

# **PARTIAL REFORM EQUILIBRIUM AND ECONOMIC NATIONALISM IN PUTIN'S RUSSIA**

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Submitted to  
Central European University  
Department of Political Science

In partial fulfillment of the requirements for the degree of Master of Arts

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Budapest, Hungary

2011

## **Abstract**

The thesis focuses on the dynamics of the state-business power relations during Putin's presidency and the persistence of Hellman's concept of the Partial Reform Equilibrium, which was in a mutual benefit of the energy sector and the strengthened state. Consolidation of the Partial Reform Equilibrium seems to be related to economic nationalism, which provides popular legitimacy for Putin's system. The main outline for this study is given by the importance of the oil and gas sector, which has been in fact sustaining the development of the country. The analytical framework driving this study is based on historical institutionalism and the critical constructivist approach to economic nationalism. The research argues that the mutual compromise between business and state is based on economic nationalism, which is what maintains and reproduces the low level equilibrium.

## **Acknowledgements**

I would like to thank to Attila Fölsz for supervising my MA thesis, for overall guidance and very helpful comments on earlier drafts of this work.

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## Introduction

Russia plays an important role in regional as well as international politics. Its internal development can have number of external consequences – as for example the use of strategic resources. The post-communist transition of the country brought along numerous problems; unfinished reforms allowed large scale rent-seeking, which resulted in the emergence and persistence of Hellman's (1998) concept of the Partial Reform Equilibrium (PRE). PRE is a low level equilibrium that follows the first phase of sub-optimal reforms. Rapid privatization, together with weak institutional settings allowed the establishment of oligarchs and gave them a position to oppose those reforms that might have disvalued their rents. Continuing high scale corruption led to growing inequalities in the society where the few were in the possession of extreme wealth while the wide public was left in poverty (Black and Tarassova 2003, 272). Oligarchs, a closed group of former businessmen and members of former ruling elites, were believed to be buying and corrupting political and bureaucratic representatives, to be “capturing the state“, and thus pursuing their vested interests at the expense of the whole society (Hellman, Jones, and Kaufmann 2003).

Crucial changes went far beyond the economic reforms and inevitably required redefinitions of national identity, which went from identifications with the West to specific power configuration within Eurasia. These developments were reflected also in economic policies that were presented as being in the interest of the nation. The 1998 crisis and Vladimir Putin's ascendance to power marked a new stage in Russian transformation that was accompanied by changed perception of national identity of Russia as a Eurasian power, which was emerging from commercial and security interests (Tsygankov 2005). Putin presented his state building project of bureaucratic empowerment and re-nationalization in terms of national interests, which was supposed to change the power relations and lead to the shift from the

state to business capture. It seemed that the state gained its autonomy and the oligarchs became subjected to it, because under the label of national interests Putin managed to impose the state mandate over strategic industries (Desai 2007, 204). However, this power shift has not triggered further reforms and Putin's system maintained its stability by reproducing the former stage of Partial Reform Equilibrium. He took advantage of nationalistic policies and endorsed further the most striking issues of Russian post-communist transformation: corruption, state intervention, and specific treatment of strategic industries.

Even though the problem of Russian transformation is covered by a huge amount of literature, issues emerging by employing the framework of the Economic Nationalism were left behind. Economic nationalism encompass the complex set of relationship between political economy and national identity (Pickel 2005, 13) and therefore may offer important explanations of the Russian transition, regarding the fact that the Partial Reform Equilibrium is present even after Putin's project of state strengthening persisted. To research this outcome of transformation most conveniently, it is be useful to focus on the leading sector of the Russian economy, namely the energy sector. The fuel and energy sector has key importance for the Russian economy as well as for the country's international status. Therefore, the largest energy sector corporations are perceived as the "national champions". The significance of this industry for the economy is long dated; it was utilized for decades to maintain economic growth and consumer satisfaction in the USSR (Bradshaw 2010; Lane 1999; Sim 2008).

This thesis will focus on the role of economic nationalism in Russia during Putin's presidency and question why the reforms of the energy industry were left abandoned. The initial research question is: How did the fuel and gas sector contribute to the Partial Reform Equilibrium and what was the role of economic nationalism for legitimating policies leading to the persistence of the Partial Reform Equilibrium even during Putin's presidency? It will be

hypothesizing and discussing the main reasons behind the development that contributed to the emergence and persistence of the Partial Reform Equilibrium (which have various consequences - slowing development and failure to develop liberal economy). The following hypotheses reflect on the interconnections of PRE, strengthened state, and the role of economic nationalism:

*H1: PRE is maintained and further reproduced by the consolidation of the Russian state.*

*H2: The consolidation of PRE even by and with a reasserted state was particularly possible due to some legacies (e.g. historical legacies: Leninist legacies, communist heritage, imperialist Russian tradition of geopolitical power, and the strong state).*

*H3: Consolidation of PRE reflects a mutually beneficial compromise between the energy sector giants and the ever stronger nationalist state, which is based on and profits from economic nationalism.*

