

Russia and the Caspian States in the Global Energy Balance



Russia's Regions and Energy Policy in East Siberia

Martha Brill Olcott, Ph.D., and Nikolai Petrov, Ph.D.



JAMES A. BAKER III INSTITUTE FOR PUBLIC POLICY
RICE UNIVERSITY

RUSSIA'S REGIONS AND ENERGY POLICY IN EAST SIBERIA

BY

MARTHA BRILL OLCOTT, PH.D.

SENIOR ASSOCIATE
RUSSIA AND EURASIA PROGRAM
CARNEGIE ENDOWMENT FOR INTERNATIONAL PEACE

AND

NIKOLAI PETROV, PH.D.

SCHOLAR-IN-RESIDENCE
CARNEGIE MOSCOW CENTER

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**ABOUT THE STUDY:
RUSSIA AND THE CASPIAN STATES IN
THE GLOBAL ENERGY BALANCE**

Russia's position as a major energy supplier has great significance not only for its foreign policy but for its relationships with major energy-consuming countries. The nature of Russia's future geopolitical role in world energy markets has become a major concern of international energy security with important implications for Europe, Japan, and the United States. Given a range of economic and geopolitical uncertainties, the fate of Russian and Caspian natural gas exports remains a major risk factor in global energy supply. For this study, researchers examined several scenarios for Russian and Caspian oil and natural gas production, possible export routes, and the geopolitics involved.

STUDY AUTHORS

JOE BARNES
STACY CLOSSON
JAREER ELASS
PETER R. HARTLEY
AMY MYERS JAFFE
KENNETH B. MEDLOCK III
MARTHA BRILL OLCOTT
NIKOLAI PETROV
LILIA SHEVTSOVA
LAUREN SMULCER
XIAOJIE XU

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**JAMES A. BAKER III INSTITUTE FOR PUBLIC POLICY
RICE UNIVERSITY - MS 40
P.O. BOX 1892
HOUSTON, TX 77251-1892 USA**

**[HTTP://WWW.BAKERINSTITUTE.ORG](http://www.bakerinstitute.org)
BIPP@RICE.EDU**

ABOUT THE AUTHORS

MARTHA BRILL OLCOTT, PH.D.

SENIOR ASSOCIATE
RUSSIA AND EURASIA PROGRAM
CARNEGIE ENDOWMENT FOR INTERNATIONAL PEACE

Martha Brill Olcott is a senior associate with the Russia and Eurasia Program at the Carnegie Endowment for International Peace in Washington, D.C. Olcott specializes in the problems of transitions in Central Asia and the Caucasus as well as the security challenges in the Caspian region more generally. She has followed interethnic relations in Russia and the states of the former Soviet Union for more than 25 years and has traveled extensively in these countries and in South Asia. Her book, *Central Asia's Second Chance*, examines the economic and political development of this ethnically diverse and strategically vital region in the context of the changing security threats post 9/11. In addition to her work in Washington, Olcott co-directs the Carnegie Moscow Center Project on Religion, Society, and Security in the former Soviet Union. She is professor emerita at Colgate University, having taught political science there from 1974 to 2002. Olcott served for five years as a director of the Central Asian American Enterprise Fund. Prior to her work at the Carnegie Endowment, Olcott served as a special consultant to former Secretary of State Lawrence Eagleburger. Soon after 9/11, she was selected by *Washingtonian* magazine for its list of "71 People the President Should Listen To" about the war on terrorism.

NIKOLAI PETROV, PH.D.

SCHOLAR-IN-RESIDENCE
CARNEGIE MOSCOW CENTER

Nikolai Petrov is scholar-in-residence at the Carnegie Moscow Center, where he works with the Domestic Politics and Political Institutions program and directs the Society and Regions project. He also serves as a columnist for *The Moscow Times*, a member of the Program on New Approaches to Research and Security (PONARS), a member of the *The Journal of Power Institutions in Post-Soviet Societies'* scientific board, and a member of *Russian Politics and Law's* editorial board. From 1990 to 1995, he served as an adviser to the Russian parliament, government, and presidential administration. Petrov is the author or editor of numerous publications analyzing Russia's political regime, post-Soviet transformation, socioeconomic and political development of Russia's regions, democratization, federalism, and elections, among other topics. His works include the three-volume *1997 Political Almanac of Russia* and its annual supplements. He is the co-author of *Between Dictatorship and Democracy: Russian Post-Communist Political Reform* (Carnegie Endowment for International Peace, 2004), *The Dynamics of Russian Politics: Putin's Reform of Federal-Regional Relations* (Rowman & Littlefield, 2004 and 2005), and *Putin's Russia: Past Imperfect, Future Uncertain* (Rowman & Littlefield, 2007). Petrov earned his Ph.D. from Moscow State University.

Abstract

In recent years, Russia's enormous reserves of strategic natural resources have played a central role in the country's economic rebirth and its reassertion of geopolitical influence. Much of these resources are concentrated in the vast and remote eastern areas of the Russian territory, in regions significantly distant from Moscow. As a result, tensions exist between regional elites and the leaders in the Kremlin and the Russian White House over the question of who controls the development of these resources, particularly with regard to the highly profitable energy reserves. Since Vladimir Putin came to power, he has sought to assert central government control over regional development strategies in oil and gas-rich areas, as well as consolidating Russia's energy industry by making regional and private firms subordinate to the state-owned corporations Gazprom and Rosneft. In East Siberia, where Putin is increasingly concerned with the prospect of the region ceding to Chinese control, he has sought various means to bring economic development, and particularly the development of energy resources, back under strong central authority. Power struggles between local authorities and elites in East Siberia and the federal government in Moscow have ensued, and the ongoing conflict between the two parties has had marked effects on resource development in the distant region. This paper discusses the recent political and economic events that frame the current situation in East Siberia, with a particular focus on the Irkutsk region, one of the key places in the federal government's resource development strategies.

I. Introduction

Vladimir Putin has repeatedly emphasized how the development of Russia's strategic resources is the key to his country's economic rebirth and its reassertion of geopolitical influence. To accomplish this vision through the use of energy resources, Putin has focused on two main strategies. First, he has sought central government control over regional development strategies in energy-rich territories and, where there are important transit corridors, to ensure local decision makers reflect the priorities of the Kremlin and the Russian White House (the prime minister's seat). Second, he has consolidated Russia's energy industry, effectively making privately owned

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firms and regional firms subordinate to Russia's two state-owned energy giants, Gazprom and Rosneft.

East Siberia has been a region of particular concern to Putin, given its vast natural resource wealth, its declining population, and its proximity to China. The risk of this region falling under Chinese control is a preoccupation of the Russian leadership. The state found it easier to support the development of this region under the Soviet economic system than it does in the current, partially market-based economy. Today it is much harder for Moscow to provide financial incentives to keep the region populated by Russians. But Putin has used the enhanced federal authority to mobilize Siberia's natural resource base to modernize the country's economy. Energy development is the first priority for the Siberian region, followed by development of the timber and agriculture industries. The construction of local infrastructure and the development of small- and medium-sized business are also priorities, and regional and local governments are legally required to coordinate their development strategies with Moscow.

This paper looks at the role that regions and questions of regional development play in Kremlin decision making about energy projects, with a focus on developments in Irkutsk Oblast, Krasnoyarsk Krai, and the Republic of Sakha (Yakutia). These territories, when Sakhalin is included, contain the overwhelming majority of Russia's oil and gas reserves in East Siberia and the Far East.¹

These reserves are geologically similar to one another, but quite distinct from those in Western Siberia. The reserves in Irkutsk, Krasnoyarsk, and Sakha are all mixed oil, gas and condensate reserves. Virtually all have high helium content and the reservoir pressure is below hydrostatic pressure, requiring the instillation of powerful compressors.² This makes the deposits challenging to exploit, and reinforces the Kremlin's view that the national interest of Russia will only be served if the deposits are developed according to a common plan, with some sharing of

¹ For a detailed overview of these assets see Nina Poussenkova, "The Wild, Wild East: East Siberia and the Far East: A New Petroleum Frontier?" Working Paper no. 4 (Moscow, Russia: Carnegie Moscow Center, Economic and Energy Policy Program), 2007, <http://www.carnegie.ru/en/pubs/workpapers/77259.htm>.

² Ibid. 14.

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technology and a strategy for sale that serves domestic and foreign markets through an efficient use of export routes. The development of these fields is covered by a single licensing regime.

Those interested in the study of Russia's energy policy would profit from a closer look at how politics in this region are evolving. The challenge for the local authorities is to try to capture resources, both from the businesses active in their region and from federal authorities. The nature of this challenge was substantially transformed during Vladimir Putin's presidency, when the process for selecting governors moved away from elections to federal appointment, and the tax burden of businesses was shifted from subsidiaries to the main corporation, with strong incentives offered to move these corporate headquarters to either Moscow or St. Petersburg. This led to a significant loss of tax revenues for Russia's energy-producing regions.³

The Kremlin's approach to energy development in East Siberia and the Far East does not coincide with the priorities of foreign investors, or even with the best interests of some of Russia's own energy companies. The way in which Russia's regions are administrated also does not facilitate the Kremlin's goals with regard to the energy sector. Irkutsk Oblast and Krasnoyarsk Krai are both part of the East Siberian Federal District, while the Republic of Sakha comes under the purview of the Far Eastern Federal District. While foreign investors may opt to pursue a project in a single one of these regions, the Kremlin thinks of them as an integrated whole—with a single energy sector that has been slated for development according to a centrally defined plan, along with Sakhalin's resources.

The energy plan, issued in 2002, and the follow-up strategy for gas development in East Siberia and the Far East, issued in 2007, are designed to allow Russia to meet its geopolitical ambitions as well as its economic goals.⁴ These plans do not provide a detailed strategy of how this is to be

³ Galina Kurlyandskaya, "Moscow and Regions Share Russia's Oil and Gas Revenues," *Federations* 6, no. 1 (February–March 2007): 18–19; 25, <http://www.forumfed.org/en/pubs/V6N1.pdf>.

⁴ See Ministry of Energy of the Russian Federation, "The Summary of the Energy Strategy of Russia for the Period of up to 2020," 2003, http://ec.europa.eu/energy/russia/events/doc/2003_strategy_2020_en.pdf. Minister V.B. Kristenko, "Prikaz Minpromenergo RF ot 03.09.2007 n 340 o programme sozdaniya v vostochnoy sibirii I na dal'nem vostoke edinoy sistemy dobychi, transporterovki gaza i gazosnabzheniya s uchetom vozmozhnogo eksporta gaza na rynki kitaya i drugikh stran ATR," Ministry of Industry and Energy no. 340, September 3, 2007. Also see, Ministry of Industry and Trade of the Russian Federation, "Vostochnaya gazovaya programma utverzhdena!" *MINPROMTORG*, September 7, 2007, <http://www.minprom.gov.ru/activity/energy/news/329>. Ministry of Industry and Trade of the Russian Federation, "Perspektivy razvitiya TEK k innovatsionnoy ekonomike," *MINPROMTORG*,

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achieved—nor precisely how Moscow plans to meet the competing goals of enhancing the volumes of gas available for export to the Asia-Pacific region while using gas as a source of energy for economic development of these regions themselves. This lack of precision has created an atmosphere of competition between regions, as well as between investors or potential investors who want to secure control of these valuable assets as well as to successfully exploit them.

