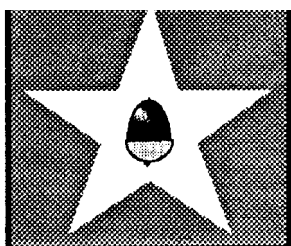


Conflict Studies Research Centre

James Sherr

**The Contest Between
Power & Policy In Russia**

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The Contest Between Power & Policy In Russia

James Sherr

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To admirers of the Putin regime, the YUKOS affair is a chastening reminder that Russia remains a museum of contradictory truths. Leninists were famous for 'resolving' contradictions. Lenin resolved several himself in his celebrated maxim: 'there is no greater nonsense than the separation of internal from external policy'. This maxim guided policy throughout the Soviet period: from the coupling of the NEP with 'peaceful coexistence' in the 1920s, through the rise of the command-administrative system during the 'Fascist danger' in the 1930s and on progressively to the point where a 'dialectical leap' was reached, and the links between *perestroyka* and 'new thinking' demolished the Soviet system, the Soviet Union and the Cold War as well. In the Yeltsin era, the same maxim elucidated the scheme of connections - and pattern of incoherence - that drove developments inside Russia, between Russia and its 'near abroad' and in its policy towards the wider world. Since December 1999, President Putin has redefined the connections between internal and external policy authoritatively - and in ways that impress the West.

But the fact is that Lenin's maxim often collides with another, which even Mikhail Gorbachev was obliged to restate: the fundamental question for a Communist is 'the question of power'. Since the 'collapse of Communism', the question of power has been the fundamental question for most successor regimes, beginning with Russia's.

The YUKOS affair is about power. It is not about Russia's national interests, and it is deeply damaging to them. It is not, except in a relatively incidental sense, about elections, because neither the December 2003 elections for the State Duma nor the March 2004 presidential elections pose serious threats to Putin and the system of power that he is still constructing. A powerful and independent business sector does. Now that it is emerging, the fundamental contradiction at the heart of Putin's project has come to the surface. Putin wants the benefits of powerful, independent business without having to suffer either their power or their independence. A more immediate and urgent contradiction has also come to the surface: the contradiction between Putin's 'vertical of power' and Russia's international influence.

Elections & Business

How confident should Putin be about the December elections? About one thing he can be very confident. The country's most organised and popular opposition, the CPRF, will remain in opposition. For years, opinion polls have linked it to a declining demographic base, the maximum support of 40 percent of the electorate and the unconditional hostility of another 40 percent. Thanks to his confidence

that 40 percent would decline to vote Communist under any circumstances, Boris Yeltsin, at the nadir of his popularity (8 percent), devoted 'administrative resources' to support the CPRF in both the December 1995 parliamentary elections and the first round of the presidential elections. Putin no less than Yeltsin would prefer that the Russian electorate is confronted by an enemy rather than an alternative. The 'leading role' of the CPRF is almost as sacred to him as it is to a Communist.

It is also highly congenial, because the CPRF is an enemy without any serious lust for power. This is partially because much of its establishment (unlike its bereft constituency) benefits from the established system of business and patronage and wants to continue doing so. It is also because well tempered opposition has secured influence. To be sure, the Communists would like to increase this influence and force the system to take account of their interests at every level. But they know which battles to fight (poverty, housing and the collapse of public services) and which lines not to cross (Chechnya, the FSB [Federal Security Service] and the business interests of the Kremlin).

Nevertheless, Alexander Prokhanov, co-chairman of the People's Patriotic Union of Russia, is probably right to warn that 'the level of rigging will be unprecedented'. And possibly necessary if Putin wishes to secure his goals. Although Putin's popularity has dipped, he remains enormously popular. His party, United Russia, is not. Moreover, its ally in the 2000 presidential elections, the Union of Right Forces (SPS), is under the leadership of Boris Nemtsov, who is now a rival, working to secure an alliance with the liberal party, Yabloko.

