

Russian Energy Politics: Fuelling Power

Written by Craig Pirrong

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CRAIG PIRRONG, JAN 9 2008

The phrase “Russian energy politics” is dangerously close to a redundancy; in Russia, politics is energy and energy is politics. To be sure, energy is politicized in virtually every country, but nowhere is the nexus between petroleum and politics tighter than in the Russian Federation. After all, in what country is the Chairman of the Board of the state champion oil company (Rosneft) also the First Deputy Chief of the Russian Presidential Administration (Igor Sechin), while the Chairman of the Board of the natural gas monopoly (Gazprom) is also the Deputy Prime Minister and presumptive national president (Dmitri Medvedev)?

Energy exerts a decisive impact on every aspect of Russian politics, from the domestic to the geopolitical. Domestically, huge rents from energy have been conducive to the formation in Russia of what scholars Douglas North, John Wallis, and Barry Weingast call a “natural state.” As North, Wallis, and Weingast argue:

[a] *natural state* is a specific way of structuring political and economic systems so that the economic rents created by limited entry are available to secure credible commitments among politically powerful groups. Potential rivals in a natural state stop fighting (or fight less) when the economic rents they enjoy depend on continued existence of the state and of social order. Natural states limit economic entry to create rents and then use those rents to credibly commit powerful groups to support the state. In other words, natural states use the economic system as a tool to solidify the stability of the ruling coalition.

They also note that to maintain the stability of the division of rents, natural states have an incentive to suppress civil society; undermine democracy in order to reduce the likelihood of a transfer of political power and limit citizen access and power; undermine the independence of the judiciary; and control or restrict entry into valuable economic activities. In a nutshell, stability among the ruling elite is a fetish in natural states, as instability can touch off devastating internecine conflicts over rents.

Rents and natural states go together, and Russia’s current energy bounty – driven by its physical endowment and an unprecedented spike in energy prices – has created a stream of rents beyond the wildest imaginings of Russians at the time of the collapse of the USSR. Events in Russia over the past several years support the main contours of the natural state thesis that increased potential for rent seeking markedly affects domestic political organization.

In Russia, this boom in energy rents has coincided with, and has quite plausibly been a major cause of, an undermining of Russia’s already weak civil society, judicial, and democratic institutions. Moreover, the late-Putin era has seen the fetishization of stability alongside the evolution of rival political clans, each with a strong cohort of violence specialists with roots in the security services, restively coexisting in a tenuous equilibrium. These clans are among the major beneficiaries of the rents flowing into Russian coffers, and securing their claims to these rents is their major preoccupation.

And that is where the North-Wallis-Weingast formulation can be misleading. They emphasize that rents can be the glue that keep a natural state together, but underappreciate that the stability of such arrangements can be tenuous indeed. Such tacit truces between rivals for rents can be supported under some circumstances, but can break down when conditions change. In particular, such “cartels” of rent seekers are sustainable when the rival parties have relatively long time horizons; with low discounting of the future, repeat interactions and the threat of defecting from

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tacit agreements to share rents support cooperation and suppresses conflict. However, shocks that increase uncertainty can truncate time horizons, and if these shocks are sufficiently severe, cooperation is no longer an equilibrium strategy. In these circumstances, stability can rapidly degenerate into chaos and violence. That is, natural states can be brittle, and their apparent stability chimerical.

The recent uncertainty over presidential succession has clearly shaken the Russian political elite. Indeed, there have been recent public outbreaks of struggles among the clans, and the many growls emanating from under the Kremlin carpet (to paraphrase Churchill) suggest that the public feuds are just battles in a much larger war. The main case for retaining Putin in power advanced by many elements of the elite (notably the Sechin clan) is that only Putin can keep the clans in check. Although Putin's anointment of Medvedev has evidently eased some of the anxiety over succession, the combination of the uncertainty over the future division of power between Medvedev and Putin, the inherent ambiguity and volatility of any such division, and the billions in rents at stake (most of them energy derived) will conspire to make the months to March 2008 and far beyond fraught with peril.

In sum, in terms of domestic politics, huge resource rents—most notably, rents from energy—have transformed Russia into a natural state in which the dominant factor driving political and legal arrangements is the division of rents. As North et al suggest, such arrangements corrode civil society, and such corrosion is clearly evident in Russia. Contrary to their (relatively) sunny predictions that these arrangements also facilitate stability and lead to the suppression of political violence among the elite, however, this stability is very brittle. And again, this brittleness is clearly evident in current Russian politics.

Moreover, the ramifications of energy rents extend far beyond Russia's borders, and not only to the extent that regional and international stability is affected by the internal stability of a former superpower possessed of a massive nuclear arsenal and a UN Security Council veto.

Russia's energy rents will be larger, the more that competing suppliers of energy restrict output. This fact sheds light on much recent Russian foreign policy. In Central Asia in particular, Russia has engaged in a diplomatic full court press to wall off that region's energy resources from European and American countries. Gazprom in particular benefits greatly from limited competition for Turkmen gas, and the company and the Russian government (as if one can distinguish them) have acted aggressively to forestall the development of pipelines that could divert this gas from Russian, which is to say Gazprom's, pipes. The new Great Game in Central Asia revolves around energy, and involves not just Russia and Europe, but Turkey, Azerbaijan, Iran, the US, and notably for the future, China.

But Central Asia is not the only area in which Russia is maneuvering to control or coordinate production of energy in a way that will enhance Russian energy rents. Russian initiatives with countries as diverse as Qatar, Algeria, and now Nigeria are all driven by Russia's desire to restrict competition in the international trade of energy. These efforts focus primarily on natural gas because that commodity's particular infrastructure needs make it particularly vulnerable to such anti-competitive efforts.

Moreover, it should be noted that uncertainty and the potential for supply disruption can drive energy prices higher. This undermines Russia's interest in promoting stability in major energy producing regions, such as the Gulf, Nigeria, or South America. Indeed, it may provide an incentive to sow instability in these regions. As a result, there is a reasonable basis for suspicion over the motives behind its policies regarding Iran, as well as other energy producing nations.

Energy is also an instrument that Russia uses to advance other geopolitical objectives. Energy is the primary tool that Russia employs to reassert its influence the "Near Abroad." Moreover, Russia repeatedly attempts to utilize energy to drive a wedge between European regions and individual countries, and between Europe and the US. These efforts are undertaken in service of the desire by some elements in Russia who believe their nation is in conflict with Western and "Atlanticist" blocs.

In brief, one cannot understand Russian domestic politics or Russian foreign policy without understanding the role of energy. At present, the resurgence of Russian state power both domestically and internationally is figuratively fueled

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by high energy prices.

And in this there is a cautionary tale. The influence of the USSR in the world during the 1970s was financed by the windfall of the last oil shock; without such a windfall, the Soviets would not have been able to overcome their severe structural weaknesses in industry, and especially agriculture. The end of this windfall precipitated the collapse of the USSR. Current Russian assertiveness is similarly dependent on an energy windfall.

Although it would be rash to predict a modest, let alone precipitous, decline in energy prices occurring in the near future, it would have been similarly rash to do so in 1985. As a much more open, market oriented economy, Russia is far better positioned to weather a decline in oil prices than the Soviets were, but Russia would still suffer terribly from a decline in energy prices. But perhaps the most disturbing realization is that high oil prices are no blessing to Russian civil society, democracy, and political stability, or its non-resource economy, or to the stability of the world outside of Russia's borders. High energy prices or low, there is much room for pessimism about Russia. The "devil's excrement," indeed.

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