Hellman's (1998) conception of PRE claims that the early winners of the initial reforms are trying to maintain their interests by blocking further reforms. These activities are likely to result in the state capture. However, as the literature review indicates, the strengthened position of state has not introduced further reforms, neither consolidation of the institutions of market economy. Strangely, with Putin's attempts to strengthen the state and overcome the state capture, it seems that PRE persisted and the state actually managed to benefit from it (H1). To study the background and reasons of the consolidation of PRE by the strengthened state, it is important to reflect on the socio-cultural and historical settings, because considering the mainstream literature, it appears that relying just on the economic influences is not sufficient. Apparently, also the state strengthening process was based on the nationalist justifications (H2). However, the main focus of nationalist prescriptions was not aimed at

benefiting the nation, but at those closely bounded with the state. Some authors (e.g. Yakolev) argue that the strengthened state became dominant, which meant a shift from state capture to business capture by the state. Other authors (e.g. Myant and Drahokoupil) doubt the capacity of the state to engage in the business capture. Nevertheless, interactions of the state and interest groups created a complicated network of power relations. In fact, it gives the impression that the state-business interactions are to some extent guided by a mutually benefiting compromise between business and political elites, which allows them to preserve certain benefits. Therefore it is likely that, as Eichler (2005) expects, economic nationalism (in the terms of rhetoric and policy prescriptions) was used by the Russian elites to contribute to the perception of shared national identity, which allowed them to pursue their own interests (H3).

The thesis is divided into three chapters. The first chapter provides theoretical background that shows the actual state of the field and attempts to suggest its limitations. It reviews the theoretical literature on Partial Reform Equilibrium and critically approaches its application to the Russian development and reflects on the post-communist transformation in Russia. It also focuses on the different approaches to economic nationalism with an aim to provide a legitimacy tool to evaluate the changed perception of national identity. Based on the background literature and theoretical framework presented in this chapter, the hypotheses were derived and are elaborated on in the last section of the chapter.

The second chapter aims at analyzing whether Putin's state-building project influenced the outcome of the "reform" processes and the persistence of the Partial Reform Equilibrium. The (assumed) shift in state-business relations during Putin's presidency and the reasons behind this shift are outlined. Subsequently, the aim is to evaluate closer the kinds of policies that were used to shape the national identity and whether the slide to economic nationalism

and Putin's state-building project influenced the outcome of the reform processes and the persistence of the Partial Reform Equilibrium.

The final chapter discusses the changed power relations between business and state. The power shift is depicted on the case studies of YUKOS and Rosneft. The case studies reveal the effects and outcomes of partial Putin's partial renationalization and changes in the legislation. Further analysis demonstrates changed patterns in ownership (private, foreign and state shares) and how it is interrelated with the expressions of economic nationalism in regard to Eichler's (2005, 69) notion that national identity can be used as a "tool for legitimatization of the particular economic strategies of transformation." It shows that national identity has been used for political purposes and thus, as Abdelal (2005, 26) argues, it has reflected the economic and political tendencies of the leaders. Based on the attempts of the power holders to link economic prescriptions with national identity, in order to create legitimacy for the economic policies undertaken, it will be argued that economic nationalism is the outcome of the problematic Russian transition.

## ***Methodology***

Nationalism played an important role in the developing countries, and nationalist politics affected the institution building as well as reform processes. National identity was many times reinterpreted and reflected in changes in socio-cultural and economic settings. In this regard, to develop the theory, thesis focuses on literatures on economic nationalism and Partial Reform Equilibrium that were not sufficiently interconnected in the available literature, but their interconnection would bring important additional insight into the



development of the Russian Federation and show how the economic nationalism influences the persistence of Partial Reform Equilibrium.

Determinants of the economic nationalism were considered the independent variables and the occurrence of the PRE the dependent variable. Explanation of outcomes was assessed through the approach of political economy, constructivist perspective on economic nationalism, and historical institutionalism – in order to draw the relations and processes between the state and energy industry.

The thesis relies predominantly on qualitative methods, theoretical literature and empirical analyses. Quantitative research has supportive role, statistical data on the performance of Russian economy – specifically reflecting the oil sector performance – are used in order to support the arguments and provide additional explanations. The thesis operates with secondary data, which were gained from the statistical databases of the OECD, United Nations' UNCTAD STAT, CIS Statistics, Transparency International and the World Bank.

As a starting point of the research, theoretical literatures on the Russian transition, PRE, and economic nationalism were reviewed and out of this empirical puzzle, hypotheses were generated. Even though the Russian state seems to be the most important factor which is shaping policy outcomes, rationalist approaches are not well suited for this study. As the transition period faces a struggle of the past legacies and reform processes, the analysis will use the historical institutionalism approach to assess the transformation of the Russian state. Especially regarding the weakness of civic society in post-communist Russia, the dominant position of interest groups and the “verticality” of power, it is essential to reflect on the power structure and assume the ability of power relations to exercise some influence over the “constructions of reality”. Therefore the most suitable approach to study economic nationalism is the critical constructivist approach (Helleiner 2005, 231), which enables us to

take into the account dominant domestic elites and their role in constructing interpretation of national identity within the frame of particular national interests. The constructivist approach assumes that these constructions are produced and reproduced by the speech acts of the elites (Pedersen 2009) and therefore to better capture the integration of national identity and economic nationalism, the thesis based on the assumptions of critical constructivism on role of the elites analyzes the official discourse of the Russian government.

