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## Rosneft, Gazprom and the Government: the Decision-Making Triangle on Russia's Energy Policy

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**Pavel Baev**

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## Executive Summary

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Russia finds itself exposed to many risks in the fast-moving global revolution in energy affairs, and cannot avail of its opportunities despite its unique combination of natural resources and experience in their exploitation. It has entered the phase of economic stagnation, and the under-performance of the energy sector is one of the key determinants of the durability of this trend. Energy export can no longer be wielded as a heavy-impact instrument of foreign policy, and the squabbles for shrinking oil and gas revenues form a key driver of the evolving crisis of the petro-authoritarian regime built by President Vladimir Putin. Escalating problems in the Russian energy sector are caused by the system of decision-making on oil and gas matters, in which Putin acts as a supreme arbiter in the flexible triangle formed by the government and two super-large state companies—*Gazprom* and *Rosneft*.

It is the imperative of checking the decline of budget revenues that determines the priority in government policy of greater confiscation of profits and heavier taxation of the energy business. This squeeze on the interests of energy 'oligarchs' provokes them to appeal to Putin for tax breaks, which he is increasingly reluctant to grant, given the need to pursue an active social policy. The constant flow of insoluble issues makes Putin irritable and generally less engaged with the energy business than he used to be.

*Gazprom's* notorious inefficiency in its core business emboldens competitors to capture greater shares of the domestic market and to demand exemptions from its export monopoly. Putin is loath to carry this political liability but remains reluctant to contemplate reforms that would amount to unbundling of this conglomerate.

*Rosneft* under the control of Igor Sechin has become the champion of the Russian oil industry, executing a series of acquisitions and signing a series of deals with Western 'majors'. Putin's benevolence is the key to the success of this aggressive business strategy, so in the near future *Rosneft* will probably elbow *Gazprom* out of some parts of the gas business. That, however, will only add to the unhealthy growth of Sechin's super-corporation—and further enfeeble the government's efforts at taking a modicum of control over the energy sector. Parochial interests, political expediency and corruption will prevent Russia from enacting a modernization strategy for the energy sector.

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## Introduction

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Russian energy policy has never been a coherent process shaped by strategic assessments of fundamentals. Currently, however, it is in greater confusion than even at the V-shaped bottom of the economic crisis in early 2009. The key parameters of the energy sector, including the volumes of produced oil and natural gas, are on a slightly rising plateau; the picture for extractable reserves is reasonably positive; world prices on oil have remained remarkably stable for the last three years. Yet, instead of steady sailing toward rational destinations, Russian energy industries are at a loss and lack any useful guidelines to follow. Global energy markets are experiencing revolutionary changes that are opening up spectacular opportunities, and Russia—with its incredible variety of resources and vast experience in their processing—is perfectly positioned to take advantage of the expanding demand. It is, nevertheless, stuck in the old ways of exploiting the natural riches and remains in denial of the imperative to modernize.

This self-defeating adherence to the traditional pattern is not a result of satisfaction with the present state of development in the energy complex; there are, in fact, mounting concerns about shrinking export revenues and the deepening dependency of the state budget on oil and gas income.<sup>1</sup> The demonstrated inability to connect with the ongoing revolution in energy affairs is primarily the consequence of the byzantine character of decision-making in Vladimir Putin's court, where clans of special friends are squabbling for a greater share of lootable resources, while the economic rationale of "mega-projects" or the cost-efficiency of investments are entirely irrelevant. President Putin used to have keen an interest in energy matters, and impressed many of his counterparts in the mid-2000s with his firm grasp of technical details, particularly in the gas business. In his third presidential term (which is to all intents and purposes the fourth term of his domination over Russian state affairs), however, he has grown visibly indifferent to the too fast-moving "unconventional" changes and easily irritated by *Gazprom's* vicissitudes in the key European market. Minions and lieutenants are taking advantage of this supreme disengagement in order to advance their parochial interests, disregarding the attempts of the government of Prime Minister Dmitri Medvedev to execute a hopeful but hopelessly incoherent growth-stimulating policy.

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<sup>1</sup> Sound analysis of the trends in the Russian energy sector can be found in Th. Gustafson, "Putin's petroleum problem," *Foreign Affairs*, November-December 2012.

Energy export can no longer be wielded as a heavy-impact instrument, or even “weapon”, for Russian foreign policy; it remains, nevertheless, an absolutely central factor in keeping the Russian economy from plunging into a deep crisis.<sup>2</sup> Chronically low investment activity and the high net outflow of capital have caused an economic slowdown that, since mid-2013, has acquired the pronounced character of stagnation, with the predictable consequences of rising unemployment and contracting budget expenditure.<sup>3</sup>

What should make the Kremlin seriously worried is the possible interplay between the economic and political crises. The explosion of street protests in Moscow in the first half of 2012 happened in the context of a reasonable healthy economic situation, and the arrival of stagnation in the mid-2013 saw a lull in the protest activity; in 2014, however, discontent with economic hardship might get in sync with a new wave of political rallies, and lead to a mutually reinforcing momentum. In this highly fragile situation, even a slight drop in oil prices could cause strong knock-on effects and undermine the regime's control over both economic volatility and political turmoil.