Unless these tendencies are brought under control, two of Putin's objectives are threatened. The first is preserving the system whereby the government's laws get through parliament without any serious battle. The second is securing a two-thirds majority, which is what is required for constitutional changes and a third presidential term. President Putin insists that there won't be a third presidential term, and today he means it, but he is clever enough to know that in a few years time he might not.

Against this background, Mikhail Khodorkovskiy's forays into Yabloko and the ranks of single mandate candidates are an irritation that Putin can do without. They are also a colossal miscalculation. Khodorkovskiy has made himself the latest hostage to Putin's unfulfillable promise that 'the oligarchs will cease to exist as a class'. The promise remains extremely popular to an electorate, 70 percent of which would like to see Russia's 1990s privatisations investigated and 'corrected'. Yet since exiling Berezovskiy and Gusinskiy three years ago, Putin has done little to show that he takes his promise seriously. The fact that Khodorkovskiy, like these other two, is of Jewish origin probably means nothing to Putin, but in an election season, it does not hurt. Some time before the affair started, Roman Abramovich sensed the change in the weather, packed his bags and took much of his capital with him.

Yet the real threats in the elections will not be countered by populism, but by hard work: the struggle to divide the Communists (by supporting Sergey Glazyev's moves to separate from them) and the battle to regain control of SPS through the efforts of Russia's indispensable *gosudarstvennik* (statist), Anatoliy Chubays, and the latter's own henchman, Alfred Kokh. And the real threat posed by Khodorkovskiy is not electoral, but more fundamental.

Business & Power

Let us admit that this affair has nothing to do with 'dictatorship of the law', or at least admit that the law has a suspect memory. Like Ukraine's former Deputy Prime Minister, Yulia Tymoshenko, Khodorkovskiy's associate, Platon Lebedev, has been put in jail for crimes that were allegedly committed many years before: crimes that did not upset the law at the time or during the three-and-a-half years that Putin has been in power. The law also has a suspect set of standards. As Putin's economic adviser, Andrey Illarionov has noted, 'not in 1994 but in 2001 in broad daylight ... an obscure firm backed by RAO UES (United Energy Systems, chaired by Putin's ally, Anatoliy Chubays) diverted \$750 million into its account. And then \$550 million out of that sum lands in the accounts of RAO UES ... The Prosecutor General's Office passed no decisions on this and did not react in any way.' In Putin's Russia, like Soviet Russia, the law could too easily be an instrument of dictatorship.

But let us also admit that Putin has a point. Americans can tell Russians with earnest conviction that in a democracy, business has as much of a right as any other private institution to take part in the political process. But what 'other' private institutions would they be talking about? The Russian Federation is a country in which twelve companies produce an estimated 70 percent of GDP. Not even the top 500 American companies produce that amount. Moreover, American business (80 percent of whose revenue is earned in the service sector) is no more than first amongst equals in a system of countervailing powers embracing trade unions, government employees, the environmental and health lobbies, the race relations industry, supporters of Israel, the Christian right and even the poor, who have lobbyists, organisation and money. In Russia the only power that can stand up to business is the state.

Let us add to this fact that, where YUKOS was concerned, Putin faced a point of decision. YUKOS, a \$31 billion company, is set to merge with Sibneft, creating a \$45 billion entity which will be Russia's largest oil company, eclipsing LUKoil (in which, like UES, the state is the majority shareholder). UES itself is scheduled to be broken up in 2008, and YUKOS is one of a core number of 'strategic investors' that have cropped up in its 70 regional units. Khodorkovskiy, who has been openly critical of Putin's policy over Iraq, has also secured the Bush administration's backing for his ambitions to enter the US market and build a pipeline to Murmansk in order to realise his goal of supplying 10-15 percent of America's oil. On 3 June, almost a month before Lebedev's arrest on 2 July, Prokhanov described Khodorkovskiy's movement to the 'political foreground' as a signal that 'that if the President doesn't suit the business elite anymore, then they need their own envoy in politics who would be ready to take the reigns of power'. The President probably knows better than to share Prokhanov's vision of Khodorkovskiy as a future prime minister or president of Russia. But he has seen a threat and reacted to it. *He* has done so, for if the YUKOS affair were simply a plot on the part of LUKoil, Rosneft and FSB colonels, it would not have cut so deep or gone so far. And during a month in which the President found two hours and 45 minutes to meet with the editor-in-chief of *US News and World Report*, he would have had more than 40 minutes to spare for the President of the Union of Industrialists and Entrepreneurs, Arkadiy Vol'skiy.