Regarding the practical restrictions, to capture the official discourse, the sampling method follows logics of Panov's (2010) research. Therefore the thesis analyzes Putin's annual speeches to the Federal Assembly (during his presidency, there are 8 speeches available). Speeches to the Federal Assembly are the best instances of the official Kremlin discourse and allow capturing the annual development or changes in political directions. They are carefully prepared by whole team of Kremlin experts and advisers and are the best to depict what is the image of the Russian nation (Panov 2010, 90). They represent a political discourse and it is generally agreed that political discourse is "primarily seen as a form of political action", that displays political process (Van Dijk 1997, 20). This analysis will be approached through interpretative techniques. Besides the structure of official discourse it is important to consider the choice of lexical items (that may seem as official criteria of decorum, but at the same time may be a means to manipulate public opinion or legitimate political power), selection and focus of the topic, framing and priming techniques, and syntax (use of pronouns: our vs. their, word order and underlying of specific meaning) (Van Dijk 1997, 25- 34).

Besides the discourse, national purposes can take the form of economic policies and measures. The analytical framework adjusted to study economic nationalism is distinguishing between the supply side and the demand side of the economic nationalism. The Russian government seems to be the driver of Russian nationalism. Therefore, analyzing its

standpoints and policies covers the supply side of economic nationalism. On the other hand, the demand side focuses on the societal support and the socio-economic base of the economic nationalism. It is briefly sketched based on the attitudes of society. Attitudinal dimension has been embraced by employing secondary data from surveys (VTSIOM, FOM).

In order to demonstrate the effects and outcomes of Putin's partial renationalization and changes in legislation, case studies of energy corporations were conducted. I chose the cases of YUKOS and Rosneft, because YUKOS case can serve as a most striking representative of the development of a privatized energy company and Rosneft can serve as an example of state owned companies. The analysis demonstrates changed patterns in ownership (private, foreign and state shares) and how it is interrelated with the expressions of economic nationalism in regard to Eichler's (2005, 69) notion that national identity can be used as a "tool for legitimatization of the particular economic strategies of transformation".

## Chapter 1: Theoretical Framework and Background Literature

In order to provide the background literature and identify the gaps and limitations of the theories and empirical knowledge on Russian state, its power and relations with the business sector, it is at first necessary to critically review the literature related to the state-business (power-) relations and economic nationalism in Russia and provide the theoretical framework for the thesis. As the literature review will indicate, there are various perceptions on the reasons for a power shift from business to state. The main focus will be on the main economic changes, the dynamics of the state, the capacity of the state institutions, and their interconnection with the economic nationalism. Subsequently, theoretical approaches to economic nationalism will be discussed in order to develop an operative framework to evaluate changed perceptions on Russian national identity throughout the transition era and to grasp the particular representations of national identity vis-à-vis Putin's "state-building" efforts and the persistence of the Partial Reform Equilibrium.

### ***1.1 Partial Reform Equilibrium, Business Capture, and State Capture***

As it was pointed out in the introduction, privatization gave rise to oligarchs. Notably, it was the loans for shares program (introduced in 1995) that provided them with the major boost, due to information asymmetry between the wide population and the group of insiders. Consequently, these insiders, technocrats from the previous regime, gained their wealth at nonmarket prices (Myant and Dahokoupil 2011, 146; Shih 2006, 3). Han (2005, 3) and many other authors (e.g. Black and Tarassova 2003) demonstrated that the weak state institutions posed a major constraint to reforms because they were unable to deal with strong interest

groups, like the oligarchs. Han (2005) hypothesized that the privatization and institutionalization allowed these interest groups to engage in large scale rent-seeking. Consequently, he assumed that the “privatized state weakens society and makes it unable to form strong collective action”. This implication seems to be derived from Hellman’s (1998) model of PRE.

The concept of the PRE supposes that the early winners of the initial reforms are the main obstacle for the continuation of the successful transformation. For the early winners of the initial reforms, maintaining the low level equilibrium is advantageous, as it allows rent-seeking and maximization of their rents, especially as proper institution building is lacking behind. Economic benefits are enjoyed by this narrow group on the expense of the general interest of early losers (Hellman 1998). Therefore the early winners are trying to block further reforms that might threaten their interests, which may subsequently result in the state capture. State capture is according to Hellman and Schankerman (2000, 553) “the extent to which the formulation of official laws, regulations or decrees is influenced, or vetted, by a narrow set of interest groups in the economy through the provision of benefits to politicians”. It can be considered as a form of grand corruption that is causing enormous social, economic, and political costs (Hellman and Kaufmann 2001). This outcome could be avoided by effective political competition, because the working political competition prevents short term winners from capturing the state (Hellman 1998).

The PRE concept follows a tradition in the literature that is concerned with the special small-sized interest groups which has a favorable position to affect policy outcomes for their benefit at the expense of the general interest of the majority. Within this tradition, Olson’s (1965 in Shih 2006, 21) assumptions are analogous with the conception of PRE, where on the one side stands Olson’s distributional coalition and the early winners who if having incentives are influencing introduction of policy changes, and the encompassing coalitions and the

interests of the majority, the early losers, on the other. As general society comprises the early losers of the initial reforms, it have a small influence over future changes since “groups such as consumers, taxpayers, the unemployed, and the poor do not have either the selective incentives or the small numbers needed to organize so they would be left out of the bargaining“ (Olson 1982, 37).

Han (2005, 4-5) assumed that as the rent-seekers were competing for their gains and power, they were not likely to take effective collective actions and therefore the state would eventually gain the autonomy and capacity to continue with the reforms – in the end, privatization was supposed to lead to higher state autonomy, although the validity of this claim seems questionable, especially regarding the economic crisis of 1998 (discussed later) preceding the changes. Moreover, various oligarchs were strongly linked with the state via regional governments, and some were strong enough to pursue their interest and veto reforms without engaging in collective actions.