This paper cannot aspire to investigate all the controversies and conflicts that bedevil the Russian energy complex. It has the limited focus of examining the peculiar construct of decision-making on oil and gas matters, in which Putin acts as a supreme arbiter in the flexible triangle formed by the government and two super-large state companies—*Gazprom* and *Rosneft*.

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<sup>2</sup> I have argued this point in P. Baev, “How Russian Energy ‘Weapon’ Turned into an Oil Pillow and Gas Rattle,” *PONARS Eurasia Memo* 294, September 2013, <[www.ponarseurasia.org/memo/how-russia%E2%80%99s-energy-weapon-turned-oil-pillow-and-gas-rattle](http://www.ponarseurasia.org/memo/how-russia%E2%80%99s-energy-weapon-turned-oil-pillow-and-gas-rattle)>.

<sup>3</sup> Medvedev had to admit the deterioration of the economic situation, but his intentions for turning it around by making ‘hard decisions’ are far from convincing; see D. Medvedev, “The Time for Easy Decisions is Past,” *Vedomosti*, 27 September 2013, <[www.vedomosti.ru/opinion/news/16830781/vremya-prostyh-reshenij-proshlo](http://www.vedomosti.ru/opinion/news/16830781/vremya-prostyh-reshenij-proshlo)>.

## The Government Puts Pressure on the Energy Potentates

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It is a fact of Russian political life that President Putin insists on executing personal control not only over strategic directions but also over minor matters pertaining to the operations of the energy complex, habitually engaging in micro-management through a small group of trusted aides. The main administrative embodiment of this control is the Commission on Strategy for Developing the Fuel-Energy Complex and Ecological Security, which was formed in the mid-2012 and has had four meetings since.<sup>4</sup> It has a far higher profile than the government Commission on the Issues of the Fuel-Energy Complex, Reproduction of the Mineral Resources Base and Increasing Energy Efficiency, chaired by Deputy Prime Minister Arkady Dvorkovich.<sup>5</sup> Nevertheless, most of the real work on managing the energy complex and preparing key decisions is concentrated in the government. It may lack high-profile personalities—like, for instance, former finance minister Alexei Kudrin or former minister of natural resources Sergei Shmatko—but it coordinates the activities of several solid and well-established bureaucratic machines, including the Ministry of Energy (headed by the relatively young Alexander Novak) and the Ministry of Natural Resources and the Environment (headed by the only slightly more experienced Sergei Donskoy).

Dvorkovich may appear a political featherweight unable to take on the seasoned veterans of the energy business, but he is in fact a smooth operator with a keen understanding of 'palace intrigues' and a good sense of global trends in the market. He understands perfectly well that the government's predominant concern is to secure an increase (or at least the minimal possible drop) in revenue, and seeks to exploit this imperative for establishing firmer control over the unruly oil and gas potentates. For that matter, he initiated the slight reduction of tax on exports of oil and gas and a more significant increase of tax on production of energy resources. This may secure an overall increase in government revenue, but it puts the interests of exporters ahead of the preferences of companies working on the domestic market.<sup>6</sup> The government is central to the protracted battles around the

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<sup>4</sup> The activities of the Commission, including Putin's every contribution to proceedings, are presented on its website: <<http://state.kremlin.ru/commission/29/news>>.

<sup>5</sup> This Commission's website is not very informative: <<http://government.ru/department/143/>>.

<sup>6</sup> For a competent criticism of this initiative, see Sergei Aleksashenko, "Long-term miscalculation," *Gazeta.ru*, 18 September 2013, <[www.gazeta.ru/comments/2013/09/18\\_x\\_5657253.shtml](http://www.gazeta.ru/comments/2013/09/18_x_5657253.shtml)>.

painful question of increasing or freezing the regulated tariffs on electricity and gas, but its absolute priority is the greater confiscation of profits and heavier taxation of the energy business. This goes against the core interests of the companies and sets a dilemma for Putin, who understands the need to maximize budget revenues but is reluctant to squeeze the purses of his special friends.