This paper pays particular attention to developments in Irkutsk, in large part because of the struggle by TNK-BP to retain control over its license to develop that oblast's giant Kovykta gas field. It also provides insight into the broad range of problems that are characteristic of the challenges in developing East Siberian and Far Eastern energy assets. Some of these challenges—such as securing and preserving licenses, insuring transport of output, and establishing long-term working relationships with local as well as national authorities—are found in projects anywhere in the world. But others are specific to the conditions in Russia over the past decade, as the center has sought to reassert control over the regions, and regional elites have been battling to protect some autonomy of decision making in setting regional developmental priorities.

Much has been written about the evolution of Russia's political system since the departure of Boris Yeltsin. But most of these writings tell the story from the point of view of the center, with little attention to how these changes have impacted the country's regions. The paper draws on a project launched by the Carnegie Moscow Center in 2006 to study precisely this question.

Putin came to power in 1999, with a stated goal of restoring the “verticals” of power. He created a horizontally integrated federal system that was managed by its center. He quickly moved to strengthen the heads of federal institutions in the regions, primarily presidential envoys, simultaneously weakening regional leaders' control over federal civil servants. In 2000, the

April 1, 2008, <http://www.minprom.gov.ru/activity/electro/appearance/19>. Ministry of Industry and Trade of the Russian Federation, “O programme sozdaniya v vostochnoy sibir i na dal'nem vostokey edinoy sistemy dobychi, transportirovki gaza i gazosnabzheniya s uchetom vosmozhnogo eksporta gaza na rynki kitaya i drugikh stran ATR,” *MINPROMTORG*, June 15, 2007, <http://www.minprom.gov.ru/appearance/report/46>. Gazprom, “Realizatsiya Programmy osvoeniya gazovykh resursov v Vostochnoy Sibiri i na Dal'nem Vostoke osushestvlyayetsya do 2020 goda neskol'kimi etapami,” <http://www.gazprom.ru/docs/topics/2683.shtml>.

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center tightened control over the use of federal budgetary resources in the regions, redirecting budgetary funds through regional branches of the federal treasury. In addition, new laws spelled out the delineation of power between the center and regions, and the center moved to tame local media outlets and civil society. Seven new federal districts were also created in 2000, purportedly to coordinate the activities of federal agencies working in those districts, but the net effect was actually to usurp some of the administrative functions of regional administration. In 2004, Putin pushed through legislation that gave him the right to appoint regional governors, whose tenure requires confirmation by regional legislatures. This reform not only gave the Kremlin more leverage with regional governors, but also weakened the power and diminished the legitimacy of the Federation Council—half of whose members are appointed by the governors (and the other half by the regional legislatures).

Putin had many formal and informal tools to use in implementing these ends. At the very base of Russia's institutional structure, Russia's constitution—sometimes ignored under Yeltsin—grants the center a privileged position over the regions. Chapter three of the constitution delineates the powers between Moscow and its subunits and gives Moscow sole jurisdiction over a long list of areas, while only giving the regions shared jurisdiction over another much shorter list.⁵ In addition, since 2000, almost all the bilateral agreements between regions and the federal center that created exceptions to the constitution have either expired or been abrogated.

The constitution also provides the fiscal landscape of federalism. Article 71 of the Russian constitution (which delineates powers between the federal, regional, and local levels of government) grants the federal government control over the federal budget, federal taxes and levies, and, most importantly, federal funds for development.⁶ These funds previously found their way from the federal coffers directly into regional budgets, but in 2000, Putin added another level of bureaucracy to channel the funds through regional branches of the federal treasury instead.⁷ These provisions give the center considerable power to influence regional

⁵ The Constitution of the Russian Federation, Chapter 3, <http://www.constitution.ru/en/10003000-04.htm>.

⁶ Ibid.

⁷ Michael A. McFaul, Nikolai Petrov, and Andrei Ryabov, *Between Dictatorship and Democracy: Russian Post-Communist Political Reform* (Washington, D.C.: Carnegie Endowment for International Peace, 2004), 229.

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development plans, given that very few regions have developed their own regional development funds.

Putin created federal districts with presidential envoys ostensibly to coordinate the activities of the ministries in the regions outside of Moscow. The presidential envoys were supposed to wrest the loyalty of federal bureaucrats working in the regions from the local administrations, restoring it to Moscow. However, many of those bureaucrats (as described throughout the paper) have recognized that they must serve multiple constituencies, including business and political interests in the region, if they are going to effectively perform their mandated tasks.

The current presidential envoy for the Siberian Federal District, Anatoly Kvashnin, has held the position since 2004 and, like many of the other envoys, hails from the so-called “power ministries.” Kvashnin comes from the most senior ranks of the military: From 1997 until his appointment as envoy, he was chief of the General Staff of the Russian Armed Forces and first deputy defense minister.⁸ Kvashnin has several councils to advise him on different policy areas, including a committee on the economics of Siberia, which is composed of the heads of regional administrations (governors), the leaders of local parliaments as well as the leaders of large- and medium-sized industries. The Far Eastern Federal District is headed by Igor Safonov, who has held that post since 2007. Safonov, an officer of the KGB in the Soviet period, worked with Putin in St. Petersburg and served as a deputy minister of Internal Affairs (MVD) during the Putin presidency. The current structure provides an avenue for better communication between different levels of elites. Federal employees in the region, who outnumber regional employees almost two to one, now answer to the federal envoy. This system puts the majority of regional employees back under the control of the federal government.

To highlight these political changes under Vladimir Putin—and their impact on resource development—this paper examines the case of the Irkutsk region. Historically, Irkutsk has frequently been at the center of developments in Eastern Siberia. Founded as a fort in the early eighteenth century, Irkutsk Oblast became the center of the East Siberian administration in 1802,

⁸ Renaissance Capital, “Anatoli Kvashnin,” http://research.rencap.com/eng/government/government_detail04.asp.

and was a hub on the Trans-Siberian railroad by the end of the nineteenth century.⁹ Today, it competes with neighboring Krasnoyarsk Krai and the Republic of Sakha for pride-of-place in the Kremlin's development plans for East Siberia and the inland portion of the Far East. Taken collectively, these three regions will define the development of East Siberia and impact the way that the Far East transport corridor evolves.

II. Why Study Irkutsk?

Located in East Siberia, with a territory almost twice the size of Texas (476,866 square feet) and a population of only 2.7 million people, Irkutsk exemplifies Russia's economic problems and its enormous potential. The oblast has all of the trappings of the post-Soviet "rust belt"—high unemployment, poverty, and an unfavorable demographic situation. At the same time, it has enormous economic potential. There are vast oil and natural gas reserves (including the Kovykta field), Russia's largest unexploited gold deposit (Sukhoi log), substantial hydroelectric power and potential, as well as productive heavy industry (especially aluminum and defense manufacturing). The region also has the capacity to export lumber and is home to one of Russia's most treasured tourist sites (Lake Baikal). The starting point for the East Siberia-Pacific Ocean (ESPO) oil pipeline, Irkutsk provides a window into Russia's evolving priorities with regard to China, and East Asia more broadly.

Irkutsk is physically the largest oblast in Russia,¹⁰ although it includes a giant swatch of largely unpopulated permafrost zone. The city of Irkutsk is considered Siberia's most "European" city, having historically served as a base for Russian expansion into Asia.

The most distinguishing features of Irkutsk's political life are self-reliance and stability of the elite. At the same time, the region exemplifies a tendency toward political pluralism. This is in large part a product of the complex balance of power between influential corporations and business players: the aluminum industry (RUSAL); an energy company (Irkutskenergo); a forestry firm (Ilim Pulp); and oil and gas interests (TNK-BP, Gazprom).

⁹ It was expanded to incorporate the former Ust-Orda Autonomous District in January 2008. See, Ivan Kudryavtsev, "Edinoglasnoe Sliyanie," *Vesti*, April 17, 2006, <http://www.vesti.ru/doc.html?id=112043>.

¹⁰ It is smaller than Sakha, a republic of Russia, and Krasnoyarsk, which is a "krai" region, not an oblast.

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Irkutsk has also preserved a strong degree of political independence even under Vladimir Putin's rule, which it has managed to sustain throughout the conditions of the current power "tandem" between Putin, who is now Russian prime minister, and Russian President Dmitry Medvedev. It is one of only a handful of Russian regions that has managed to get a Putin-appointed governor (Aleksander Tishanin) dismissed at the will of local authorities.

Tishanin lasted less than three years as governor of Irkutsk (from September 2005 until April 2008) and was removed through a no-confidence vote by the local legislature, which then appealed directly to Putin for Tishanin's dismissal. The event that led to his removal was Tishanin's refusal to ratify the budget passed by the regional legislature. Tishanin was replaced by Igor Yesipovsky (formerly a senior official in the Rostechology Corporation, one of Russia's main armaments companies).

Irkutsk, though, has not capitalized on its economic potential, ranking only 23rd out of 83 Russian regions for gross domestic product (GDP) per capita.¹¹ Median income and wages have increased in recent years, but economic growth in the oblast has been uneven and has not kept pace with the national average.

The availability of energy, timber, and mineral resources has shaped the region's industrial composition, mostly left over from the Soviet era and heavily resource dependent. Metallurgy accounts for the largest part of industrial production at about 24 percent. The timber industry is in second place at about 20 percent, followed by electric energy production and equipment manufacturing, accounting for about 13 percent each. Natural gas, chemical production, fuel, and food industries each account for less than 10 percent of total industrial production.

The region's heavy industry played a major role in the economy of the Union of Soviet Socialist Republics (USSR) as a whole, sustained by the hydroelectric power produced by Irkutskenergo (the regional energy producer, which is now effectively under the control of RUSAL). But the region has not prospered in the new conditions of post-Soviet Russia, and the economic and

¹¹ Anton Nagornyak and Nikolai Samsonov, "Chetyre v odnom," *Ekspert – Sibir* vol. 34, no. 130 (September 18, 2006), http://www.expert.ru/printissues/siberia/2006/34/rating_kompaniy/. Angarsk was first passed from Sidanko to YUKOS, and then Rosneft bought it after YUKOS was forced into bankruptcy.

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political elites in neighboring regions have proved more adept at advancing their interests in the center than have those in Irkutsk.

Non-ferrous metallurgy—now dominated by a single company, RUSAL (a Basic Element holding)—is the region's most important industry. RUSAL's Irkutsk (formally SUAL) and Bratsk factories together produce 1.2 million tones of aluminum a year, which represents more than 30 percent of Russia's aluminum production and 4 percent of the global total. The second most important industry is wood pulp production, represented by two companies: Ilim Pulp (now a joint venture with International Paper) and Continental Management (also part of the Basic Element group). Chemical production is next, represented by Sayanskkhimplast (owned by Renova), and petrochemicals follows, controlled by the Angarsk Petrochemical Company.¹² Angarsk is Rosneft's largest refinery, producing 9.8 million tones of crude oil annually.

There are also a number of enterprises from Russia's military industrial complex located in Irkutsk. The most important of these is the Angarsk Electrolytic Chemical Combine, part of Russia's nuclear sector and run by the state-owned Rosatom. Irkutsk also is the home of the Irkut aircraft company (part of Russian Technologies) and the Korshunov Iron Ore plant (owned by the Mechel Group). All of these businesses draw energy from Irkutskenergo.