Effects of privatization on the likelihood of government to implement further reforms were explored also by Hellman and Schankerman (2000, 555). They distinguished between low capture and high capture states. For the low captured they assumed, similarly to Han, that privatization would lead to better quality of governance. However, their research showed that there is no evidence for this argument in the high capture states, as was the Russian Federation. Therefore, it is crucial for analysts to take into account the level of state capture more precisely, in order to envisage the effect of privatization.

Research of Black and Tarassova (2003, 219) also does not support Han’s general argument of privatization leading to state autonomy that is then leading to further reforms. They argued that if privatization takes place under corrupted measures, it will undermine the political support for future economic reform. Consequently, the attempts to implement further economic reforms might become in the perception of the society correlated with fraud and

corruption. To be able to judge the effects of privatization and subsequent reforms, it is necessary to look at the broader picture to this problem area. Hellman and Kaufmann (2001) noted that external shocks and crises can play an important role in subverting the given political equilibrium behind the capture economy. The critical elections and mobilizing of the capture economy losers can also trigger further reforms. Regarding the Russian case, it is important to analyze the role of the 1998 crisis and the presidential elections in 2000. Concerning the elections, the role of the transformation losers provides an interesting case, because based on Hellman's earlier notion (1998) that losers do not use time to organize themselves, just elections are the way to influence the outcome of policies. Therefore an important question is whether their election participation could be considered as a crucial effect on triggering the changes connected with the 2000 elections. Seeing that, on the other side of the puzzle stands the question about the freedom of the elections in Russia.

Myagkov and Ordeshook (2008) pointed out increasing trend in manipulation of the turnouts in Russia. Their research showed that the distribution of turnouts of the national elections in Russia indicate their artificial augmentation. Hale (2011, 34) referred to this situation as „electoral patronal system“. Formally, the elections are regular and pluralistic, but as Evans (2011, 42-43) argued, after the first competitive elections held in 1993, democratic consolidation did not proceed further. Especially since 2000 the votes became skewed in favor of Putin's ruling party - United Russia. Since 2000 have been introduced tougher institutional measures (e.g. harsh registration requirements, threshold) that decreased transparency of elections (Mebade and Kalinin 2009, 1). Consequently, the country has moved towards greater authoritarianism rather than the democratic consolidation.<sup>1</sup> Ruling

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<sup>1</sup> The soviet style of “election results” with high frequency of 90-100% turnouts that creates an illusion of unanimity has returned. Neither Moscow that was under highest overview of international monitors avoided frauds. While the 2003 Duma electoral turnout seems to be normally distributed, in 2004 presidential elections were turnouts over 80% extremely frequent. But still, the most striking example is Tatarstan with 43 voting district where in 2004 reported 100% participation in 33 of the districts and in 24 of those 100% of votes was in favor of United Russia (Myagkov and Ordeshook 2008).

elites managed to “capture the votes” by diminishing any effective opposition forces, frauds, bribes, threats, patron client relations, restricted access of OSCE observers (Myagkov and Ordeshook 2008). Moreover, the ruling fraction around Putin managed to manipulate mass media, political parties, and public opinion is immense scope (Evans 2011, 43), United Russia gained the informational advantage that was reinforced by negative campaign against opponents (Mebade and Kalinin 2009). However as Wilson (2005, 266) noted, Putin has just perfection the techniques of “fixing elections”<sup>2</sup> that were already introduced in Russia in 1990s and have been widespread around other post-Soviet countries.

Ballot rigging restrained the possible influence of losers over the transformation path and basically preserved their diminished role. As the early losers encompassed the civil society the space for citizens’ action was even more restricted (Evans 2011, 45). Mobilization potential was low. Civil society is inevitable for democratic development as it introduces opportunities to learn how to organize collective will and is able to oppose unfavorable decrees of the government or the interest groups (Spencer 2010, 3-4)

The financial crisis of 1998 changed, according to Han (2005, 6-21), the power structure in the Russian Federation. Large banks, as the main rent-seekers of the 1990s, were replaced by the conglomerates and industrial capital. These changes had naturally consequences for the political economic system of the country. Han reasoned that even though the economic power of the oligarchs was not weakened, it is necessary to point out that the status quo of political and economic power of the state vs. the powerful business shifted from the bank sector to energy sector tycoons.

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<sup>2</sup> Wilson called it “virtual politics” which differs from totalitarianism; it works rather as system of managed democracy by Kremlin. Virtual politics maintains under condition that there “powerful but amoral elite” is present, “a passive electorate; a culture of information control; the lack of an external counterpoint” (Wilson 2005, 41).



Additional explanations of the business and state interactions were discussed by Yakolev (2006). For the period of the mid-1990s he agrees with the prevalent notion of the state capture model of Hellman, Jones and Kaufman (2003), but according to him it needs to be stressed that this model should be used for the analysis on the federal level only. Regional authorities, however, had lower possibilities to engage in rent-seeking and developed a business strategy of “free entrepreneurship”, keeping a distance from the state. From this perspective, it can be assumed that Putin’s effort for centralization brought restrictions of rights and fiscal resources of the regions and non-oligarchic business sectors and reinforced the federal control. Thereafter, Yakolev stressed that the 1998 crisis brought the need, shared by all economic agents, for macroeconomic stability. Stronger concentration of the market power led later to the reinforcement of the state’s position as well in the face of the big businesses. Introduction of extensive system of regulations started to infringe the interests of the largest companies and led to numerous conflicts (Yakolev 2006, 1033-54).