Yet there is a way out of the state vs oligarch impasse that Putin might have taken. Indeed, it is the path that many of his advocates in the West believed he was taking, the path favoured by Boris Nemtsov, Grigoriy Yavlinskiy and Putin's own economic

advisor, Andrey Illarionov: to develop a civic state, a state governed by rules and underpinned by rule enforcing institutions, beginning with an effective and politically neutral judiciary. The difference between authorities who force oligarchs to obey rules and authorities who force oligarchs to obey *them* is that the former accept the rules should apply to everyone. To be sure, no halfway intelligent supporter of Putin supposed that he was a 'democrat': a believer in the inalienable virtues of pluralism and criticism, let alone a free press. But nearly all of his supporters believed that he, like a Prussian monarch rather than a Romanov monarch, wished to build a *Rechtsstaat*: a state under law. Such a state would not persecute one oligarch for financing opposition political parties whilst allowing itself the liberty of extorting \$200 million from other oligarchs to finance its own.

So Putin has chosen another path: the extension of the 'administrative vertical' into business. As an administrative principle, it is bad enough, because what Russia desperately needs is not more vertical subordination, but horizontal integration within and between institutions. As an economic principle, it is disastrous. Of course, it has nothing to do with central planning or any of the more obvious and odious forms of 'allocation'. But it is ruinous on two levels. First, like the cardinal principles of Soviet socialism, it runs contrary to human nature. To insist that a businessman who has earned \$7 billion should not express views about his country and its foreign policy, let alone work alongside those who share them, is to insist upon a principle that can only be upheld by force. Second, it sabotages planning: not central planning, but long-term business planning. The latter requires predictability and the principles and institutions that underpin it, beginning with property rights. Without such rights, there is no solid basis for attracting international partners and their investments, there is no incentive for keeping one's own money in the country, and there is certainly no incentive for investing in long-term projects like oil pipelines, which only begin to produce a return on investment after many long years have elapsed.

Prime Minister Kasyanov and individuals far closer to the seat of power than Kasyanov will naturally use every attempt to assure everyone that the project of building a state under law is still in place. With every justification, they will also insist that this is a long-term project, whereas wilful oligarchs can pose urgent and immediate threats. Yet this is another way of saying, 'don't watch our tactics; watch our strategy, even when our tactics undermine our strategy'. For those thinking about 'betting on Russia', the issue is not starting down the right path - Putin has certainly done that - but having the vision and wisdom to continue down the path taken. Even if British Petroleum does not withdraw from its \$8 billion deal with TNK, bets must now be off. Vision and wisdom have yielded to the Russian tradition, recently summed up by Illarionov: 'as soon as we have put some distance between ourselves and the abyss, there is again a wish to get back there'.

Power & National Interest

The YUKOS affair is likely to revive an orthodoxy in the West and in much of the Russian analytical community: Russia 'doesn't even have a strategically focused foreign policy'. Under Yeltsin it was easy to subscribe to this orthodoxy. But Putin has impressed the West with his ability to announce objectives and then achieve them. Even before 11 September 2001, his stock in political and business circles was impressively high. Now this confidence is appearing misplaced. One month before the YUKOS investigation was launched, Nikolay Zlobin, Director of Russian and Asian Programmes at the Washington based Center for Defense Information,

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argued that this image of Putin's Russia had long lacked substance. With good reason, he spoke of the unreformed and intellectually limited character of Russian policy elites, the 'Potemkin-like nature of Russian-American relations', and 'a policy of ignoring deep-seated problems and serious mutual disagreements'. His catalogue of ignorance, improvisations and mistakes will have resonance in a Washington establishment engaged enough to be 'concerned' about Russia, but too self-confident to worry about it. Nevertheless, it is only one part of the picture.