Irkutsk Oblast has significant undeveloped oil and gas reserves, and while many Western energy experts have focused on the political and transport challenges associated with the giant gas deposit at Kovykta, most of the attention in the Irkutsk region itself has been on the problem of gasification in the oblast, the routing of the ESPO pipeline, and the ownership struggle over Irkutskenergo.

There is a great deal of disagreement over the precise size of Irkutsk's oil and gas reserves. The Russian Academy of Science estimates recoverable hydrocarbon reserves in the Irkutsk region at 2.6 billion tones of oil and condensate (some 10 percent of total Russian reserves) and 7.5 trillion

¹² Anton Nagornyak and Nikolai Samsonov, "Chetyre v odnom," *Ekspert – Sibir'* vol. 34, no. 130 (September 18, 2006), http://www.expert.ru/printissues/siberia/2006/34/rating_kompaniy/. Angarsk was first passed from Sidanko to YUKOS, and then Rosneft bought it after YUKOS was forced into bankruptcy.

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cubic meters (tcm) of gas (5 percent of total Russian reserves).¹³ According to *Oil and Gas Vertical*, Gazprom estimates a total of 8.5 tcm of gas in Irkutsk.¹⁴ The region, however, has not been thoroughly explored.

While the hydrocarbon industry presents long-term opportunities for the local economy, Irkutsk is not dependent upon the energy industry as a major employer or for energy supplies. Refining, for example, only accounts for 5 percent of regional industrial production and 80 percent of electrical energy in the region, which is produced by three hydroelectric stations. Gasification of the region, which is a major part of the region's development plan, may improve the lives of residents and, according to some estimates, may lead to a doubling of GDP. Others, though, believe that the importance of gasification is exaggerated, and that Irkutsk's economic revival is dependent upon the expansion of industry in areas that are already adequately equipped with power. However, the decisions about gasification, like virtually all other aspects of energy policy, now fall under the purview of federal authorities.

Irkutsk has been something of a bellwether for the future of the Russian extractive industries and industry in general, and a window into some of the most interesting dramas that have played out between the Kremlin and Russia's oligarchs over the past decade. The history of the planning process of the ESPO pipeline is intertwined with Mikhail Khodorkovsky's effort to define Russia's policies to China in terms of the corporate fortunes of YUKOS, the company he then headed. YUKOS also was the owner of the Angarsk Petrochemical Company, which refines West Siberian crude and produces about 70 percent of petroleum products used in East Siberia, as well as a considerable amount of product used in the Russian Far East.¹⁵ The history of Kovykta and TNK-BP's efforts to develop that project illustrates the challenges that foreign and other private companies have faced, as TNK-BP (the fusion of the international oil company BP and a private Russian firm) lost the license to the prolific Kovykta natural gas field to Russian state-owned gas monopoly Gazprom.

¹³ Irkutsk region administration, Institute of Geography of Siberian Division of RAS, Natural Resources of the Irkutsk Region and their Utilization.

¹⁴ Of these: 1,555.4 Bcm A+B+C1, 707.9 Bcm C2, and 6,249.1 Bcm C3+D.

¹⁵ The company was one of the last possessions of Mikhail Khodorkovsky's YUKOS.

III. The Saga of the ESPO Pipeline

Much of the future development of Irkutsk's oil and gas development is dependent upon Transneft's (Russia's state-owned pipeline company) construction of the ESPO pipeline and how much capacity this pipeline will eventually provide. This project has been slow to be realized. Its original route took it close to Lake Baikal, raising the ire of ecologists and, even when an alternate route was settled on, the project has been plagued by cost overruns.

The project was initially planned to be implemented over a 15-year period, from 2005 to 2020. The slow lead in was to allow the East Asian market to eventually be served in full, through a combination of West Siberian and East Siberian oil. It had the added advantage of giving the Kremlin time to decide on a full-blown strategy for getting Russian oil and gas assets to the East Asian markets, which markets to prioritize, and how to balance the demands of these markets with projected increases in gas usage, particularly in Russia.

The first segment (Taishet-Skovorodino, 2,757 kilometers (km)) should come on stream in late December 2009. ESPO-1 has a current budget of \$12.5 billion, plus an additional \$1.94 billion to be spent on the terminal at Kozmino (Russia). Its current time table became realistic in February 2009, when Transneft, the China National Petroleum Corp. (CNPC), and the China Development Bank signed an agreement under which Rosneft will supply 15 million tones a year (or 300,000 barrels a day (bbl/d)) of crude over 20 years to China. In return, the Chinese have loaned the Russians \$25 billion, with \$15 billion going to Rosneft and the remainder to Transneft.¹⁶ ESPO oil will then go from Skovorodino to the port at Kozmino by rail.

The second segment (ESPO-2) will traverse an additional 2,100 km to Kozmino. Construction on this leg could begin by the end of 2009 and is to be completed by late 2012 or early 2013, with the rail links to Kozmino to be done by late 2010.¹⁷ ESPO-1 is designed to transport a maximum of 220.5 million barrels per year, with the combined capacity of ESPO-1 and ESPO-2 totaling

¹⁶ Anna Shiryayevskaya "Russia, China Ink Oil Cooperation Agreement," *Platts*, April 21, 2009, <http://www.platts.com/Oil/News/8505958.xml>.

¹⁷ "Putin Says ESPO May Have Parallel Gas Line," *Oil & Gas Journal*, 107, no. 6 (February 09, 2009): 10.

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367.5 million barrels per year.¹⁸ There are also plans to build a parallel gas pipeline along the same route, should the major projects in Krasnoyarsk, Irkutsk, and Sakha be designated for export.

There has been considerable controversy over the possible routings of the ESPO pipeline, whether it would go from Angarsk to Daqing, China, or Angarsk to Nakhodka (Russia's major Pacific port) for shipment to East Asia. Khodorkovsky was a major proponent of the former route, and YUKOS began shipping oil by rail from its fields in Tomsk Oblast and Krasnoyarsk Krai in 1999.

In that same year, a package of agreements on energy cooperation was signed between Russia and China, including an agreement between YUKOS, Transneft, and CNPC on the preparation of a pre-feasibility study for Russia-China pipeline construction. A general agreement on the development of the feasibility study for the project was signed in September 2001.

Khodorkovsky, however, began moving quickly to try and secure the development of this pipeline route. He knew that the Japanese were pressing the Russian government to choose the Nakhodka route, offering a financial stimulus package to be used in developing the Far East and East Siberia. In May 2003, the heads of YUKOS and CNPC signed a general agreement on the long-term contract to pump oil through a 2,247-km pipeline, including 1,452 km through the territory of Russia and 795 km through China. The delivered volume was to amount to 20 million tons for the first five years, and to 30 million tons starting in 2010, with YUKOS guaranteeing half the supply from its own fields.

Meanwhile, Transneft proposed a \$5.2 billion pipeline to run 3,765 km and carry 50 million tons per year without guaranteeing a source of supply for that volume. However, the delivery of crude to Nakhodka, a major sea port, could have diversified export markets for Russian crude as compared to the Angarsk-Daqing option, which would have made Russia dependent on a single buyer, namely China.

¹⁸ "Transneft: ESPO's First Stage on Track for Yearend," *Oil & Gas Journal*, 107, no. 3 (January 19, 2009): 12.

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In 2003, Moscow decided in favor of the Angarsk-Daqing pipeline route, but was unwilling to give Khodorkovsky and YUKOS a green light for their project. The Ministry of Natural Resources vetoed the proposed pipeline because it envisaged the construction of the pipeline through the Tunkinsk valley (included in the Tunkinsk national park), coming within 800 meters of Baikal. It also vetoed the competing Angarsk-Nakhodka pipeline for environmental reasons. Instead, then-Prime Minister Mikhail Kasyanov proposed combining both projects by building the pipeline from Angarsk to Nakhodka with a branch to Daqing.

Kasyanov's government fell, as did Khodorkovsky and YUKOS. On December 31, 2004, Prime Minister Mikhail Fradkov signed a decree on the design and construction of the ESPO pipeline. Transneft redefined the project to call for a pipeline and port project to run from Taishet to Skovorodino, and then eventually on to Perevoznaya Bay near Nakhodka, with an initial estimated cost of \$11.5 billion. The project was turned over to Transneft for execution and management.

Environmentalists once again began to attack the planned ESPO pipeline route. There were multiple environmental complaints about the first route, and activists were able to muster large numbers in public protests. A demonstration organized by the Russian United Democratic Party, Yabloko, and the Union of Right Forces took place at the presidential envoy's residence. Thousands of protestors marched in Irkutsk, some shouting slogans such as, "[Transneft President] Vainshtok, enemy of the people!" A demonstration even took place in Moscow.¹⁹ In addition to putting the ecosystem around Lake Baikal at risk, the pipeline was to pass through permafrost areas, regions with high seismic activity, and complicated geographic, geological, and hydrological conditions. It would also cross the biggest river of the Baikal basin (Upper Angara), as well as the Amur River (upstream from the city of Khabarovsk), and pass through protected natural territories. Some scientists and lobbyists, especially those connected with fishing companies, opposed Transneft's plan to place the pipeline's termination point at Perevoznaya. They contended it would threaten the natural habitat of the Far Eastern leopard and severely damage the fishing industry in the Primorsk region in the event of an oil spill.

¹⁹ Polina Mokhovets, "President Putin to the Rescue: Hands (and Pipelines) Off Lake Baikal," *WPS Russian Media Monitoring Agency: Politruk*, no. 260, April 28, 2006, <http://www.wps.ru/en/pp/politruk/2006/04/28.html>.

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Finally, in April 2006, Putin ordered the ESPO pipeline route moved from Lake Baikal to some 400 km to the north. Russia's environmental activists took the rerouting of the pipeline as a great victory, although it is hard to know whether the Kremlin was swayed by their arguments or found it convenient to use environmental concerns as an excuse to favor a developmental strategy that would send more resources northward. As already noted, the new route put the pipeline much closer to the oil fields of Yakutiya and the Irkutsk region, whose reserves were to be used for filling the pipeline, and it created room for speculation that the major oil companies that benefit may have provided financial or other kinds of support to some of the environmental groups involved.²⁰ Additionally, in April 2008, the Khabarovsk local government announced that the second leg of the pipeline would be rerouted north of the city to avoid affecting its water supply. The new route would be 120 km longer, running the total project cost upward by an additional \$847.5 million.²¹

Map: ESPO Pipeline Route²²



Source: International Energy Agency

²⁰ Poussenkova, "Wild, Wild East," 46.

²¹ RIA Novosti, "Far East Oil Pipeline Rerouted North of Khabarovsk," *Russian News and Information Agency Novosti*, April 29, 2008, <http://en.rian.ru/russia/20080429/106189401.html>.

²² Energy Information Administration, "Russia: Government-Proposed Far East and Gas Pipelines (U)," <http://www.eia.doe.gov/cabs/Russia/images/RFproposedFarEastPipeMap.pdf>.

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This new routing does not eliminate the environmental threats to Baikal. While the pipeline will no longer cut across the seismic water intake area of the lake, the transport of crude oil by railway along the banks of Baikal still puts its ecosystem at risk. However, rather than Perevoznaya, the end point will now be Kozmino Bay.²³

The resource base of the first stage of the oil pipeline will be provided by the fields of West Siberia, as well as several East Siberian fields that are better prepared and that are close to the route of the future pipeline.²⁴ The share of East Siberian oil is intended to grow from an initial 7–10 million tones to reach 20 million tones in 2010 and 40–45 million tones in 2015.