Myant and Dahokoupil (2011, 146) claimed that for Putin’s state-building project, the power of oligarchs needed to be restrained. State power was used against those not willing to comply. Thus, the state consolidation under insufficiently developed democratic institutions led to suppression and capture of business<sup>3</sup>, and Pointkovsky (2009, 52) claimed that property rights were subordinated to the loyalty to the Russian government. Losers of the transition benefited from the improved economic conditions after the crisis in 1998, but if one looks back at Helman’s model, there is again a situation in which the economic development is trapped in the low level equilibrium, due to lack of proper economic and democratic institutions.

Therefore, restrained power of the regions and improved economic conditions allowed Putin to enhance the power of the state and capture non-oligarchic businesses, but his

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<sup>3</sup> Business capture depicts situation in which the state manages to take control over businesses by unlawful measures and its influence over businesses exceeds the standard practices (U4 (n.d.)).

subjugation of the oligarchs seems to be unclear. Authors agree on the shift of power from the bank sector to the energy sector tycoons, but the power positioning of new oligarchs in the energy sector seems to have remained questionable. Strong financial support for campaign for presidential (2004) and parliamentary (2003) elections by the newly established oligarchs showed that the position of interest groups and the rent-seeking activities were not diminished (Yakolev 2006, 1034). The arguments of Black and Tarassova (2003, 222) went in same direction: they noted that the oligarchs have remained enormously powerful. Though, some examples indicated stronger position of state and a stronger demand of state to subordinate interest groups to its interests. Boris Berezovsky and Vladimir Gusinsky can be mentioned as a case in this point. Both after engaging in activities aimed against president Putin lost their power, wealth, and had to leave Russia.

Apparently, power relations and interactions of the state and business created a complicated network. But regarding the well-preserved position of oligarchs, the power shift from business to state needs to be reconsidered and analyzed more thoroughly. Thus to find out the reasons of the strengthened state, research needs to discover and embrace the interconnections between the shifts of power (business-state), pursue of (collective) oligarchic interests, and the improved state capacity. Improved state capacity may indicate the strengthening of institutions. Still, numerous researchers have been building their theories on Hellman's (1998) model of PRE, which assumes that the institution building process is in the transition countries often lags behind. Godoy and Stiglitz (2007) also highlighted institutions as an important factor, but they argued that the role of institutions for the proper development of the state had not been properly grasped by researchers (especially until 1997). They focused in their research on legal institutions. However, they did not demonstrate clearly why they constrained themselves just and especially on the legal institutions; encompassing other institutions of market economy might be desirable. Nevertheless, as Myant and Drahokoupil

(2011, 123) noted, the modern bureaucratic state apparatus has an important role in the maintenance of the detachment of the private and public spheres of influence with the aim to avoid power holders to use the state and its resources for private interests and enrichment. In the same manner, Black and Tarassova (2003) argued that particularly when considering the uncertain period of transition, institutions need to come first. But it was not properly specified which are the institutions that matter for successful transition, why it is so, what role they should play, and what the interrelation is among them.

The negative aspect for successful development of the institutions in Russia is that it has no strong liberal or democratic experience. Shevtsova (2010, 154) illustrated this disadvantage on the liberalizing attempts introduced by Gorbachev's perestroika. As these attempts for liberalization did not have any historical background, they were interpreted by Russian elites as unwanted processes that would lead to the collapse of the Russian Federation and thus tried to oppose any further liberalization. Mayant and Drahokopil (2011, 142-145) argued that the historically inherited institutional structure has a strong role in influencing the transformation, as state power depends on formal and informal rules and the institutions. Transformation in Russia was an example of immense problems with the consolidation of the state and political power.

Li-Chen Sim (2008) analyzed the role of business in the privatization of the oil industry and provided concrete case studies of Russian major oil enterprises. He accounted for the state as the most important factor shaping policy outcomes. For his analysis, he employed a rational choice institutionalism approach in order to analyze the interactions between agents and institutional parameters and then to explain various transition-related issues, including rent-seeking of oligarchs. But in rational choice institutionalism, the central goal is to discover the laws of political behavior and action (Steinmo 2001). For the countries in transition it might not be that clear which laws are actually in "operation"; therefore Sim's attempt to

employ the rational choice institutionalism might be problematic. There might be a conflict of past legacies and new efforts. Moreover formal change of laws does not necessarily lead to the change of the “real” functioning of institutions and one can hardly predict which laws are going to be changed and how is it going to influence the functioning of the institutions. Therefore, historical institutionalism approach seems to be more suitable to use for the explanation of the state in transformation, as it introduces the path analysis of the political outcomes.

## **1.2 Economic Nationalism**

There are various approaches that gained remarkable position in the International Political Economy (IPE) literature on economic nationalism. Difficulties with providing a clear definition of the nation, national identity, nationalism<sup>4</sup>, and subsequently of economic nationalism, allowed the rise of numerous conceptual quarrels. The most basic question that needs to be approached is whether the focus of economic nationalism is on the state or on the nation. As Crane (1998, 55) argues, the state may overlap with the nation, but state interests are not always expressions of the national identity.