The second part is that Putin recovers well from his mistakes. US policy after the Iraq war is neatly summarised in the axiom attributed to Condoleezza Rice: 'punish France, ignore Germany, forgive Russia'. Although Russia has made itself hated in much of the Pentagon, thanks to its supply of advanced technology equipment (and specialists) to Iraq, here for once the Pentagon is not driving policy. Does this suggest that Russia is simply lucky, or might it suggest (as Alexei Pushkov did in *Nezavisimaya Gazeta* on 21 April 2003) that Putin has been managing the Americans rather well?

The third part is the crucial part. Since he came to power, Putin's priority has not been the West, but the reconstruction of Russia's power from the interior outwards. Yet the Russian foreign policy establishment favoured by the West prefers to dwell upon Russia's relations with the West. In its catalogue of uncertainties, improvisations and incompetence, there is rarely any mention of the former USSR, Eurasia or China. True to form, Zlobin asserts that 'everyone, it seems wanted to believe that Vladimir Putin has abandoned petty pursuits in foreign policy in favour of grand ambitions'. Everyone where? In Washington and London, perhaps. Surely not in Georgia, Moldova or Ukraine.

If we want to consider what the YUKOS affair has damaged, we must first consider what Putin has accomplished. He has made Russia an energy superpower. Across Eurasia he has been establishing a near monopoly of energy refining and transit networks, current and projected, and he has systematically exploited economic and financial assets for geopolitical gain. To be sure, Putin has not done this himself. These accomplishments reflect the interests and influence of Russia's energy giants, not to say their resources. Yet Putin and his administration have used their own influence to ensure that these enterprises secure geopolitical benefits for Russia.

The liberal wing of Russia's foreign policy establishment does not care to dwell upon this fact for at least two reasons. The enlightened reason is their belief that Russia's future depends upon integration into the global economy, whose centres of power and influence are situated far afield of the former Soviet Union. The unenlightened reason is their belief that relations between Russia and its neighbours are not the West's proper business. Western governments do not like to dwell upon these issues either, because in their post-Cold War schéma there is no place for the notion that Russia is still engaged in 'great games' - and they certainly don't enjoy being reminded that NATO and EU enlargement can be seen as great games themselves.

Yet when it comes to Putin and Russia's *gosudarstvenniki*, a more traditional narrative is needed. By the end of 2000, Putin had used Russia's debt and energy cards to acquire control of Moldova's energy and financial sectors and secure a distinct revision to Ukraine's geopolitical course (albeit one substantially balanced, then and now, by the NATO-Ukraine relationship). In February 2002, Putin proposed a 'single export channel' for all exports of gas from Central Asia. Since then (June 2002), he has secured agreement to route nearly all of Kazakhstan's

current and projected oil production via Russia's transit network and in April 2003 concluded similar long-term agreements over the export of gas from Turkmenistan, which has the third largest reserves in the world. As Vlad Socor has painstakingly documented, both of these agreements enable Russia to purchase energy supplies at prices well below market levels and then resell them on external markets at a 100-200 percent mark-up. Both threaten to render stillborn American proposals for trans-Caspian pipelines (which Russia opposes), a Turkmenistan-Afghanistan-Pakistan pipeline (which Russia opposes) and, before Iraqi oil re-entered the scene, the Odessa-Brody pipeline (which Russia first opposed but now insists should carry Russian oil south). Barring major changes in Turkmen and Kazakh policy, the Baku-Tblisi-Ceyhan oil pipeline and Baku-Tblisi-Erzurum gas pipeline (also opposed by Russia) will be limited to the transport of Azeri oil and gas.