One particular paradox of the management of the Russian energy complex is that the over-sized state-owned corporations, like *Gazprom* and *Rosneft*, operate without any government control, pursuing their parochial interests and even resisting transfer of the due share of dividends to the state budget.<sup>7</sup> The government representatives on their boards (ministers and their deputies cannot perform this role any longer) cannot influence corporate policies, even if they are at cross purposes with official guidelines. Seeking to rectify this awkward situation, Medvedev and his experienced Minister for Economic Development Alexei Ulyukhaev made privatization of state companies one of the key priorities in economic policy, budgeting also for considerable financial gains and predicting improvements in the investment climate. These plans, however, were completely derailed by the determined resistance championed by *Rosneft* and *Gazprom* but firmly backed by *Sberbank*, *Russian Railroads* and defense industry giants, like the *United Shipbuilding Corporation*, so that in 2013 the privatization program has come to a complete standstill.<sup>8</sup>

The most obvious shortcoming of government policy is failure to stimulate investment in the development of new resources and new technologies, so that taxation is merely a heavy burden, with no built-in stimuli. Both private and state-owned companies are effectively discouraged from exploring new fields in Eastern Siberia, as tax breaks are highly uncertain; the inflexibility in setting the tax regime was also one of the key reasons for the collapse in mid-2013 of the pioneer Shtokman off-shore project, in which *Statoil* and *Total* were the key partners.<sup>9</sup> Short-term needs to maximize budget revenue are dominating over the long-term task of modernizing Russia's main source of economic strength.

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<sup>7</sup> On the desperate efforts of Dvorkovich to make the *Rosneftegaz* holding company release the accumulated profits, see M. Tovkailo, E. Sobol et al., "Sechin will Deliver Almost Everything," *Vedomosti*, 17 July 2013, <[www.vedomosti.ru/companies/news/14166891/sechina-lishayut-pribyli](http://www.vedomosti.ru/companies/news/14166891/sechina-lishayut-pribyli)>.

<sup>8</sup> See S. Kulikov, "The Plan for Privatization is Implemented by 4 percent," *Nezavisimaya Gazeta*, 13 September 2013, <[www.ng.ru/economics/2013-09-13/1\\_plan.html](http://www.ng.ru/economics/2013-09-13/1_plan.html)>.

<sup>9</sup> By summer 2013, *Gazprom* abandoned the plan to relaunch the Shtokman project, leaving it for "next generations"; see V. Milov, "Shtokman Development Should Not be Abandoned," *Forbes.ru*, 31 August 2012, <[www.forbes.ru/sobytiya-column/kompanii/108894-brosat-razrabotku-shtokmana-nelzya](http://www.forbes.ru/sobytiya-column/kompanii/108894-brosat-razrabotku-shtokmana-nelzya)>; E. Khodyakova, "Gazprom May Give up on Developing Shtokman," *Vedomosti*, 3 June 2013.

## Gazprom Confidently Drives Depression in Gas Industry

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The deeply embedded and invariably deepening inefficiency of *Gazprom*, the behemoth of a company that emerged from the Soviet Ministry of the Gas Industry and survived all the astounding transformations of the quarter of a century essentially intact, hardly needs detailed substantiation.<sup>10</sup> The gas monopoly has grown into a sprawling conglomerate, so that it is exposed to risks originating in the financial sphere (through the *Gazprombank*), in the oil sector (*Gazpromneft* is Russia's fourth largest oil company), and even in the media business (*Gazprom-Media* owns the NTV group of TV channels and the *Moscow Echo* radio station). In its core gas sector, *Gazprom* is on the defensive against the growing pressure for reforms, portraying itself as part of "national heritage" and claiming to perform a crucial social function with its gasification program.<sup>11</sup> While it has become plain obvious for the state leadership, including President Putin, that the gas industry is sinking into a morass of trouble, the *Gazprom* leadership sticks to its optimistic forecasts and continues business as usual.<sup>12</sup>

This invincibility can only be sustained due to special relations between Putin and Alexei Miller, who was appointed *Gazprom's* CEO in mid-2001, having only one qualification for this position of great responsibility—from 1991 to 1996 he worked in the Committee for External Relations of St. Petersburg mayor's office—under an undistinguished bureaucrat who was destined to become Russia's "national leader".<sup>13</sup> It is hard to figure out how exactly this special relation has been functioning, since Putin and Miller have spent almost no time together, and the few direct contacts documented are entirely

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<sup>10</sup> One penetrating analysis is by A. Åslund, "Gazprom: Challenged Giant in Need of Reform," pp. 151-168, in A. Åslund, S. Guriev, and A. Kuchins (eds), *Russia After the Global Economic Crisis*. Washington DC: Peterson Institute for International Economics, 2010.

<sup>11</sup> Gasification goes hand in hand with the policy of raising the gas tariffs, which leads to an increase in unpaid debts, particularly in the regional public-utility sector. In 2012, this indebtedness increased by 47%, reaching \$US 5 billion; see P. Stroganova, "Gazprom Threatens to Cut Investments in Gasification of the Indebted Regions," *RBC Daily*, 13 March 2013, <<http://rbcdaily.ru/industry/562949986185991>>.

<sup>12</sup> *Gazprom's* website (<[www.gazprom.ru](http://www.gazprom.ru)>) presents a problem-free business strategy, and Alexei Miller writes in his column that it is impossible to imagine Russia without *Gazprom* (<[www.gazprom.ru/press/miller-journal/352575/](http://www.gazprom.ru/press/miller-journal/352575/)>).