According to Balaam and Veseth (2001, 28) a realist approach to economic nationalism sees the nation-state as the most important unit of sovereign political authority. Therefore, realist explanations are state-based and expect that the economic interstate

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<sup>4</sup> As the nation is a relatively contemporary phenomenon, it cannot be a “natural thing”, but rather a construction. Looking at the roots of nationalism in a country, there is a question on which base the term “nation” has been constructed. Whether the nation is “natural”, “primordial” - constructed on a belief in a common descent, or on the other hand whether it is creation of leaders and political elites (Brass 1994, 83). One of major signs of functioning nationalism is a symbolical language, through which is constructed the reality of the “nation”, as one of the basic categories influencing social life. By language is done classification of “nationality” (Vörös 2009, 79). Then, nationhood is not a social fact, rather a “contestable – and often contested – political claim” (Brubaker 1998, in Dral 2008). In general, in the conception of nationalism, nation and the nation-state are considered as key concepts. Its importance is rising especially based on its ability to account for a mobilization of wide masses (Alter 1991 in Strazay 2009, 160).

relations are competitive, with a direct link between successful pursuit of political power and economic wealth. This approach advocates the primacy of politics over economics; here the market should be dependent on the state interests and national security. National economic interests that are crucial for the survival of the state, such as defense and sufficiency of energy resources, should be achieved in a way that would avoid dependence on other states. For these reasons, the state can object to the foreign ownership of firms and adoption of protectionist measures in trade policies (Smith, El-Anis and Farrands 2011, 2). Simply to avoid the vulnerability of the national community, the state is supposed to turn economic activities to national advantage in regard to other economically dominant states. Therefore, this approach is pragmatically accepting state interventions in the economy (Crane 1998, 57).

For the research of the economic nationalism in Russia, where the economy is dominated by power relations, Putin's model of state strengthening, and the importance of the energy sector in terms of national security, one may argue that the realist approach to the economic nationalism is well suited and may be useful to explain specific features of the Russian transformation. However, realism can be seen as a purely statist ideology, concerned with state power and interests, and in fact, there is no nationalism in it. Abdelal (in Helleiner 2005, 221) argues that "statism is an expression of autonomous state with interests distinct from the society", while nationalism is an expression of constructed social identity and "is not equivalent to statism"...and therefore "national perspective to IPE ...cannot be equivalent to the realist perspective". Liberals would, according to Crane (1998, 58), agree with realists on the interconnections of economic nationalism as being part of state power and its interests in the economy, however would favor mutual gains from economic cooperation.

The main critique against the rationalist approach within the economic nationalism is according to Smith, El-Anis, and Farrands (2011, 5) the "objectiveness" of national interests. Policies that are presented as being designed on behalf of benefiting the interests of the nation

could in fact be easily favorable just for certain groups that are able to influence policy-makers.<sup>5</sup> Accordingly, as Helleiner (2005, 221) notes, the study of economic nationalism “involves examining how national identities and nationalism shape economic policies and processes”.<sup>6</sup> Currently, constructivism is one of the most influential critiques of realism. Constructivists object to realists’ purely materialistic view of the world, over which individuals have no control. They assume that reality is not „objective“, but rather “socially constructed”. Alexander Wendt (1999 in Gilpin 2001, 19) noted that the two main characteristics of constructivism are that (a) not the material forces, but the shared ideas are determining the human structures, and (b) consequently these shared ideas construct the identities and interests. Constructivism highlights the “role of ideas, social structures, and human volition in political affairs; people can construct a better political and more human universe than the one described by realists” (Gilpin 2001, 19-20).

Helleiner (2005, 220) pointed out that the constructivist approach to the study of IPE looks at interrelationships between identities and interests, and the “different ways in which identities can be linked causally to policy outcomes”. Similarly, Crane (1998, 75) sees economic nationalism in a sense of the construction of an imagined community, because economic life, in the same way as history or culture, is subjected to “interpretation and reinterpretation to serve abiding demand for collective identification”. Economic policy decisions do not have to be rooted just in economic settings, but may have socio-cultural background (Crane 1998, 56). Looking just at the body of policies can lead to improper

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<sup>5</sup> Such anti-liberal, and many times anti-democratic, measures are sometimes generalized to objections towards EN per se, regardless that these policies were not necessarily motivated by nationalist thought. This doubt is well expressed in liberal objection to the realist approach to EN, which is supposed to be just a “phrase to describe a wide variety of policies that challenge liberal economics, ranging from tariffs and quotas to restrictions on foreign investment and state subsidies for domestic industries” (Helleiner 2005, 221) and not policy aimed at benefiting the nation. However, EN is in the current debate understood as connected with nationalist content, rather than “protectionism” ideology. Therefore the term can be “associated with the wide varieties of policies, including economic liberal ones” (Helleiner 2005, 220). In Russia, as an example of liberal approach to EN, can be depicted Yeltsin’s rapid neoliberal shock therapy that was prescribed by the IMF because these concepts were fitting to Russian identification as a “Western nation” (Helleiner 2005, 223), as the liberalization process in Russia was connected with the perception of national identity and not the state purpose (Hall 2005, 120).

<sup>6</sup> But again, it remains problematic to approach the definition of the nation and nationalism.

conclusions. To approach the nationalist motivations one needs to study the background – history, culture, and the society.