The EU is a diffident player in this contest, and until Bush appeared on the scene, the United States, which has been an active protagonist (and funded the bulk of new Caspian projects) refused to accept that there was a contest at all. Proof that the Clinton administration was committed to a pluralistic and commercially driven approach (rather than a geopolitically driven and monopolistic one) was its blocking of Export-Import Bank credits to American contractors, as well as its support of a key Russian project, the \$4 billion Tengiz-Novorossiysk pipeline, which ExxonMobil funded. Yet this pluralistic approach has not altered Russia's determination to control what it can control.

In fact, the events of 11 September 2001 and the Iraq war have reinforced this determination, albeit in dissimilar ways. The terrorist attacks on New York and Washington persuaded Putin that the United States and Europe would pay a price to emancipate themselves from their dependency on Middle Eastern oil. His 'strategic choice' to support the United States (and concede a military platform in Central Asia) was based on the calculation that the United States now needed Russia, both as an ally in the 'war on terrorism' and as an energy supplier. How this energy was supplied was no longer something the Americans would quibble about. The Iraq war, surely as audacious a geopolitical step as anything Putin has undertaken, reawakened anxieties about US unipolarity and dictated a search for counters to it. Set against these developments, not to say EU enlargement and a second wave of NATO enlargement, the transformation of the CIS into an economically usable 'space' is seen not only as a defensive measure by Putin, but as a precondition for giving Russia 'equality' in an unbalanced international system. It is also seen as an ever more practical measure, because the 'war on Saddam', like the 'war on terrorism' has diverted America's attention from Eurasia - and may continue to do so if the 'awe of American power' continues to fade before the challenges of 'victory'.

Hence, two recent steps which, like so many previous ones, have caught the United States by surprise. The more dramatic of the two has been the flying visit to Georgia of two players whom the United States and the EU thought were safely excluded: Alexey Miller (CEO of Gazprom) and Anatoliy Chubays (CEO of UES), both of whom are stitching up agreements that place the sanctity of Georgia's Western orientation and its Black Sea pipelines in some doubt. No 'improvisations' here. Georgia faces a winter, an election and a possible regime change - and despite billions of dollars of Western investment in pipelines, a Train and Equip Programme and a host of new security mechanisms, Russia remains an occupier and the country's supplier of gas. The parties who prepared this coup proceeded from a knowledge of Georgia's political culture, the psychology of its leaders and the weak links of its political system that the West has never quite grasped.

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The second step was the summit on 2 June between President Putin and China's new head of state, Hu Jintao, which produced a \$150 billion, 25 year deal between YUKOS and China's National Petroleum Corporation for the construction of a 2,400 km Angarsk-Daqing pipeline that will supply China with 700 million tonnes of Russian oil. For China, the commercial logic of the deal is compelling. Over the past ten years, it has become the world's third largest importer of oil. The newly discovered Angarsk oil field has reserves equal to those of Kuwait. For Russia, the commercial logic of a pipeline from Angarsk to Nakhodka, supplying Japan with a quarter of its oil, might have been more compelling. But without losing out commercially, Russia made the geopolitical choice. China, once the strategic partner of the United States, has since Bush's election become its 'strategic competitor'. Apart from Angarsk-Daqing, it has expressed interest in a project congenial to Russia and damaging to the energy strategy of the United States: the construction of a Kazakhstan-China pipeline, a project that would dash any remaining hopes of exporting Kazakh oil to the West via the Caspian. To date, the Russo-Chinese strategic partnership, supported by arms sales and a rhetorical, uncoordinated approach towards 'multipolarity', has been moderately endowed with will and limited in substance. Geo-economic interest and genuine interdependence would ground it in both.

So, President Hu must be asking the same question as policy makers in Washington. What has happened to his business partner, Mikhail Khodorkovskiy, whom Putin had so recently supported? Will Putin be able to provide satisfactory answers to Hu and to others?