<sup>13</sup> The cadre purge that Miller executed in *Gazprom* is described in V. Panyushkin and M. Zygar, *Gazprom—Novoe Russkoe Oruzhie* [Gazprom—New Russian Weapon], Moscow, Zakharov, 2008.

businesslike. However, Miller was always able to get supreme support in every conflict in the *Gazprom* management, and the oft-circulating rumors about his resignation were invariably disproved.

One special service that Miller was able to provide to Putin was to turn *Gazprom* into a heavy-impact instrument for foreign policy, particularly in Europe where the issue of dependency on the import of Russian gas acquired pivotal political importance, particularly after the first Russian-Ukrainian gas “skirmish” in the first days of 2006. Putin was eager to go into every technical detail of the gas-political intrigues, but he missed the big picture of reconfiguration of the European market under the impact of the EU “20-20-20” policy, dismissing it as wishful “green” thinking.<sup>14</sup> He still cannot quite reconcile his vision of a steadily growing flow of Russian gas to the expanding EU market with the reality of contracting demand, but even more disappointing for him is the disappearance of political dividends from the gas business. *Gazprom* is experiencing all sorts of setbacks in this core market, including the probe initiated by the European Commission, and Putin cannot fail to see that his every attempt to use his authority to advance the gas interests backfires.<sup>15</sup> This waste of political capital translates into irritation aimed not only at his European counterparts but also at Miller, who is failing to secure reliable ties with traditional partners such as E.ON or ENI.

*Gazprom* remains the single channel for the Russian gas business in Europe, but on the domestic market and increasingly on the Asia-Pacific markets it is unceremoniously pushed aside by aggressive competitors. Oil companies use the guideline on cutting down flaring for demanding greater access to gas pipelines, but the main challenger is the dynamic *Novatek*, which has been controlled since the late 2000s by Gennady Timchenko, a low-profile billionaire who has his own special friendship with Putin.<sup>16</sup> *Novatek* is developing a large-scale LNG project on the Yamal peninsula (partnering with French *Total* and, most recently, Chinese *CNPC*) and lobbying hard for the change in legislation that would break *Gazprom*'s monopoly in exports, at least as far as liquefied gas is concerned.<sup>17</sup> Such a “coup” would not inflict any material damage on *Gazprom*'s interests, but it

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<sup>14</sup> My evaluation of this misperception is in P. Baev, “Russian Energy as a Challenge and a Bonus for European Security,” *Studia Diplomatica*, vol. 64, No. 1, 2012, p. 91-100.

<sup>15</sup> See A. Stulberg, “Russia and the Geopolitics of Natural Gas: Leveraging or Succumbing to Revolution?” *PONARS Eurasia Memo* 296, September 2013, <[www.ponarseurasia.org/memo/russia-and-geopolitics-natural-gas-leveraging-or-succumbing-revolution](http://www.ponarseurasia.org/memo/russia-and-geopolitics-natural-gas-leveraging-or-succumbing-revolution)>; A. Roley, “Gazprom on the Ropes,” *New York Times*, 11 October 2013, <[www.nytimes.com/2013/10/12/opinion/gazprom-on-the-ropes.html?\\_r=0](http://www.nytimes.com/2013/10/12/opinion/gazprom-on-the-ropes.html?_r=0)>.

<sup>16</sup> See “From Petrograd to Petrodollars,” *The Economist*, 5 May 2012, <[www.economist.com/node/21554184](http://www.economist.com/node/21554184)>.

<sup>17</sup> For a balanced assessment of this prospect, see D. Bochkarev, “Liberalization of Natural Gas Export to Help Russia Restore Positions on the European and Global Markets,” *RIAC Analysis*, 1 August 2013, <[http://russiancouncil.ru/en/inner/?id\\_4=2182#top](http://russiancouncil.ru/en/inner/?id_4=2182#top)>.

might constitute the first step in the long-overdue dismembering of this “mother of all state corporations”.<sup>18</sup>

Putin remains reluctant to contemplate such an unbundling but he has acknowledged the risk of putting *Gazprom*'s interests above those of industrial lobbies and public-utility consumers. The government has therefore elaborated a proposal to freeze the tariffs on gas and electricity.<sup>19</sup> This amounts to abandoning the long-set goal of bringing domestic prices on gas closer to the level of export prices, but for *Gazprom* it means a contraction of revenues and, very probably, a further decline in market capitalization, which is currently around 35% of the record high set in mid-2008. From being a major pillar of the hyper-centralized regime, *Gazprom* has become a serious personal liability for Putin, who is generally not known for tolerating such a drain on his authority—but he is obviously at a loss when it comes to modernizing this dinosaur and disposing of the loyal Miller.