Implementation will require the construction of approximately 50 oil pumping stations, an oil trans-shipment complex with a tank farm and a sea terminal on the Pacific coast, five oil metering stations, and numerous infrastructure facilities. Transneft plans to commission seven oil pumping stations in 2007, three of them in the Irkutsk region, three in Sakha, and one in the Amur region. Tank farms will be built at three stations: Taishet station (with a total capacity of 260,000 cubic meters), Pumping Station 10 (260,000 cubic meters), and Skovorodino (310,000 cubic meters). Completion of this project will require substantial improvements to the existing pipeline system in Irkutsk Oblast

Setting a competitive tariff for the transport of oil through the ESPO will be challenging, both because of the distances that the West Siberian crude oil will need to travel, and because the Russian railroad system is a highly interested and politically well-connected party, although its influence may wane somewhat under Medvedev's presidency.

The single tariff system that has been proposed by Transneft makes transportation costs to deliver oil from East Siberia to the Pacific Ocean more than twice as expensive as those along

²³ Poussenkova, "Wild, Wild East," 46.

²⁴ Vankor, Talakan, Srednebotuobinsk, Verkhnechonsk, Yurubchensk, and a number of smaller fields in the north of the Irkutsk region—Dulisminskoye, Markovskoye, Danilovskoye, Yaraktinskoye.

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the currently operated pipeline routes.²⁵ To a certain extent, higher transportation costs will be offset by the premium the exporters can receive when delivering oil to the Asia-Pacific region.

The project has been subject to considerable delays. In February 2008, Transneft announced that it was pushing back the completion date of its first leg (from Taishet to Skovorodino) from December 2008 to late 2009, with Transneft President Nikolai Tokarev blaming the extension on harsh conditions and delays caused by environmental concerns.²⁶ On June 16, 2008, President Medvedev called for legal action against subcontractors who failed to meet their deadlines. That April, Transneft had unilaterally voided a contract with a Krasnodar subcontractor and filed a \$1.25 billion lawsuit, claiming that the company had only completed 17 percent of its assigned project.²⁷ Transneft said in June 2008 that 2,000 km of pipeline had been built out of a projected total of nearly 2,700 km for the first leg.²⁸

The project is important to Irkutsk because of the investment it will bring into the oblast, in terms of oil field and transport development. But for regional planners, it is even more critical to know the timing and the exact route of the pipeline, so they get a sense of the manner in which it will shape the parameters of future economic development in the region, including the role of the critical railway industry.

Some of the major projects that would benefit from the ESPO pipeline include the Verkhnechonsk field (Verkhnechonskneftegas) and the Talakan field (operated by

²⁵ Transneft proposed to establish a single oil-pumping tariff from Taishet to the end point of the pipeline at the level of \$38.8 per ton. For West Siberian oil that will initially account for 75–80 percent of crude pumped through ESPO, Transneft proposed to establish the tariff from Surgut to Skovorodino up to the completion of the second stage in the amount of \$49.8 per ton for deliveries to China, and the same level of tariff for the section Surgut-Skovorodino by pipeline + Skovorodino-sea terminal by railway. However, Russian Railways are against this idea because the \$49.8 tariff proposed by Transneft means that the railroad component will amount to \$18 per ton, i.e. about one-half of the tariff to deliver cargo from Skovorodino to Nakhodka (some \$39 per ton in 2006).

²⁶ RIA Novosti, "Russia's Transneft Delays Siberian Oil Pipeline Project," *Russian News and Information Agency Novosti*, February 07, 2008, <http://en.rian.ru/russia/20080207/98613723.html>.

²⁷ RIA Novosti, "Medvedev for Legal Action Over 'Failed' Trans-Siberia Pipeline Firms," *Russian News and Information Agency Novosti*, June 16, 2008, <http://en.rian.ru/russia/20080616/110726513.html>.

²⁸ Interfax, "Some 2,000 Kilometers of ESPO Pipeline Built," June 5, 2008.

Surgutneftegas).²⁹ If the Kovykta field is developed for export and the ESPO pipeline for gas is constructed, then the Irkutsk region will be a major beneficiary as well.

IV. Irkutsk: Putting Kovykta Into Perspective

If the Kovykta field is developed in the next decade, then the level of gas extraction in Irkutsk in 2020 should reach as much as 46 billion cubic meters (Bcm). However, several factors work against this scenario, including the harsh climate, the difficult geological conditions, the lack of infrastructure, and most importantly, the lack of clarity regarding who will develop this deposit. TNK-BP, which owned the license to develop the Kovykta field through its acquisition of RUSIA Petroleum,³⁰ was forced to sign over the rights to Gazprom in 2007 after an attack by Rosprirodnadzor, Russia's state-owned environmental protection agency. The agency maintained that since the company extracted 33 million cubic meters—instead of 9 Bcm, or 272 times less than originally planned—its license should be forfeited. For its part, TNK-BP had held up investing in the exploitation phase of this project because of the lack of an export route.

Even after the license was transferred to Gazprom, the pace of developing Kovykta has remained in question, as has the future market for this gas. The regional administration favors sending this gas to market in Irkutsk proper, which among other things would benefit local business interests that control the licenses for small fields around Kovykta. Gazprom, which favored such an approach before it controlled the deposit, now argues for foreign export of this gas and using more distant northern fields to gasify Irkutsk Oblast. Furthermore, there is still the question of what role TNK-BP will play in the project, which will not be decided upon until TNK-BP's internal fights between BP and its foreign partners are fully resolved.³¹

²⁹ The Talakan field, discovered in 1987, is located in the southwest of Yakutiya. The field's recoverable reserves are estimated at 124 million tones of oil and 47 Bcm of natural gas. Surgutneftegas obtained the license for the field in 2001, when it was taken away from YUKOS's Sakhaneftegas. After a court ruling, Surgutneftegas was granted the license on a permanent basis and bought up YUKOS assets in 2004. In 2006, the license-holder extracted 242,800 tones of oil and plans to ratchet up its production. See Poussenkova, "Wild, Wild East," 26.

³⁰ For a brief history of how BP obtained the license, see "Kovykta Project," *TNK-BP*, <http://www.tnk-bp.com/operations/exploration-production/projects/kovykta/>.

³¹ Robert Dudley was forced out as president of the company in the summer of 2008, when it looked like BP might be forced out of the country entirely if the BP management did not acquiesce to demands of TNK's key Russian shareholders that more of the management of the company be turned over to them.

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While Gazprom may become the region's major energy exporter, in the near term this honor will reside with Rosneft. Rosneft plans to extract around eight million tones of oil annually by 2020, mostly from the Upper Chona deposits. This estimate seems high, especially due to the fact that the extraction levels are expected at only 1.3 million tones in 2009. Rosneft won a highly controversial auction in July 2007 to receive exploration and production licenses to the Preobrazhensky, Verkhneichonsk, and West Chonsk blocks, which collectively could have 3.6 billion barrels of oil and 490 Bcm of gas.³²

Verkhnechonsk borders on and is one of the biggest fields in East Siberia, holding reserves of 201.6 million tones of oil, 3.4 million tones of gas condensate and 95.5 Bcm of natural gas, and borders on Kovykta. The license for the project was granted in 1993 to RUSIA Petroleum, 63 percent of which is now owned by TNK-BP.

With Kovykta as its priority, RUSIA Petroleum in 2002 established a 100-percent-owned subsidiary, Verkhnechonskneftegas, and transferred to it the license for the project until 2017. As the Russian government sought to consolidate its holdings of strategic reserves, this license too was under risk (given its low level of developmental activity). The Ministry of Natural Resources announced in 2003 that it might revoke Verkhnechonskneftegas' license. In response, RUSIA Petroleum in December 2003 sold shares of Verkhnechonskneftegas to its shareholders for \$1.2 million. Before any serious reapportioning of assets could occur between shareholders, Rosneft in 2005 also bought 25.9 percent of Verkhnechonskneftegas from Interros. And, in 2006, the Irkutsk administration sold off its share in a controversial auction in which TNK-BP bested Rosneft.³³

The pace of exploration has dramatically increased since that time. Despite its internal corporate struggle, TNK-BP made the decision to move forward with the full-scale development of

³² Reuters, "Rosneft, CNPC JV Wins East Siberian Oil Licences," *Reuters UK*, July 31, 2007, <http://uk.reuters.com/article/oilRpt/idUKL3185091320070731>.

³³As of March 2008, the major shareholders of Verkhnechonskneftegas are TNK-BP, with 68.4 percent of its shares, and Rosneft, with 25.94 percent. See Interfax, "Verkhnechonskneftegas Will Be Ready to Supply Oil to the Eastern Siberia-Pacific Ocean Oil Pipeline System in September 2008," *TNK-BP*, March 27, 2008, <http://www.tnk-bp.com/press/news/2008/3/295/>.

Verkhnechonsk field in late 2008.³⁴ Peak oil production from the field is expected in 2012–13, with exploration and production slated to last until 2027. Total expenditures in field development are roughly estimated at \$3.8-\$4 billion.³⁵ Initially the expectation was that the oil from the field would be transported by some 600 km of feeder pipelines and railway, but now this need will be met by the ESPO pipeline, which runs near to the neighboring Talakansk field and which Transneft will link up with the Verkhnechonsk field.

The history of the development of Irkutsk's gas industry in recent years has largely been shaped by the efforts of Gazprom, supported by the Kremlin, to gain control over the principal deposits in this region and merge them into Gazprom's unified gas delivery system. Much of Gazprom's rise has been at the expense of TNK-BP, holder of the majority interest in RUSIA Petroleum,³⁶ which until 2007 was the license holder for Kovykta.

In a much more minor drama that occurred earlier, Gazprom pushed out Itera,³⁷ taking controlling interest of Bratskecogas (78.1 percent, the remainder stayed with the Bratsk administration).³⁸ In September 2006, after years of pressure from Gazprom, which had whittled

³⁴ "TNK-BP to Supply Verkhnechonsk Oil to ESPO Pipeline," *Kommersant*, October 03, 2008, http://www.kommersant.com/p-13338/r_500/TNK-BP_ESPO/.

³⁵ Poussenkova, "Wild, Wild East," 37.

³⁶ RUSIA Petroleum was founded in 1992 to develop the Kovykta and Verkhnechonskoye fields by a coalition of enterprises and the Irkutsk Regional Property Fund. Kovykta had been discovered in 1987, but at that time its reserves were estimated at only 190 Bcm, and the field was thus allocated to local use. Only in the late 1990s, after Interros and BP obtained stakes in RUSIA Petroleum and supported more geological research, did Kovykta's real potential emerge. With the unification of the TNK-BP in 2003, the company achieved de facto control of RUSIA Petroleum, holding 62.89 percent of the stock. In June 2007, BP agreed to sell its stakes in RUSIA Petroleum and the East Siberia Gas Company to Gazprom. However, on May 20, 2008, Gazprom announced that the near-\$1 billion deal was to be put off indefinitely until the two sides resolve standing issues. See Petr Sapozhnikov, "Oil Industry 1999-2000," *Kommersant*, October 23, 2001, http://www.kommersant.com/t288425/r_3/n_38/Oil_Industry_1999-2000; RIA Novosti, "Gazprom Says \$1 Bln Deal to Buy Kovykta Gas Field Delayed," *Russian News and Information Agency Novosti*, May 20, 2008, <http://en.rian.ru/business/20080520/107904438.html>.