Even though one can easily see in Russia the strong focus on the nation-state, power relations, and security (energy and military) would implicitly presuppose the utility of the realist approach to economic nationalism; however, the driving force behind is the manipulation of national identity. Therefore the solution of this conceptual struggle can be provided by the critical constructivist approach<sup>7</sup>. It is the most useful for this study, as it focuses on dominant domestic elites' role in promoting the particular conception of national identity that may be in line with their material interests and thus construction of national identity relies on specific power relations (Helleiner 2005, 231).

Eichler (2005, 41) suggested that the leaders of Russia used the national rhetoric in order to pursue their own interests. Therefore, as Abdelal (2005, 21-26) pointed out, nationalism refers to constructed societal identity, which foreshadows the purposes and direction for the economic policy of the government, which tends to present the policies in line with the attempts to “cultivate the nation” and by that allow for “economic sacrifices” in order to achieve societal goals.

Emerging from the previous points and based on Eichler (2005, 69), economic nationalism will be employed to “explore the relationship between political economy and national identity”, in order to capture all important aspects of Russian postcommunist transformation. Therefore, in this thesis economic nationalism will be approached as a conception based on the perception that national identities are constructed, in order to fit the frame of “national interest”, which can fit the material interest of the elites, but are powerful

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<sup>7</sup> This approach can provide with important explanations, because it is necessary to look for interpretations also outside of the mainstream framework. Price and Reus-Smit (1998 in Conteh-Morgan, 2005, 74) note that the „critical constructivist scholarship by Giddens, Habermas, or Foucault is more skeptical about this autonomy of ideas from power“. Power relations are important part in the constructions of reality and the specific powerful groups can play a determining role in the processes of social construction.

enough to symbolize popular sentiments that have power to join together citizens in a given state territory. By creating such collective sentiments, the nation will be more likely to bear the costs that are emerging from the need to achieve the goals/policies presented by politicians as leading in their final stage to the wellbeing of the nation. “National purposes” can take the form of economic policies, or a discourse that contributes to the perception of shared national identity, which then, as Abdelal (2005, 25) argues, makes the “society more willing to bear the economic costs of pursuing the long term goals that compose its identity”.

### ***1.3 Implications***

As the literature review indicates, most of the studies described are related to the period of the late 1990s and the early and mid 2000s; therefore there is an opportunity to look for their outcomes and consequences and to update their validity for Putin’s presidency. The main issues that emerged from this review are covering the reasons behind and the influences accounting for the changes in the relationship between the business and state. Therefore, what is important for future research are the interconnections between the business-to-state shift of power, carriage of (collective) oligarchic interests, and the widely questioned improvement of state capacity.

Hellman and Kaufmann (2001) noted in general the 1998 crisis, elections, mobilizing of losers and various other factors can be the push for further reforms and improving the efficiency of institutions. Subsequently, various other authors suggested that it was the crisis in 1998 that triggered the shift from the bank tycoons to the oligarchs in the energy sector. But how does the power shift within the business sector account for the state-business



relationship? Change in power structures within the main players of the economy does not directly imply the growing capacity of the state. The beginning of Putin's presidency was still characterized by state capture. By the end of his first term, the state was argued to have made the shift to dominate over big businesses. However, the campaigns for presidential (2004) and parliamentary (2003) elections were strongly supported by money from the oligarchs. Is it therefore justifiable to speak about the shift of power to the state? Authors addressed in this chapter assumed that the energy oligarchs seemed to be subordinated to the state. But did this subordination come about by the enhanced capacity of the Russian state to manage the economy or were there some different reasons for this shift? Putin's system has stabilized the state power, but the actual capacity of the state to engage into the business capture is not clear.

The review suggests that the economic nationalism can be understood in terms of explanation of the post-communist transformation that can be in Russia connected with the identity formulation. National identity has been subsequently used for political purposes and thus, in a way, reflected the economic and political tendencies of the leaders.<sup>8</sup> In the name of "national interest", society was simply more willing to bear the costs that brought policies driven by the material interest of the elite. However, "national interest" was closely tied to the interests of the elites and therefore cannot be viewed in idealist terms, as benefiting the general interest of the whole Russian nation, but as the interpretation of the business activities being framed in line with the nation's interests. Benefits emerging from the PRE were firstly skewed towards the bank sector oligarchs and later towards *silovarchs*, who gained their positions thanks to the 1998 crisis and Putin's restructuralization and therefore were closely bounded with the state. These conditions in Russia meant that the losers of the transition were left behind; just the state-business interactions mattered.

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<sup>8</sup> Yeltsin's early liberalizing reforms were followed by interpretation of Russia as part of the West. With the new constitution in 1993 took Yeltsin more nationalist and anti-western approach. Russian identity was depicted as a Eurasian great power. After the economic crisis of 1998, national identity was redefined in more economic terms and Putin fully articulated this approach by introducing his state-building model and interpretation of business activities in the nation's interests (Eichler 2005, 74-80).

## **Chapter 2: Putin's State-Building Project and the Influence of Legacies**

As it was noted in the Chapter 1, economic policy decisions are not emerging just from economic settings, but it is important to consider socio-cultural background as well. Policy outcomes, based on constructivist approach to the study of IPE, depend on the interrelations between identities and interests. Therefore to approach the motivations behind the economic nationalism one needs to study the background – history, culture, and the society.