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<sup>18</sup> One devastating analysis is “Gazprom: Russia’s Wounded Giant,” *The Economist*, 23 March 2013, <[www.economist.com/news/business/21573975-worlds-biggest-gas-producer-ailing-it-should-be-broken-up-russias-wounded-giant](http://www.economist.com/news/business/21573975-worlds-biggest-gas-producer-ailing-it-should-be-broken-up-russias-wounded-giant)>.

<sup>19</sup> See S. Kulikov, “The Gift to the Industry Worth a Trillion May Turn Out to Be a Mistake,” *Nezavisimaya Gazeta*, 27 September 2013, <[www.ng.ru/economics/2013-09-27/4\\_trillion.html](http://www.ng.ru/economics/2013-09-27/4_trillion.html)>.

## Rosneft Going Strong—Toward Becoming another Gazprom

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The big story in the Russian energy complex this year is the spectacular expansion of *Rosneft*, the state-owned corporation. At the start of the 2000s it was a player of no significance, but it has now become the champion of the oil industry. The acquisition of TNK-BP for \$US 12.5 billion in cash (plus 19.75% shares) made *Rosneft* into a “major”, controlling more than half of Russian oil production and comparable in size with PB or *Total*; it has also partly removed the stain on the company's reputation due to its key role in looting *Yukos* assets after the imprisonment of owner Mikhail Khodorkovsky.<sup>20</sup> Yet the international rating agencies are not raising it to the top category, while experts warn about its predisposition to over-extend at the expense of efficiency, which might soon produce another unmanageable *Gazprom*-type conglomerate.<sup>21</sup>

Much in the *Rosneft* success story is attributed to the ambitious Igor Sechin, who had patronized *Rosneft* for many years before becoming its CEO in 2012 (former CEO Sergei Bogdanchikov fell out with Sechin and was kicked out in mid-2010), stepping down from the position of deputy prime minister. He is proud to be a member of the most inner circle of Putin's trusted lieutenants, so despite having no official position but having an obvious conflict of interests, he has been appointed as secretary of the above-mentioned presidential Commission on Strategy for Developing the Fuel-Energy Complex.<sup>22</sup> Sechin is often portrayed in Russian media as a larger-than-life character and a mastermind of Russian energy strategy, but his track record of mixing business with politics betrays neither a deep strategic mind nor a talent for management. Dvorkovich, for that matter, was able to outplay him in several encounters.<sup>23</sup> Sechin is also often characterized as a chief in the aggressive clan of *Siloviki*, which

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<sup>20</sup> That story is scrutinized in M. Sixsmith, *Putin's Oil: The Yukos Affair and the Struggle for Russia*, NY, Continuum, 2010.

<sup>21</sup> Credit ratings are presented at the company's very useful website, <[www.rosneft.ru/Investors/instruments/Ratings/](http://www.rosneft.ru/Investors/instruments/Ratings/)>; for an expert opinion, see A. Åslund, “How Rosneft is Turning into Another Gazprom,” *Moscow Times*, 21 June 2013, <[www.themoscowtimes.com/opinion/article/how-rosneft-is-turning-into-another-gazprom/482022.html](http://www.themoscowtimes.com/opinion/article/how-rosneft-is-turning-into-another-gazprom/482022.html)>.

<sup>22</sup> On the uncertain responsibilities executed by Sechin in this Commission, see D. Butrin, K. Melnikov, “Irresponsible Secretary,” *Kommersant*, 5 July 2012, <<http://kommersant.ru/doc/1973838>>.

<sup>23</sup> See V. Milov, “Is Putin Getting Tired of Sechin?” *Forbes.ru*, 23 November 2012, <[www.forbes.ru/sobytiya-column/220639-pochemu-pravitelstvo-medvedeva-smoglo-potesnit-vsemogushchego-sechina](http://www.forbes.ru/sobytiya-column/220639-pochemu-pravitelstvo-medvedeva-smoglo-potesnit-vsemogushchego-sechina)>.

includes the bosses of various special services and armed bureaucracies, but there is no evidence to suggest that *Rosneft* serves the interests of the FSB (the Federal Security Service) or contributes to the coffers of a “deep state” of any kind.<sup>24</sup>

One business strategy that *Rosneft* executes better than any other Russian company is building partnerships with Western “majors”, which see great potential in the “green” fields that are yet to be explored in East Siberia and in the “brown” fields where production has been declining but the introduction of new technologies could yield plenty of new volumes. Sechin has proclaimed that his dream is to discover a huge new field in the Kara Sea, and *Exxon Mobil* shows readiness to partake in the exploration, adding vast new reserves to its books.<sup>25</sup> Another great ambition that Sechin has cherished for many years is to expand oil export to China; the opening of the “strategic” East Siberia-Pacific Ocean (ESPO) pipeline in 2012 paved the way for a new export deal, which was supposed to be signed at the margins of the G20 summit in St. Petersburg but was postponed.<sup>26</sup> There are serious doubts about the benefits for Russia in taking huge loans from China (while remaining reluctant to allow direct investment in the energy assets) and repaying these with crude oil, while on the Chinese side, there is a criminal investigation into the corruption driving the deals with *Rosneft*.<sup>27</sup> Sechin’s high activity in the international arena and his success in keeping *Rosneft* clear of serious trouble has helped to uphold the market capitalization, which had already by the end of 2009 recovered close to the record high reached in mid-2008. However, the acquisition of TNK-BP has not propelled the share price to a new high.