³⁷ Itera Holdings, Ltd., which owns Itera Oil and Gas Company, Ltd., is a Moscow-based holding group originally founded as a commodities trader in 1992. It entered in the natural gas sector in 1994, when it acquired rights to gas in Turkmenistan. Formerly one of the largest gas producers in Russia, it has been involved in a number of high-profile deals with Gazprom that have been the subject of allegations of malfeasance and corruption. In the first quarter of 2008, it supplied 6.454 Bcm of natural gas and posted \$51 million in profit. See RIA Novosti, "Russian Gas Producer Itera Posts 29% Net Profit Growth in Q1," May 12, 2008, *Russian News and Information Agency Novosti*, <http://en.rian.ru/business/20080512/107177887.html>.

³⁸ Bratskecogas was a creation of the Bratsk administration. It was made in order to develop a gas condensate field located some 17 miles from Bratsk. The development of the field began in 1994 and was designed to move Bratsk away from the utilization of coal for local power generation, as it was worsening an already heavily-compromised environment.

away Itera's assets throughout the former USSR, Itera signed a memorandum of cooperation with Gazprom concerning the development of the Bratsk field.³⁹ This memorandum envisaged the development of the Bratsk field within Gazprom's proposed framework for gasification of Irkutsk. This memorandum is a continuation of cooperative ventures between Itera and Gazprom.⁴⁰

This agreement was rather inconsequential for Gazprom, which had its eyes on the Kovykta gas condensate field, located 450 km to the northeast of Irkutsk City.⁴¹ Gazprom's commitment to gasification of Irkutsk would serve as another card to be used against TNK-BP. The siege of the Kovykta license dragged on for more than a dozen years. RUSIA Petroleum held the license for the exploration and development of the main area and included Chandinsk and Yuzhno-Ustkut areas for development within the framework of a single production project, which they led as project operator.

In 1997, Kovykta's major stakeholders began negotiations with China, Japan, South Korea, and Mongolia. There was hope that the gas would be marketed primarily in China, with Japanese and South Korean financing, and with Mongolia serving as a transit country. In November 2000, RUSIA Petroleum signed a new trilateral agreement in Beijing with CNPC and the Korean firm Kogas to prepare an international feasibility study (IFS) in 2002. At the end of 2000, Kovykta was included in the list of projects to be implemented under production-sharing-agreement (PSA) terms by the State Duma. The Federation Council approved this law in January 2001.

But this decision did not accelerate the development of the field. The project was mired down by the conflicting priorities of the major shareholders, as well as difficulties created by the

³⁹ It is expected that by 2009 some 400 million cubic meters of gas will be produced from the field: 100 million cubic meters for regional gasification and the rest channeled for processing. Itera will deal with field construction and is slated to begin trial development by late 2007. Gazprom will build the pipeline and low-pressure networks.

⁴⁰ In June 2006, Itera and Gazprom signed an agreement for the period 2006–2010 that envisages cooperation on a broad range of issues, including reconstruction and upgrading of USGS, establishment of joint gas-chemical enterprises, gas sales to Gazprom, and the deliveries of raw materials to Gazprom's gas processing plants.

⁴¹ In early 2002, the Resource Commission of the Russian Ministry of Natural Resources estimated Kovykta's gas reserves in the C1+C2 categories at 1.9 tcm, which provides for annual gas production of approximately 40 Bcm, and gas condensate reserves at 108 million tones. See, Poussenkova, "Wild, Wild East."

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bankruptcy proceedings against SIDANCO, which was one of RUSIA Petroleum's stockholders.⁴²

The project also encountered problems early on with Gazprom, which did not want to be cut out of the transport decisions involving China. They preferred to offer Beijing natural gas from the Yamal peninsula rather than from East Siberia, an option that did not attract Beijing's interest. The project partners differed on whether gas should be shipped directly to China (BP's position) or through a pipeline to the Russian port of Nakhodka (as TNK proposed) instead of exporting gas directly to China. Gazprom supports the latter.

With the unification of TNK-BP in 2003, the company achieved *de facto* control of RUSIA Petroleum, controlling 62.89 percent of the stock. At the same time, as the result of the IFS, the reserves in the project were substantially upgraded with proven natural gas reserves amounting to two trillion cubic meters (tcm), while recoverable reserves were estimated at 1 tcm.⁴³

But the riches of the project came with a number of conditions. The Kovykta deposit was tied to plans for the gasification of the Irkutsk region, with the license holders expected to deliver 4 Bcm per year domestically. This would require: the construction of a 670-km pipeline from Kovykta-Sayansk-Angarsk-Irkutsk; gas distribution; helium plants; and gas deliveries to industrial and residential consumers. This was never envisioned as profitable, as the benefit of the project to the license holders was to be provided by the export component.

The IFS envisioned that China would take 20 Bcm/y and Korea 10 Bcm/y, with gas supplied to the export markets through a 4,500-km pipeline with a capacity of 30 Bcm/y. The route agreed upon in the IFS was to extend from the field to Irkutsk, on to northeast China and then to markets in Korea and the Bohai Bay in north China. The gas price at the border would be about \$100 per 1,000 cubic meters, which was in line with Chinese expectations. Total costs for the project, for both upstream and pipeline, were estimated at \$15–\$20 billion. It was expected that the project

⁴² Sapozhnikov "Oil Industry"; Poussenkova, "Wild, Wild East," 49.

⁴³ Poussenkova, "Wild, Wild East," 49.

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would be approved by the governments of the three countries in March 2004, which would provide an opportunity to start commercial activities at the field.

The projected start date did little to attract Gazprom, which as late as 2000 was still publicly claiming that it lacked interest in East Siberia. But by the end of 2000, Gazprom was committed to the development of a single system of gas production, supplies, and sales in East Siberia and the Far East. The Kremlin had appointed the company as coordinator of all gas-related activities in East Siberia and the Far East. In 2002, the government provided a juridical basis for this system.

These developments made it almost impossible for Kovykta's potential foreign partners to negotiate directly with the license holders, which of course had been the Russian government's and Gazprom's intent. In addition, Gazprom began demanding that all the gas from Kovykta be channeled to the united gas transport system (USGS) to meet the needs of domestic industry and consumers. In one version of its programs, Gazprom indicated that it was possible to pump up to 20 Bcm of gas to the USGS in order to mitigate the threat of a gas deficit in the western part of Russia. Gazprom also began pressing the PSA designation for Kovykta be revoked. And, Gazprom had no interest in becoming a minority shareholder in the project. It refused to take a stake in RUSIA Petroleum offered at market price by Interros and the Irkutsk administration in 2004.

Throughout all this, the clock on RUSIA Petroleum's license was ticking away. According to the licensing agreement, the commercial development of the field was to commence in late 2006, and gas export to begin in 2008, with a total planned volume of 34 Bcm. The Ministry of Natural Resources began threatening to revoke RUSIA Petroleum's license as early as 2003, arguing that the subsurface user had no real obstacle to gasifying the region.

While true that RUSIA Petroleum had little enthusiasm for a project that was linked solely to Russia's internal market, the Russian government, for its part, did not make it easy for the company to develop even this less lucrative sector. In December 2003, RUSIA Petroleum submitted its version of the project for gasifying the Irkutsk region, and, in March 2004,

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established the East Siberian Gas Company (ESGC), in which TNK-BP and the administration of the Irkutsk region held equal stakes.

The plan envisaged the construction of the 670-km gas pipeline Kovykta-Sayansk-Angarsk-Irkutsk, a gas separation and helium plant in Sayansk, and supplies of gas (first to consumers located within a 10-km radius of the pipeline).

TNK-BP planned to sell the bulk of gas in Sayansk. The Russian shareholders of the company controlled Sayanskhimplast, which produces PVC, and, hence, consumes ethane and propane-butane. It was estimated that Sayanskhimplast would consume up to 2–2.5 Bcm of gas annually. TNK-BP also planned to build a plant to produce dimethyl ether, as well as a gas distribution plant. After 2007, the goal was to gasify settlements located within 100 km from the gas pipeline.

But the Ministry of Natural Resources pressed TNK-BP to meet the license requirement of 9 Bcm/y as of January 2007, with the license holders responding that the demand for gas in the region had decreased since the license was issued in 1992, down to 2.5 Bcm, and that it would reach only 4 Bcm in 2010.⁴⁴ Gazprom, meanwhile, kept maintaining that the demand would amount to 6–7 Bcm, increasing the argument for why TNK-BP should be denied its license. Gazprom also had a competing gasification agreement (signed with the Irkutsk administration after the RUSIA Petroleum agreement).

Gazprom's plan to gasify the region is based on the use of small fields located in the north of the Irkutsk region, while Kovykta gas is to be delivered to the USGS through pipelines built by Gazprom. This plan was more expensive than the RUSIA Petroleum plan (for which the planned pipeline was never built).

The competing agreements were something of a hot potato for the Irkutsk administration. Boris Govorin, the former governor of the Irkutsk region (and previously Irkutsk's mayor), focused on Kovykta as a strong proponent of regional gasification, and liked the RUSIA Petroleum plan. But

⁴⁴ Poussenkova, "Wild, Wild East," 51.

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Putin's appointee, the ill-fated Alexander Tishanin, signed an agreement with Gazprom on gasifying the region on the basis of small fields. In fact, the two plans could have existed simultaneously, as they served the northern and southern parts of the oblast.

The gasification project would have substantial impact on several small oil companies and their license holders, as it would develop several marginal fields and make them partners of Gazprom in this project. Many of these license holders are well connected with the Irkutsk administration.⁴⁵

Sensing that the tide was clearly going against its interests, TNK-BP strove to attract Gazprom to the project, proposing in March 2006 that the two companies create an East Siberian consortium in which Gazprom would have 50 percent + 1 share, and TNK-BP would contribute its share in RUSIA Petroleum and in ESGC. Under the proposal, RUSIA would develop the field, Gazprom would transport and export gas, and another company would deal with domestic gas sales, and yet another division of the holding company would process gas.⁴⁶ But Gazprom rejected this proposal, claiming that it had other priorities in East Siberia. Gazprom further argued that RUSIA Petroleum's project plans did not account for the full-scale extraction and use of helium, which is a vital strategic resource, and that until the problem of its utilization is fully resolved, the Kovykta field should not be developed.

In September 2006, the procurator office of the Irkutsk region demanded that the Federal Agency on Subsurface Use suspend the license for Kovykta development. The Irkutsk authorities claimed that RUSIA Petroleum violated environmental legislation in 1999–2001 and had failed to meet its domestic quota requirement. (Under the license, TNK-BP was expected to produce up to 9 Bcm per year starting in 2006 to meet regional demand.)

The controversy continued through 2007, with the Federal Agency for Subsoil Use saying in February that RUSIA's underproduction could jeopardize its license. In May 2007, the Natural

⁴⁵ The Bratsk field (10.7 Bcm) is licensed to Bratskecogas, a subsidiary of Itera with part ownership by the Bratsk administration; the Atovsk field (2.1 Bcm) is licensed to Atov-Mag Plus; and the Ayansk field (10.2 Bcm) is licensed to the Irkutsk Oil Company. See Poussenkova, "Wild, Wild East," 51.

⁴⁶ Poussenkova, "Wild, Wild East," 51.