Can Putin Square The Circle?

Vladimir Putin's policy over Iraq was his first mistake in office. Yet he has been recovering from that mistake, to the relief of many and the irritation of some. Putin's attack on YUKOS is his second mistake, but this time his prospects of recovery are more doubtful.

There is a weakness in Putin's geopolitical design. It is expensive. In the short-to-mid term, Russia can compensate for its declining reserves of gas and oil with Turkmenistan's gas and Kazakhstan's oil, but even now the pipeline network that transports these resources is dated, worn and crying out for investment. In the mid-term, Russia needs to exploit its own huge and untapped reserves, but this requires even greater investment, not to say advanced technology. This means Western technology and investment. Khodorkovskiy, owner of Russia's most successful private oil company, does not dispute this. He admits that whilst YUKOS might be able to build a Far Eastern pipeline to China, it cannot afford to build one to the Sea of Japan as well, and it will be hard put to build one to Murmansk. Whilst Russia might have a near monopoly of Caspian energy resources, not to say geopolitical strategy, as Socor notes, 'Western investment capital, Western technology and market demand in Western countries are the enablers of Caspian energy development'. This state of affairs is not only unacceptable, it is unsustainable.

Hence, there is a contradiction in Putin's geopolitical design: the impulse to succeed economically and the impulse to control. Khodorkovskiy's economic success is largely the achievement of Khodorkovskiy. But it was made possible by the economic policies and the framework of rules that President Putin and his more

enlightened advisers put in place. This achievement and framework have been damaged by Putin's reassertion of control. Before he reasserted it, the United States had selected YUKOS to be its long-term partner, because YUKOS executives came closest to Western standards of transparency, accountability and contract observance. As a result, US oil companies were contemplating joint projects from the Arctic Ocean to Sakhalin. Almost any reasonable person would have celebrated this as the success of Putin's policy. Instead Putin and a circle of unenlightened interests seem to have decided that this 'penetration', and Khodorkovskiy's independence, was a threat.

The YUKOS affair was foreshadowed two years ago in the observation of a Ukrainian industrialist: 'Russian business and the Russian government are now totally separate, but they can be reconnected in a second'. Western companies will not part with billions of dollars if government and business 'can be reconnected in a second'. The globalisation that Putin exalted in his speech 'Russia at the turn of the Millennium' in December 1999 erodes control by definition. The United States gains inroads, even some ownership of Russia's infrastructure; Russia gains investment and 'penetration' of the American oil market. Even today, Russia provides 28 percent of Europe's gas, and Vladimir Potanin's Interros buys American companies. This is customarily called 'give and take'. Yet, as Potanin recently admitted in Washington, the first half of this is unacceptable to Russia's elite. Its approach to World Trade Organisation negotiations is 'gaining access without giving it'. So is its approach to energy policy and 'defence conversion', not to say its policy towards neighbours, which is still based upon achieving influence through dependency and enfeeblement. By the start of the Kosovo conflict, many Russians had concluded that Western talk of partnership was nothing more than 'empty talk' (*boltovnya*). After the events of the past month, it would be prudent to conclude that Putin's talk of 'globalisation' is *boltovnya*.

But what more specific conclusions will be drawn? The Moscow analyst Sergei Kolmakov concludes that 'if a big company like YUKOS can get hit because of something that wasn't quite right in 1994, then no small or medium business is safe'. Sadly, one must go further, because smaller Western energy 'independents' have long reported a stream of practices that no prudent business would regard as safe: the tendency of partners to walk away from agreements, a 'might makes right' approach to disputes, the failure of courts to adjudicate and despite some positive changes, the fact that junior Russian and Western companies still remain pawns in political games. It is possible that business 'majors' will now pay more heed to these independent voices. But will major governments now pay greater heed to the connections between politics and business in 'former Soviet space'? That would be a lot to hope for, but perhaps it is becoming obvious that there is a lot at stake, including Western interests.

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