What adds to the doubts of potential investors is not so much the uncertainty about the profitability of oil export to China as the tendency to engage *Rosneft* into all sorts of non-oil business ventures, including, for instance, shipbuilding in the Far East.<sup>28</sup> It is precisely Sechin’s particular closeness to Putin that secures for *Rosneft* valuable privileges, which determines the inevitability of such cost-

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<sup>24</sup> One colorful portrait is H. Brown, “Igor Sechin: The Kremlin’s Oil Man,” *Forbes*, 11 November 2009, <[www.forbes.com/2009/11/09/igor-sechin-rosneft-leadership-power-09-oil.html](http://www.forbes.com/2009/11/09/igor-sechin-rosneft-leadership-power-09-oil.html)>.

<sup>25</sup> See K. Kharatyan, “Igor Sechin’s Dream,” *Vedomosti*, 1 October 2013, <[www.vedomosti.ru/opinion/news/16947571/citata-nedeli](http://www.vedomosti.ru/opinion/news/16947571/citata-nedeli)>; on the exploration in the Arctic, see A. E. Kramer, “With Returns from the Dry Land Diminishing, Russian Oilmen Look to Arctic Waters,” *New York Times*, 1 October 2013, <[www.nytimes.com/2013/10/02/business/energy-environment/with-returns-on-dry-land-diminishing-russian-oilmen-look-to-arctic-waters.html?ref=rosneft&\\_r=1&](http://www.nytimes.com/2013/10/02/business/energy-environment/with-returns-on-dry-land-diminishing-russian-oilmen-look-to-arctic-waters.html?ref=rosneft&_r=1&)>.

<sup>26</sup> On the scale of the deal, see A. W. Meyer, “Russia Turns Away from Europe, Signs \$270 billion Oil Deal with China,” *China Daily Mail*, 22 June 2013, <<http://chinadailymail.com/2013/06/22/russia-turns-away-from-europe-signs-270-billion-oil-deal-with-china/>>.

<sup>27</sup> On the non-existent profits for Russia, see V. Milov, “Fiasco in the East,” *Gazeta.ru*, 25 March 2013, <[www.gazeta.ru/column/milov/5115473.shtml](http://www.gazeta.ru/column/milov/5115473.shtml)>; on the corruption case against Jiang Jiemin, see A. Gabuev, “Removed from the Pipe,” *Kommersant-Vlast*, 9 September 2013, <<http://kommersant.ru/doc/2271394?isSearch=True>>.

<sup>28</sup> See E. Popov, I. Safronov, “Rosneft in the Navy Yard,” *Kommersant*, 2 October 2013, <<http://kommersant.ru/doc/2309839?isSearch=True>>.

inefficient engagements that serve particular political purposes, including, most recently, sorting out disagreements with Belarus focused on control over companies producing fertilizers.<sup>29</sup> This policy-driven diversification is transforming *Rosneft* into a conglomerate similar to *Gazprom*, and it undermines the manageability and efficacy of its core oil business. It also means that *Rosneft's* near future is inextricably linked with the continuation of the Putin-Sechin “tandem”, which appears perfectly safe now but cannot be taken for granted.

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<sup>29</sup> See O. Mordyushenko, D. Ladygin, “Fertilizers from Hand to Hand,” *Kommersant*, 16 September 2013, <<http://kommersant.ru/doc/2280139?isSearch=True>>.

## Friendly Back-Stabbing on the Slippery Slope

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The pattern of quarrelsome interactions in the energy-political triangle formed by the government, *Gazprom* and *Rosneft*, with Putin active as a supreme but increasingly inattentive arbiter, makes each of the parties incapable of making practical plans—even for the near future. Stability of the business environment is supposed to be an advantage for state-owned “champions”, but neither *Gazprom* nor *Rosneft* can put together a consistent investment plan even for a year as political expediency always dictates massive redirection of funding and attention. Political interference is the main cause of the obvious failure of the two giants to get priorities right.

For *Gazprom*, the blunder of colossal proportions that is the construction of the *South Stream* pipeline across the length of the Black Sea is awaiting a final, imminent decision on constructing the under-water part, while the EU has wisely abandoned the much-trumpeted *Nabucco* project.<sup>30</sup> The market for gas in South-Eastern Europe is shrinking fast, and the only rationale for *Gazprom*'s endeavor (into which Putin has invested much personal effort) is establishing a high-capacity export channel circumventing Ukraine. The experience with the *Nord Stream* pipeline, which operates barely at half-capacity and produces no political dividends, is boldly dismissed, as many sub-contractors stand to benefit from the costly construction that is never going to be cost-effective.

