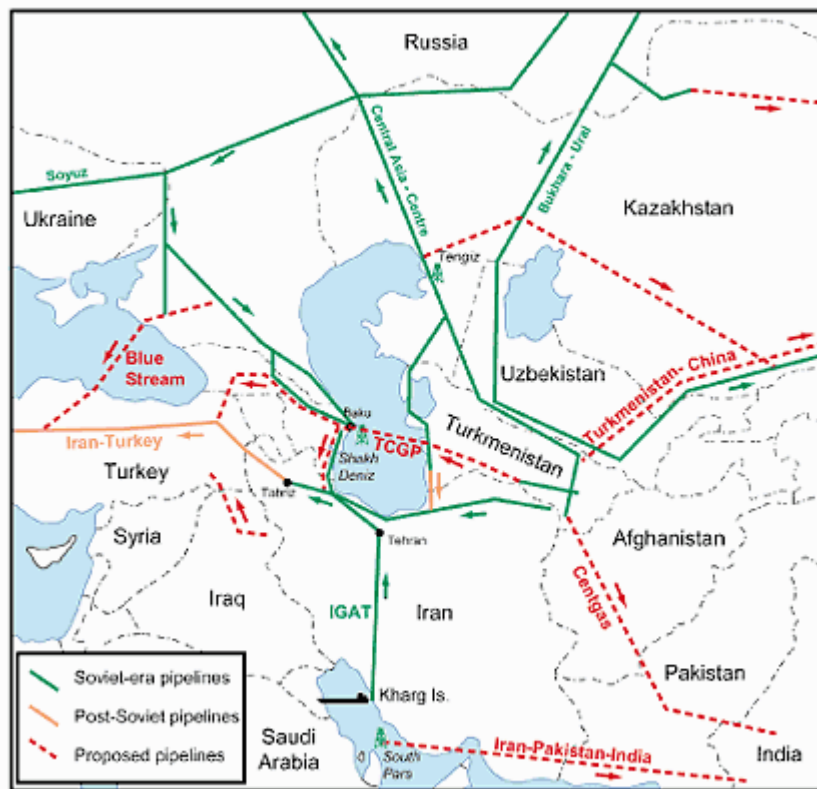
\*\* - denotes observer which has signed the 1991 Energy Charter

\* - denotes observer in which signing of the 1991 Energy Charter is pending

The Energy Charter Secretariat also has signed in November 2007 a Letter of Understanding on Cooperative Activities with the Secretariat of the International Energy Forum.

## APPENDIX B: MAPS OF GAS TRANSPORT SYSTEMS IN EURASIA

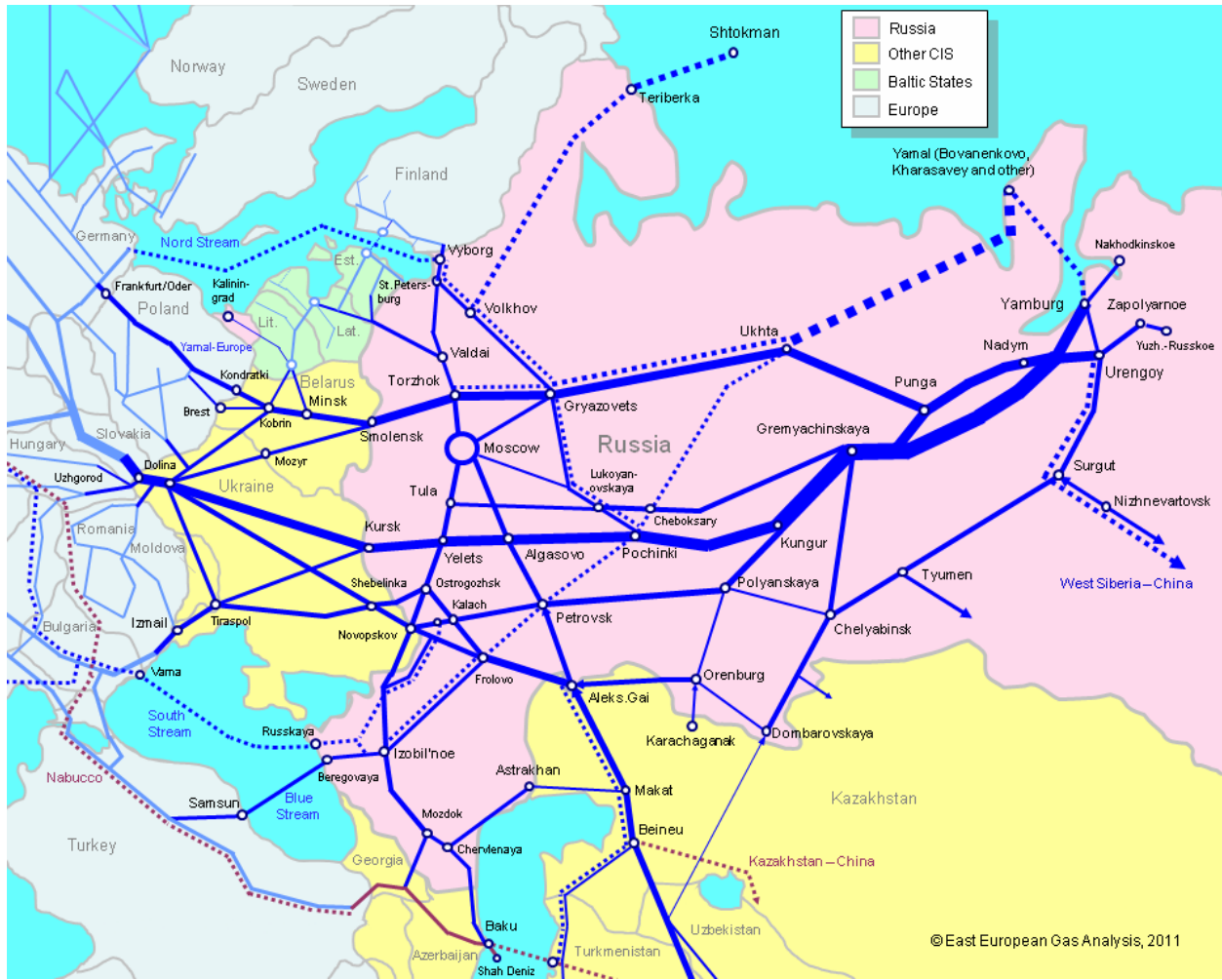
Gas pipelines in the Caspian region



Courtesy of Center for Global Energy Studies

Accessed December 16, 2011,  
<http://www.imf.org/external/pubs/ft/fandd/2002/09/mathieu.htm>

## Gas pipelines in the FSU



Accessed December 16, 2011, <http://eegas.com/fsu.htm>