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Resources minister said that the license was “bound to be withdrawn” at a June hearing.⁴⁷ In late June 2007, after several postponements of a final decision on the license, BP announced that it was selling its stake in RUSIA to Gazprom for an amount between \$700 million and \$900 million. Although the deal was meant to be finalized within 90 days, it has yet to be resolved. On May 20, 2008, Gazprom announced that the near-\$1 billion deal was to be put off indefinitely until the two companies resolved all their other outstanding issues.⁴⁸

It is not clear what priority the Kremlin will give to the development of the Kovykta field, both in general and in relationship to its energy priorities in East Siberia. Although the Russian government's actions in the energy sector have evoked much criticism, the move from a commercial approach to a strategic approach for asset development creates great flexibility in determining the order in which fields and pipelines are exploited.

V. Politics in Irkutsk

The politics of oil and gas has figured only minimally in the boisterous political environment of the Irkutsk region. Oil and natural gas companies are not represented in either the legislative assembly of the region or in the regional administration, unlike the other major industries.

Irkutsk has always been something of a political pioneer. In 1992, Irkutsk (along with Krasnoyarsk) convinced the Constitutional Court of Russia to overturn the Russian president's order to transfer the shares of the Irkutsk hydro-electro stations to the state electricity monopoly, RAO UES. In March 1993, the Irkutsk governor—supported by the people of the region and the local elites—withstood the attempt from then-President Yeltsin to remove him from office, and, four years later, became one of the first governors to voluntarily leave office. In 1994, Irkutsk held the first gubernatorial elections in the country, and in 1996, the second election of the local legislature was combined with the national presidential elections—a move that the federal Central Electoral Commission strongly opposed. Moreover, the constitution of the region was adopted in 1994 by a regional referendum—rather than by its regional deputies as was the case in

⁴⁷ RIA Novosti, “TNK-BP Could Lose Gas Field License- Source,” May 29, 2007, *Russian News and Information Agency Novosti*, <http://en.rian.ru/business/20070529/66243941.html>.

⁴⁸ RIA Novosti “Kovykta Gas Field Delayed.”

most regions. The Irkutsk region was one of the first regions in the country to adopt the new mixed system for the formation of its legislature.

Even with Putin's forced shift of power from the regions back to the center, Irkutsk retained a degree of political dynamism. In 2001–2003, and then from 2005–2008, there was intense competition between the governor and the regional Duma, the latter of which the authors witnessed firsthand during their October 2006 visit to the region. Dissatisfaction of a fractious local elite led Moscow to twice appoint governors from outside, first in 2005 and then in 2008. In 2005, Governor Boris Govorin, a former mayor of Irkutsk city, was dismissed as the governor of the region, with Aleksander Tishanin from the Russian railroads appointed in his place. Valentin Mezhevich, a senator from the region, was considered to be the first choice. He was backed by Vladimir Surkov, one of Putin's chief aides, but Tishanin was supported by Victor Ivanov, a long-time intimate of Putin, and as well as by Igor Sechin.

The center decided that the way to solve conflicts between business and government in the region was to appoint a “good boyar”—an administrator directly pursuing the interests of the federal structures. Tishanin, who came to the region only a year before his appointment and was a stranger to the local elite, quickly clashed with two of its leaders—the mayor of Irkutsk and the speaker of the regional Duma.

Tishanin was appointed to try and achieve a greater balance between competing local business interests, which were vying for tacit federal endorsement of their corporate strategies, as well as cheap energy and improvements to the transport system that favored their respective needs. He never fully succeeded, in part because these economic divisions were also mirrored in the local political parties and in the legislature, where United Russia dominates,⁴⁹ yet deputies are elected in campaigns funded mostly locally. These divisions are also mirrored in competing municipal and district level governments in the oblast.

⁴⁹ The Irkutsk regional legislature is composed of 50 deputies: 21 elected by single-mandate districts with the exclusion of the Ust'-Ordynskogo Buryatskogo district, which elects four deputies on a multi-mandate basis. United Russia has a clear majority of representatives amongst this group of 25. The remaining 25 deputies are elected through party lists. The deputies are allocated proportionally for parties who cleared the 7 percent minimum vote attainment barrier. Through this system, United Russia has received 15 deputies, and another four parties each received four or less deputies. See, “The Irkutsk Regional Parliament, (In Russian)” *Zakonodatel'noe Sobranie Irkutskoy Oblasti*, <http://irk.gov.ru/index.php?IdAction=docs&Event=section&id=4>.

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Shortly after coming to office in 2005, Tishanin put a program of “administrative reform” into action—the first step of which was to purge the regional bureaucrats and install allies into key posts, most of whom came to the oblast from some form of previous federal service. After an early gubernatorial appointment ran into opposition in the parliament,⁵⁰ Tishanin vetoed an amendment to the regional constitution that would have given the parliament the power over his nominations for the first minister, as well as the heads of several influential departments, including the finance, economic, and agricultural departments.⁵¹ While Tishanin’s successor did accept deputies’ claims to control appointments to key positions in regional administration in early 2009, this has not eliminated the political competition between the parliament and administration.

This political competition is a major reason why there was such a fierce debate over the Kremlin-backed program for the region’s socioeconomic development, which failed to gain legislative support until November 2006. This is significant given the Kremlin’s push to “coordinate” regional development plans, and shows that the legislature had some say in crafting the final version. Irkutsk, like every other region, had to fit its plan into a template provided by Moscow and had to have it approved by the Ministry of Economic Growth and Industry.⁵²

The plan does not significantly diverge from the federal authorities’ agenda for the region, but it does seem to place more emphasis on creating a sustainable economy with lasting durable industries. It is also interesting to note that while Anatoly Kvashnin, presidential envoy to the Siberian Federal District, singled out energy as the top priority in his interview about

⁵⁰ In September 2005, Tishanin chose another industrialist, Yuri Paraniev, as first minister. Paraniev had been the director of a tractor manufacturing plant in Chelyabinsk. After he and Tishanin had consultations with legislators, Paraniev’s appointment was approved in the parliament by 41–1 in December 2005. See Lenta, “Paraniev, Yuriy,” October 6, 2006, *Lenta.ru*, <http://www.lenta.ru/lib/14164255/>; Marina Shalimova, “Yuri Paraniev stal vitse-gubernatorom Irkutskoy oblasti,” *Chelyabinsk News Agency*, December 21, 2005, <http://chelyabinsk.ru/newsline/195211.html>.

⁵¹ Dmitriy Elovskiy, “Aleksandr Tishanin zaschitil svoi polnomochiya,” *Vostochno-Sibirskaya Pravda*, July 1, 2006, http://www.vsp.ru/show_article.php?id=34231.

⁵² The plan sets out three overarching goals: the creation of a high-tech industrial base for the cultivation of natural resources and their refinement into final products; fostering regional innovation; and establishing sustainable social and economic development with high levels of employment. It puts forward the period of 2006–2010 as its timeframe, setting as a benchmark 77 percent GDP growth, 8 percent growth in the human development index, a 55 percent increase in real income, and a 400 percent increase in investment. See, “Programma sotsial’no-ekonomicheskogo razvitiya Irkutskoy oblasti na 2006–2010 gody,” *Pravitel’stvo Irkutskoy oblasti*, http://www.govirk.ru/tematicheskie_razdely/strategii_razvitiya_oblasti/programma_socialno-ekonomicheskogo_razvitiya/default.aspx.

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development in Siberia, the first goal listed in Irkutsk's regional development plan is the development of a high-tech industry based on raw material such as metals.

Tishanin's tenure was further impeded by the scandals surrounding his deputy governor, Sergei Voronov, who was arrested for official malfeasance in October 2007.⁵³ He and Viktor Bushuev, head of the Irkutsk highway administration, were accused of the embezzlement of 42 million rubles from funds for road construction.⁵⁴ Voronov denounced the case as politically motivated.⁵⁵ Voronov was also a close associate of Tishanin's brother Yevgeny, who served as a senior official in law enforcement in the Irkutsk administration.⁵⁶

Tishanin pursued a number of projects that were supported by powerful interests in Moscow, as well as the federal authorities, such as: rerouting the ESPO to bypass Baikal through a more northerly path, which had the support of the Russian Railroads; favoring Gazprom over TNK-BP at Kovykta; and pushing for the unification of Irkutsk Oblast with Ust-Orda Autonomous Region. But his tactics and the roles played by his deputies in the governor's office demonstrate the limits of central control; Moscow may be able to successfully pursue policies when a regional elite is split, but when they all agree to oppose Moscow's will, the outcome is a dysfunctional region.

Subsequently, Russian Technologies⁵⁷ began lobbying the Kremlin with its candidate for the Irkutsk job, Igor Yesipovsky, then a Duma deputy, and formerly a head of the company's subsidiary, the Samara-based Avtovaz. Yesipovsky is considered a protégé of Sergey Chemezov, the head of Russian Technologies as well as the head of the Irkutsk "fellow countrymen" organization in Moscow.

⁵³ Regnum, "Aresty dvykh merov I zamestitelya glavy regiona, aglomeratsiya toksicheskii gepatit: Irkutskaya oblast' za 2007 god," *Regnum Information Agency*, December 26, 2007, <http://www.regnum.ru/news/937873.html>; Regnum, "Arestovan zamestitel' gubernatora Irkutskoy oblasti Sergey Voronov," *Regnum Information Agency*, October 18, 2007, <http://www.regnum.ru/news/901304.html>.

⁵⁴ "Zamglavy administratsii Irkutskoy oblasti vzyat pod strazhu," *Newsru*, October 18, 2007, http://www.newsru.com/russia/18oct2007/straja_glava.html.

⁵⁵ Regnum, "Aresty dvykh merov I zamestitelya."

⁵⁶ See, for example, a calendar of events available at: "Kalendar'," *Zakonodatel'noe Sobranie Irkutskoy Oblasti*, November 9, 2006, <http://www.irk.gov.ru/index.php?IdAction=docs&Event=read&id=657>.

⁵⁷ "Chemezov to Head Technologies Corp.," *The Moscow Times*, November 27, 2007, <http://www.moscowtimes.ru/article/1009/42/352066.htm>.

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Russian Technologies substantially increased its regional presence. Irkutsk became the second region prioritized after Samara, where the company had already installed one of its own as governor. This is reminiscent of the actions of Rosneft, which effectively installed governors in the Nenets and Sakhalin regions.

There has been a longstanding symbiotic relationship between government and business in Irkutsk, unlike the situation in the Orenburg region, where big business was essentially frozen out for 10 years until the 1999 gubernatorial elections. This relationship dates back to the early 1990s through the region's aluminum factories. From 1991 to 1996, the Bratsk factory was controlled by TWG⁵⁸ (the Ruben brothers, the Chernye brothers, with Oleg Deripaska as the younger partner, who then only controlled the Krasnoyarsk aluminum factory), while the Irkutsk aluminum factory came under the control of the "Renova" group. By contrast, until 2000, the regional administration was closely linked to Irkutskenergo, which supplied these companies with their energy.

Deripaska won control of the Chernye brothers' Bratsk factory in 1999, making it the building block of RUSAL and then eventually Basic Element. Despite the fact that SUAL and RUSAL were at war with each other, they united against the candidacy of Boris Govorin and supported his opponent, Viktor Borovsky, in the 2000 legislative elections. In 2001, both companies supported Sergei Levchenko in the gubernatorial elections.