For *Rosneft*, the main problem for the near future is finding enough oil to put into the Eastern Siberia–Pacific Ocean oil pipeline (ESPO) to fulfill its obligations in the long-term contract with China.<sup>31</sup> The company has borrowed so heavily in order to execute its plans for asset acquisitions (above all, taking over the TNK-BP) that its investment program in core productive assets in the years to come will be curtailed. In this regard, both *Gazprom* and *Rosneft* have contributed strongly to the trend of falling investment activity that determines the deepening stagnation of the Russian economy.<sup>32</sup>

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<sup>30</sup> On that discontinued competition, see E. Lucas, “Russia: Winning a Battle, Losing the Gas War,” *CEPA Central Europe Digest*, 2 July 2013, <<http://cepa.org/content/russia-winning-battle-losing-gas-war>>.

<sup>31</sup> See G. Bovt, “Rosneft's Chinese Oil Card,” *Moscow Times*, 25 June 2013, <[www.themoscowtimes.com/opinion/article/rosnefts-chinese-oil-card/482213.html](http://www.themoscowtimes.com/opinion/article/rosnefts-chinese-oil-card/482213.html)>.

<sup>32</sup> Former finance minister Kudrin elaborated on the impact of giant state companies on this trend; see A. Kudrin, “We have Hit the Wall of Efficiency,” *Novaya Gazeta*, 9 October 2013, <[www.novayagazeta.ru/economy/60361.html](http://www.novayagazeta.ru/economy/60361.html)>.

Russian commentators often amplify the episodes of competition between *Gazprom* and *Rosneft*, particularly when Miller and Sechin engage in public argument over whose company contributes more taxes to the federal budget.<sup>33</sup> There are indeed a number of conflicts between the interests of the two “champions”, as, for instance, *Rosneft* moves aggressively into the gas business, while Miller is increasingly envious of Sechin’s successes and better access to Putin’s “ear”.<sup>34</sup> These quarrels, however, bear rather close resemblance to the battle that Tweedledee and Tweedledum agreed to engage in, but, as witnessed by Alice, were ready to abandon instantly at the first croak of displeasure issued by the supreme arbiter.

The state-owned but cronies-controlled companies are indeed more interested in joining forces against competitors and, quite often, against the government in order to secure their privileges, particularly their monopoly on exploring the continental shelf and developing offshore projects.<sup>35</sup> It is noteworthy in this context that *Rosneft* is not only more successful in engaging Western partners in joint projects for exploring the Arctic shelf but also far more cautious in avoiding conflicts with eco-NGOs, while *Gazprom* has found itself enmeshed in a big fight with *Greenpeace*, which is inflicting serious damage on the company’s already tarnished reputation.<sup>36</sup>

In the course of the court intrigues that take the place of fair competition, *Rosneft* most probably will elbow *Gazprom* out of some parts of the gas business, but that will only add to the unhealthy growth of Sechin’s super-corporation—and will further enfeeble the government’s efforts to gain a modicum of control over the energy sector. The bureaucratic machines of the ministries are by no means powerless, but the professionals who occupy many top-level positions in these executive structures are increasingly giving up on the struggle for “modernization”.<sup>37</sup> Their assessments of the developing trends are habitually dismissed in the Kremlin as too alarmist (only to be proven too optimistic), and the arguments on the dire consequences of the irresponsible behavior of the self-serving energy giants are at best falling on deaf ears, but generally inviting censure.

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<sup>33</sup> See, for instance, M. Mesropyan, A. Agamalova, A. Terentyava, “Sechin and Miller Argue whose Company Pays More Taxes,” *Vedomosti*, 28 June 2013, <[www.vedomosti.ru/companies/news/13636111/miller-i-sechin-sporyat-kto-platit-bolshe-nalogov](http://www.vedomosti.ru/companies/news/13636111/miller-i-sechin-sporyat-kto-platit-bolshe-nalogov)>.

<sup>34</sup> One insightful report on these conflicts is O. Khvostunova, “Rosneft vs Gazprom,” Institute of Modern Russia, 30 August 2013, <<http://imrussia.org/en/economy/543-rosneft-vs-gazprom>>.

<sup>35</sup> See “Sechin and Miller demand from Medvedev to uphold the monopoly of state companies on shelf,” *Forbes.ru*, 30 January 2013, <[www.forbes.ru/news/233686-sechin-i-miller-prizvali-medvedeva-sohranit-monopoliyu-goskompanii-na-shelf](http://www.forbes.ru/news/233686-sechin-i-miller-prizvali-medvedeva-sohranit-monopoliyu-goskompanii-na-shelf)>.

<sup>36</sup> One detailed description of this fight is S. Khazov, Z. Svetova, O. Beshlei, “Our Way in the Arctic: Greenpeace, Gazprom and the Battle for the Shelf,” *New Times*, 7 October 2013, <<http://newtimes.ru/articles/detail/72242>>.