However, both aluminum giants could not defeat Govorin. On the other hand, the governor did not have the necessary power to separate the warring business factions. Moreover, by 2004 the political momentum was lost, when the major conflict between the governor and the aluminum and forestry industries ended with the forced restructuring of Irkutskenergo, and *de facto* control of the company went to RUSAL (26 percent) and SUAL—Renova (10 percent).

⁵⁸ The Trans-World Group was an association of commodities traders who played a central role in Russia's aluminum business in the 1990s. The group was led by two Russian brothers, Mikhail and Lev Chernoi, and two traders, David and Simon Reuben. TWG has been accused of corrupt practices. See Editors of Fortune, "David and Simon Reuben: Update and Clarification," *CNN Money*, July 12, 2004, http://money.cnn.com/magazines/fortune/fortune_archive/2004/07/12/375898/index.htm; Paul Klebnikov, "Gangster-free Capitalism," *Forbes*, November 26, 2001, <http://www.forbes.com/global/2001/1126/026.html>.

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The increasing role of national companies is having an obvious impact on the relationship of government and business in Irkutsk, elsewhere in East Siberia, and in Russia as a whole.

In the regions the authors studied, we encountered big businesses that were essentially national, with head offices in Moscow or Saint Petersburg, as well as those that were active in either a single region or had a largely regional base. The national or “federal” businesses were characteristic of the most profitable sectors, such as aluminum and oil, initially, then ferrous metallurgy, and, increasingly, agro-business and agricultural and machine-building.

In our study, we encountered several instances of the expansion of business corporations with federal ties: the beginning of the expansion of state-owned corporations, such as Gazprom and Rosneft in Irkutsk, the handover of OrenburgAvia to Russian Technologies, and the changeover in less prominent companies, such as the expected sale of Continental Management by Basic Element, which was itself enlarged by the merger of RUSAL and SUAL.

We also encountered cases where companies used their regional position to become national actors. RUSAL came to the Irkutsk region via neighboring Krasnoyarsk and, only then, having the Krasnoyarsk and Bratsk aluminum plants as a base, became a federal business group.

VI. Irkutsk In Perspective

Looking closely at Irkutsk's development is a very useful exercise for a Western expert interested in the development of Russia's oil and gas industry, providing cause for re-evaluating some of the general assumptions concerning how and why energy resource development decisions are made in Russia.

We tend to think of Irkutsk as synonymous with Kovykta, the struggle of TNK-BP to retain control of that project, as well as the company's internal management problems. These problems seem to suggest that Russian companies and executives are never able to fully free themselves from the influence of the Kremlin and key Russian political figures, both inside and outside of the government.

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But the story of Irkutsk's failures and successes as a region is much more complicated. This became clear to us after our seminars, travels, and interviews in the region. When we were there in October 2008, the development of Kovykta and the oil and gas sector for export was of relatively little concern to most of the regional elite. Their priority in the energy sector was meeting the region's own growing energy needs, and determining whether or not this should be accomplished through gasification, which would connect the southern parts of this enormous oblast to a centralized gas grid that would supply it from deposits in northern Irkutsk (Kovykta and further north). Another big issue was the question of who would buy out the local license holders of gas deposits in the north (which were both privately and publicly held, by local entrepreneurs and regional entities), and at what price.

Many more people were concerned about the bankruptcy of YUKOS than about TNK-BP's struggles. YUKOS had been a major employer, and the major taxpayer in Angarsk. Its insolvency caused real dislocation when the social services that it provided were withdrawn, leaving the municipality with an enormous burden to try and stimulate the development of small- and medium-sized enterprises that would provide substitute sources of employment.

The main economic priority of the government in this region is to try to keep big business happy without compounding the region's social problems. The heavily industrial character of the Irkutsk economy puts significant strain on the environment. RUSAL's plants in Bratsk and Irkutsk, though undergoing modernization, still rely on outdated technologies that lead to heavy emissions. The air quality in Bratsk is particularly bad, leading to health problems for its population. Illegal logging threatens the region's forests, as trees are cut with no attention paid to forest management. While Ilim Pulp has adopted a progressive environmental policy for its mills in the region, the mill run by Capital Management continues to dump waste byproducts from its operations directly into Lake Baikal. So while the attack on TNK-BP by Russia's environmental watchdog Rosprirodnadzor may have been politically motivated, it also played well in a region where environmental activism has been a fact of local political life.

A strong indigenous environmental movement emerged in the region in the late 1980s. Yet the environmental movement in the region today is financially and otherwise weaker than it has been

in the past. It is also financially dependent on Western nongovernmental organizations (NGOs) for a significant amount of its funding. These NGOs are still among the most vibrant civil society movements in Siberia and all of Russia, largely because of the historical tradition of activism in the region.

While these civil society organizations exist, and are even periodically encouraged by local or federal authorities, business and government are still the two most important actors in the environment arena and elsewhere. RUSAL, and especially the former SUAL, have engaged with the regional administration on environmental issues while civil society groups have largely been left out of that dialogue.

A region like Irkutsk depends heavily on the large enterprises present in its territory, and would be eager to attract other large businesses to invest in the region. Foreign investment is fine, as long as it comes with the approval of the Kremlin, but Russian investors are better understood and generally easier to deal with, as at least they share the same cultural, and usually political values, as the regional elites.

Nonetheless, the main priority of the regional government of Irkutsk—as is true of regional governments elsewhere in Russia—is to attract federal support for economic development plans, and to win federal resources, especially for transportation and communication systems in their regions. All of the East Siberian regions require major investments in infrastructure to secure their long-term economic sustainability, and there is a keen competition between the three largest East Siberian regions: Irkutsk, Krasnoyarsk, and the republic of Sakha (Yakutia).

VII. Krasnoyarsk: A Relatively Successful Marriage of Business and Politics

Krasnoyarsk Krai is headed by Aleksander Khloponin, who was elected governor in 2002, in a closely contested election.⁵⁹ In 2007, Khloponin was appointed by Putin for a new term. He is a

⁵⁹ Gregory Feifer, "Russia: Khloponin Wins Krasnoyarsk Governor Election," *Radio Free Europe/Radio Liberty*, September 23, 2002, <http://www.rferl.org/content/Article/1100866.html>.

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former director general of Norilsk Nickel,⁶⁰ and subsequently served as the head of the Taimir region, in which Norilsk—the world's largest producer of platinum and palladium, in addition to the vast reserves of Nickel for which it is named—is located. The Taimir region was fully subordinated to the authority of the Krasnoyarsk Krai in 2007, after a referendum in 2005 in which residents voted for its inclusion, as well as the inclusion of the Evenk Autonomous region into Krasnoyarsk.⁶¹

The Evenk region is where much of Krasnoyarsk's oil and gas reserves are found, some 570 million tones of oil. After the incorporation of Evenkia and Taimiria, the Krasnoyarsk region—which is half the size of European Russia and second only to the Republic of Sakha in size—became one of the country's wealthiest areas as well. Khloponin is a young protégé of Vladimir Potanin, the founder of Interros, the holding company that crafted the reorganization of Norilsk and its emergence on the global metals market. Not simply a company man, Khloponin has the reputation as one of the most economically reform-minded of Russia's governors.⁶² He is the sponsor of the annual Krasnoyarsk economic forum,⁶³ and is credited with revitalizing the Lower Angar regional economic complex project (Nizhneangarsk). This \$960 million project was to be funded solely through private investments to be made in 2009–2012, in an effort to revitalize this economically depressed region through a series of interconnected enterprises.⁶⁴ The effort was one of four “winning” projects chosen to receive support from the Russian Federation State Investment Fund in June 2006.⁶⁵

The Lower Angar project is located in the Boguchanski region of Krasnoyarsk. The construction of the Boguchansk hydroelectric station, a project planned in the Soviet era, is intended to provide the energy needed to supply the rest of the project and other energy needs in southern Krasnoyarsk. In April 2009, Russian Federation authorities promised that they would provide

⁶⁰ Khloponin also served as Governor of the Taymir Autonomous Okrug, where Norilsk is located, and which since has been formally incorporated into Krasnoyarsk Krai.

⁶¹ “Krasnoyarsk Territory,” *Kommersant*, March 08, 2004, http://www.kommersant.com/p-85/r_429/Krasnoyarsk_Territory/.

⁶² “A Siberian Governor Hunts Big Money,” *Gateway to Russia*, April 22, 2004, http://www.gateway2russia.com/st/art_230835.php.

⁶³ The forum's website can be found here: “Krasnoyarsk Economic Forum” (In Russian), <http://5.krasnoforum.ru/>.

⁶⁴ “Vse proekty Nizhnego Priangar'ya “zavyazany” na Boguchanskuyu GES,” *Federal Press*, January 09, 2008, http://fedpress.ru/federal/econom/news_kompany/id_081805.html.

⁶⁵ Poussenkova, “Wild, Wild East,” 118.

some funding to help make the new economic complex a reality, after RUSAL announced that it was going to have to delay its investment in the project from 2010 to 2012 because of its financial problems.⁶⁶ The Boguchansk hydroelectric station, to have an initial capacity of 1,620 thousand megawatts and an eventual capacity of 3,000 megawatts, will help support the development of a new road from Karabula to Yarki,⁶⁷ expanded rail links,⁶⁸ the expansion of forestry and paper processing (the region is said to rival Finland in its untapped woods), and an aluminum factory at Karabula.⁶⁹

One of the major purposes of the project is to continue to diversify the economy of this most populated of the East Siberian regions with over 2.8 million people.⁷⁰ Local as well as national authorities would like to maintain this population level. In the first years of independence, Norilsk Nickel accounted for some 80 percent of the region's budget, but by 2009, the figure had dropped to 45 percent.⁷¹ The development of the region's oil and gas industry will further help diversify its economy, but like Irkutsk, Krasnoyarsk is expected to gasify its own region before it expands its export potential

Krasnoyarsk has oil and gas reserves that are very close in size to those of Irkutsk: 1011.3 million tones of oil; 1,126 tcm of gas; and 50 million tones of gas condensate. Much of these reserves are found in Taimyr and Evenkia, which are now formally incorporated into Krasnoyarsk Krai.

Rosneft has a dominant position in Krasnoyarsk, created by its acquisition of YUKOS' holdings in this region. These were concentrated in the Yurubcheno-Tokhomonsk Zone (YKZ) in the southern part of Evenkia. Through subsidiaries, YUKOS had a controlling interest in the Yurubchen field (703 million tones of recoverable oil resources, and co-ownership of the Tersko-Kamovsk block, with the other three blocks controlled by Slavneft and Gazprom). The

⁶⁶ "Pravitel'stvo RF garantirovalo vypolnenie prinyatykh grafikov stroitel'stva Boguchanskoy GES," *Federal Press*, April 10, 2009, http://www.fedpress.ru/federal/econom/tek/id_136728.html.

⁶⁷ "RZHDstroy' poluchila razreshitel'nye dokumenty na stroitel'stvo zheleznoy dorogi Karabula-Yarki," *Federal Press*, March 30, 2009, http://www.fedpress.ru/federal/econom/train/id_135155.html.

⁶⁸ "Investitsionnye Proekty," *Korporatsiya razvitiya Krasnoyarskogo kraya*, <http://krdc.ru/investment/>.

⁶⁹ "Nizhnee Priangar'e vyshlo na start," *Kontinent Sibir*, January 20, 2006.

⁷⁰ See "Krasnoyarsk Krai at a Glance," *Krasnoyarsk Krai: The Official Web-Portal*, <http://www.krskstate.ru/eng>.

⁷¹ "Plodit' dolgostroy ne sobiraetsya," *Rossiyskaya Gazeta*, April 10, 2009, <http://rg.ru/2009/03/26/hloponin.html>.

development of the YTZ reserves came to a halt when the YUKOS situation deteriorated. So commanding was YUKOS' position in the region, that the heating supply for the region was deemed at risk in June 2005. After serving as temporary operator of the assets, Rosneft acquired YUKOS' YTZ assets in 2007.⁷² Rosneft also acquired the Achinsk Refinery in Krasnoyarsk, and the Angarsk refinery in Irkutsk.

These acquisitions have helped Rosneft capitalize on its holdings in Irkutsk. The relationship between TNK-BP and Rosneft helps the latter maximize the value of some of the holdings it acquired after the YUKOS breakup. These include East Siberian Oil and Gas Company, which has assets in Evenkia. Oil from Verkhnechonsk (62.71 percent is held by TNK-BP, 25.4 percent by Rosneft) is refined by the Angara refinery. TNK-BP takes out its share of Verkhnechonsk oil through a swap scheme involving Rosneft's Yuganskneftegaz in West Siberia, which is then shipped westward.⁷³ The Vankor deposit—some 1,462 billion barrels of proven oil reserves—will also be exported partly through an oil-swap with TNK-BP, involving its Samotlor field, which will move 13 million tones eastward annually, and Vankor will move the same amount westward.

Krasnoyarsk has been more successful in lobbying its cause in Moscow than has Irkutsk. Khloponin has been able to turn himself into enough of a Moscow insider to retain his position as governor, and was even able to get his deputy, Anatoly Tikhonov, appointed to the post of deputy of Russia's Foreign Economic Bank in Moscow in 2009.⁷⁴

VIII. Sakha: A Wealthy and Remote Giant

Sakha is the largest of the regions of the Russian Federation, with more than 40 percent of its territory north of the Arctic Circle, yet it has a population of only 950,000 people. It also has the least transparent and least reform-minded administration of the three regions. Best known for its diamonds, Sakha produces between one-fifth and one-quarter of the world's diamonds by value

⁷² Poussenkova, "Wild, Wild East," 24.

⁷³ "Verkhnechonskneftegaz," *Rosneft*, http://www.rosneft.com/Upstream/ProductionAndDevelopment/eastern_siberia/verkhnechonskneftegaz/.

⁷⁴ Aleksey Nepomnyashchiy, "Ochen' pravil'nyy zamestitel'," *Smart Money*, October 27, 2008, <http://www.smoney.ru/article.shtml?2008/10/27/6770>.

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each year. Although it was an extremely isolated part of Russia during the Soviet era, the presence of these diamond mines insures that close connections between Sakha's administrations and state security persist to the present day.

There has been a great deal of continuity in Sakha's elite. Vyacheslav Shtyrov, born in Yakutia in 1952, has been president of Sakha since 2002, having served before that as vice president (1991–1996), and simultaneously as head of Alrosa (1996–2002). Alrosa is the company responsible for mining the diamonds of Sakha and Russia, and is currently owned 50.93 percent by the Russian federal agency for state property, 32 percent by the Republic of Sakha, and 8 percent by Sakha's regions.⁷⁵

In addition to its diamonds, and gold (accounting for roughly 20 percent of Russia's gold reserves), Sakha also has total potential reserves of oil and gas that may be in excess of 9 billion tones (65 billion bbl) of oil and 7 tcm (250 trillion cubic feet) of gas.⁷⁶ The government of Sakha has continued to reiterate the sovereign rights associated with its republic status, even in the face of the constitutional changes that have reduced the sphere of autonomous authority of regions.

The history of oil and gas development in Sakha is also intertwined with the fate of YUKOS, as Khodorkovsky's firm held a 51 percent stake in Sakhaneftegaz, the republic's own oil and gas firm. The Talakan field (with geological resources of 200 million tones) was discovered in 1987, and Lenaneftegaz received the license for the project in 1993, and sold it in auction in 2000. Sakhaneftegaz won the auction, using funds from the YUKOS sale, but quickly ran afoul of local republic authorities when it sought to have the republic's share booked as debt against future income. This resulted in the auction being annulled in 2001, with Surgutneftegaz given a temporary license to work the project. Surgutneftegaz received a five-year license in 2002, and in 2004 bought the remaining YUKOS assets in the Talakan field, including the YUKOS share of

⁷⁵ "O kompanii," *Alrosa*, <http://www.alrosa.ru/about/>. The remainder is privately held by individuals or incorporated entities. The ownership of Alrosa was modified in 2008, to increase the Russian Federation's holdings. See RIA Novosti, "Russian Gov't Gains Controlling Shares of Diamond Firm," *Russian News & Information Agency*, June 18, 2008, <http://en.rian.ru/russia/20080618/111140704.html>.

⁷⁶ R. Diyashev, "Verkhnechonsky Field Shows Eastern Russia's Potential," *Oil & Gas Journal*, 97, no. 29 (July 19, 1999).

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Lenaneftgaz.⁷⁷ Sakhaneftegaz remains in a struggle with the local authorities, who have bankrupted the company in an effort to shut it down.⁷⁸

It also is the home of the Chayanda gas field, with reserves of 1.24 tcm of gas⁷⁹ and 68.4 million tones of oil and condensate. In September 2008, Gazprom was awarded licenses for parcels from this giant field. Taken in concert with Kovytkta, Gazprom is now able to fill an ESPO gas pipeline, should it choose to construct one, and having both held by a single owner helps maximize the value of both deposits. Gazprom is also likely to acquire control of the East Chayanda parcels. When TNK-BP held the license for Kovytkta, it was presumed that the Irkutsk deposit would be developed first. Now Gazprom, in consultation with Russian Federation authorities, will be able to decide upon a schedule of development, as well as the balance between gas for local gasification and for foreign export.

Sakha also has interest in diversifying the economy of the region, and here too gasification would likely help to facilitate this. The Sakha leadership has a plan to develop an integrated economic complex in southern Yakutia, similar in scope, but the plan is much less well developed in terms of execution and possible funding than the program for Lower Angarsk in Krasnoyarsk. Sakha's plan, to be funded by the South Yakutia Corporation, an open stock company, calls for the development of the Kankunsk hydroelectric station, which will provide the energy for a group of metallurgical factories to process many of the republic's rare metals, and a new highway (from Tommot to El'kon) as well as a rail link.⁸⁰ The project, which is included in the strategic development plan for the region that runs through 2020, just entered the project development phase (2009–2010).⁸¹ But given Sakha's natural resource wealth and the fact that the region still retains partial ownership of these assets, the success or failure of its

⁷⁷ Poussenkova, "Wild, Wild East," 26.

⁷⁸ "Byvshiy vitse-prezident "Sakhaneftegaza" osvobozhden iz-pod strazhi," *Interfax*, March 23, 2009, <http://www.interfax.ru/society/news.asp?id=69816&sw=%F1%E0%ED%EA%F6%E8%EE%ED%E8%F0%EE%E2%E0%EB&bd=2&bm=3&by=2009&ed=2&em=4&ey=2009&secid=0&mp=0&p=1>.

⁷⁹ Of these 379 Bcm are Category 1 reserves, 861 Bcm Category 2 reserves. *Interfax*, "Gazprom Gets Three Gas Field Licenses," *Russ Oil-Gas*, September 7, 2008, http://russogasoil.blogspot.com/2008_09_01_archive.html.

⁸⁰ "Tsel' Proekta," *Korporatsiya Razvitiya Yuzhnoy Yakutii*, <http://www.sy-corp.ru/project/44.htm>.

⁸¹ "Ob"emy Investirovaniya I Struktyra Investitsiy," *Korporatsiya Razvitiya Yuzhnoy Yakutii*, <http://www.sy-corp.ru/project/70.htm>.

regional development schemes is less vital to the long-term welfare of its local residents than in the other two regions the authors examine in this paper.

IX. Regions and the “Vertical of Power”

One of the things that our study has demonstrated is that the personalities and skills of regional leaders do matter, as do the talents and determination of local elites. Because of this, and despite the changes in the federal structure that reduce local autonomy, there are still important regional variations in how local politics operate.

While the functions and prerogatives of the representative branch of government in the regions are relatively uniform, the electoral processes in the regions we have studied each have their own political tilt. In Irkutsk, political pluralism and competition are much more developed than most anywhere else in East Siberia.

While this competition among regions centered on Moscow in Soviet times, the whole nature of the contest has changed enormously since the end of Communist party rule. In the past, Moscow determined all national developmental priorities and effectively funded them with minimal financial input from the regions (admittedly this is a simplification of a process that was extremely nuanced). Today, regions are expected to generate income and meet budgetary obligations through local taxes, particularly in the social service sector. Many regions fail in this task and are still partially supported through budgetary transfers from Moscow, but—in principle and in practice—the regions have far more autonomy than in the Soviet era. Moreover, given that Russia remains a federal system and has sanctioned private property, the regions are likely to retain a great deal of autonomy, although there will be a continual ebb and flow between the center and periphery.

Those regions that the Kremlin favors do better than those that they do not. In some cases, the favoritism is simply the result of pre-existing ties between Kremlin or Russian White House insiders and key members of a region's elite. In other cases, the competence of a region's leadership also plays a role. Finally, and probably most importantly, Putin and his team have had

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a notion of which regions were key to the overall development of Russia's future—and which were less essential.

For a number of reasons, Irkutsk has received less of Moscow's favor than either Krasnoyarsk or Sakha—even though all three oblasts have similar economic dynamics, with metallurgy, gold (as well as diamonds in the case of Sakha), and major unexploited or underexploited oil and gas reserves.

The patterns of decision making that we encountered in the regions that we studied suggest that the ways these interests are accommodated depends as much on the skills and personalities of the incumbents in office as they do on the institutional structures that set tasks. Also significant are the personalities of leading business figures and their sense of responsibility (both historic and contemporary) to the regions, as well as whose resources they are profiting from, and how both groups build up support from other entrenched political interests, who, in turn, depend upon public support to varying degrees.

We also conclude that the idea that regions should have power is so deeply entrenched among Russia's regional elite that it is hard to imagine that any serious effort to consolidate power by the center would ever fully succeed. In fact, the reverse could be the case. The ways in which the global economic crisis is playing out in Russia might have quite the opposite effect. The Kremlin and the Russian White House might decide that it is in the long-term advantage of the federal-level ruling elite to allow “seepage” of power at this point in time. The federal authorities might decide to allow regional elites to reclaim some of the autonomy of local decision making that these elites are eager to reacquire. By doing so, Moscow would transfer a greater share of the blame to the regions, should economic conditions fail to right themselves, and better insulate the Kremlin from public displeasure.

However, it is very unlikely that the Kremlin will cede control over decisions in the area of strategic resource exploitation. In fact, the opposite should be expected. If regions gain more *de facto* or even *de jure* power in various fiscal matters, they will “pay” for this by having to cede even more control to the center in the decisions relating to how and who develops the major

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natural resources found in their territories. Putin, and those who support him, have struggled too hard for Russia to regain a global role to abandon the best bargaining chip that the Kremlin has been able to muster.