<sup>37</sup> An editorial in the business-oriented *Vedomosti* sums up the defeat of “modernizers”; see “We shall Cut Down not on Mega-Corporations but on the Country’s Future,” *Vedomosti*, 1 October 2013, <[www.vedomosti.ru/opinion/news/16947631/trishkin-kaftan](http://www.vedomosti.ru/opinion/news/16947631/trishkin-kaftan)>.

The paradox of the current confusion in energy policy-making is that this behavior is not only detrimental to state interests but also highly damaging for *Gazprom* and *Rosneft*, which are firmly set on self-destructive business strategies.

## Conclusion

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The under-performance of the energy sector is one of the key determinants of Russia's lasting economic stagnation; what is more, it denies Russia an opportunity to progress from a resources-extraction and rent-harvesting economy to a new model of sustained growth. Indeed, the only road to much-needed modernization that is available to Russia's goes not through Medvedev's "innovation clusters" (like the Skolkovo "wonder-village"), nor through Putin's revived defense-industrial plants (like the tank-manufacturing *UralVagonZavod*) but toward the superbly efficient and environment-friendly energy industry, which generates a lot of demand for high-tech and provides the impetus for cultivating both applied and academic sciences. Russia has plenty of natural and man-made advantages for such a breakthrough in modernization, but the stiffening monopolization of the gas sector and widening state control over the oil sector negate these advantages, as the corporate strategies of *Gazprom* and *Rosneft* aim to exploit their privileges and maximize cash-flow.

It is more difficult to evaluate the influence of the two "champions" on the evolving political crisis. Since late 2011, this has developed out of sync with the economic slowdown, but it may in the near future gain new momentum through the interplay with discontent caused by the prolonged stagnation. One of the key manifestations of this political turmoil has been the disarray among the elites, which first came into the open in September 2011 with the stated refusal of Finance Minister, and long-term Putin loyalist, Alexei Kudrin to serve in a Medvedev cabinet. Reshuffling in the top echelons of aids and executives has continued non-stop in Putin's new presidential term, propelling and demoting such characters as Anatoly Serdyukov and Dmitry Rogozin, Vyacheslav Volodin and Vladislav Surkov; perhaps the most remarkable story in all this is the steady growth of authority of Sergei Shoigu, seasoned veteran of Russian politics and currently the Defense Minister, who has further strengthened his position with the landslide victory of his protégé Andrey Vorobyev in the Moscow Oblast gubernatorial elections in September 2013. What is characteristic of all these court intrigues is that neither *Gazprom* nor *Rosneft* play any visible role in deciding the fate of the quarreling minions.

It is probable that Miller and Sechin prefer to steer clear of the escalating fray, assuming that any alliance-building outside their respective domains could be interpreted as disloyalty and preparation for a sudden departure of the irreplaceable ruler. At the same time, their companies cannot perform the role of reliable pillars for the regime in distress, and are in fact contributing to the maturing of the

political crisis, one of the focal points of which is the rising public outrage against rampant corruption. Neither Miller nor Sechin is personally implicated in an embezzlement or nepotism scandal like those that have damaged the reputations of the head of *Russian Railways* Vladimir Yakunin or the recently and very narrowly elected mayor of Moscow Sergei Sobyenin. Nevertheless, the corporate culture in both mega-companies is based on corrupt networking to such a degree that their names are associated with abuse of political levers for exterminating competition, highly creative accounting, and shameless lack of accountability.

Enriching a small circle of beneficiaries and disregarding state interests, *Gazprom* and *Rosneft* are, however, serving as major vehicles of the policy of state-strengthening, Putin-style, and ushering the evolution of Putinism in a resolutely anti-Western direction. The Kremlin is increasingly inclined to define Russia's identity in opposition to Western models of liberal democracy; *Gazprom* is contributing to this disengagement by blaming the EU for discriminating against "business as usual" and torpedoing the "road map" for expanding Russian gas exports, while *Rosneft* is busy turning its growing oil exports to China into a geopolitical alternative to European orientation. The energy connection used to be the main factor of stability in the often uneasy Russian-European relations, but now it is generating more tension than the sobering feelings of mutual dependency. *Rosneft's* lucrative deals with Western "majors" do little to neutralize these tensions, and *Gazprom's* setbacks in the EU market cause constant irritation in the Kremlin, which is certain to turn hysterical when the probe being conducted by the European Commission is concluded—predictably punishing the bad monopolistic habits of the Russian "champion". It is generally healthy for business that the level of direct politicization of the oil and gas sectors has somewhat declined, so that *Gazprom* and *Rosneft* are not following any direct orders and are free to pursue their interests. These parochial interests, however, are often so deeply corrupt that domestic opposition and international disapproval blend together—and the two giants have to run back to seek political protection, which typically makes things seriously worse.