Russia has always lacked real democratic experience, no influential opposition to the former regime has developed and consequently the radical break with the past system has not occurred. Former elites, having the information advantage, preserved their privileged positions. Subsequently, the pledged process of democratization and liberalizations lacked real incentives. Underdeveloped institutions and absence of civil society or a wide spread consensus on post-communist transformation resulted easily in consolidation of the position of various interest groups.

Influential interest groups, as the early winners of initial reforms, could use their wealth to corrupt the government to delay or block further reforms. Weak state institutions were not able to avoid rent-seeking and to deal with these interest groups and therefore became an additional constraint to reforms. Putin aimed at strengthening the capacity of the state. Strangely, Partial Reform Equilibrium was maintained also after power shifts in favor of the state that came with Putin's presidency.

In this chapter, historical institutionalism can help to approach the influence of the legacies on the policy outcomes. It brings crucial explanations on how Putin legitimizes his

own rule by referring to and relying on various legacies. Popular legacies are being used deliberately with an aim to use the support of losers for further consolidation of the system of PRE.

## ***2.1 Socialization Experience, Communist Heritage, Construction of History, and Democratic Consolidation***

After the collapse of the USSR, post-soviet leaders needed to face a number of challenges. Apart from the restructuralization of the economy, institutions, and politics, it was simply necessary to redefine the country's identity. As Russia lost its "empire" and international position, any of the historical identities were fitting properly. Yeltsin rushed to introduce radical reforms, which led to creation of the "post-imperial identity" and Russia perceived itself as a part of the West. Post-communist transformation did not have any "guidelines" to follow, thus the paths adopted were strongly contested by economic and political actors and the economic nationalism was used by both ruling elites to legitimize their policies and by the opposition forces to contest the course of economics. Putin's presidency confirmed the former redefinition of national identity that evolved in more economical terms. This interpretation appeared throughout the 1998 crisis and became really useful for Putin as it articulated the state building model (Eichler 2005, 69-80).

Putin's state-building project emerged from the conflicting situation in which Russia lost its former power position, but still aimed at sustaining the former greatness. Simply "Russia is too big and too ethnically diverse to be a normal, ethnically based nation-state; at the same time is not big enough and not powerful enough to control its backyard in the way classical empires do" (Krastev 2008). The mentality of past eras is an obstacle for the

development of the country, which needs to integrate to the international market in order to trigger its recovery (Durgin in Krastev 2008). Moreover, after the collapse of the previous regime, the institution building needed to be done “from the scratch”; there was no past experience that may serve as a basis. Therefore, people are likely to see the whole transition and democratization as a foreign import (Parrott 1997, 11).

The socialization experience under the communist rule established the legacies of corruption and authoritarian style of ruling. Putin simply built his legacy on this and followed these trends to sustain his popularity. As Shlapentokh's (2010, 57) research unveiled, “the Russians still had not accepted the disappearance of the USSR. Only one-quarter of them, contrary to the official propaganda in the 1990s, believed in the objective necessity of the event“. The socialization experience under the communist regime as well as development during the limited democratization led to the situation where even during the 2000s more than 70% of the population accepts the current regime that rose from and is “legitimated” by electoral frauds. Perception of possible change is top-down oriented (Spencer 2010, 279) as had happened in the early 1990s when the communist regime collapsed. The changes did not come from the society, but from above. Naturally, as there was no real dissident movement, that could have developed into opposition forces. Consequently, no significant change of the elites in the political and economic life took place.

Nostalgia in the Russian society has risen, especially in the last few years. Even though the “golden era” of the Russian past can be connected with many periods of history – from ancient Russ, through the imperial Russia, up to the Soviet Union – currently, the most appealing period that frames nostalgia is the symbolic stability and welfare of the 1970s, during the rule of Leonid Brezhnev (Lee 2011, 158-9). The appeal of this era was confirmed by various opinion polls (FOM in 2006, VTSIOM 2002...). According to the VTSIOM

survey of 2010 almost 70% of the population expressed positive feelings associated with the word “Soviet” (Lee 2011, 170).

Centralization of power, territorial expansionism, and messianic ideology caused that the state’s interests have traditionally taken priority over those of the individuals. As a result, the development of democratic traditions and civil society were restricted and thus the complicating reform/stagnation path may not be surprising (Shevstova 2010, 153). The history of secret police in Russia dates back to Peter the Great, but especially the spy mania of the 1930s created the legacy that prevented the public from expressing differing views. Moreover there was the unique approach of the Soviet Union of “feeding the society with lies” about all aspects of their lives. People were socialized into the deceptive culture of dual reality (Wilson 2005, 2, 8-9). Consequently, political culture in the country has deeply rooted archaic elements that are nowadays argued to be a restriction for successful development of civil society (Sakwa 2008, 206).

Historical development caused that the definition of what it means to be Russian was missing for centuries. Therefore after the collapse of communism, new elites needed to deal with the immature conceptions of belonging to the nation (Zevelev 2009). During Putin’s presidency, the Russian government aimed at the construction of a positive national identity that would unify the people around the regime. The main tool behind the construction was the use of the past and it was reflected in various symbolic systems that were emphasizing Russian values, its superiority, collectivism, a Eurasian mission. These attempts were supported in various areas, including legislation, education, the mass media... (Zvereva 2008 in Lee 2011, 173). Most of the TV channels broadcasting over the whole Russian Federation were in the 1990s owned by oligarchs. Later, during Putin’s presidency, they moved under the (direct or indirect) control of the government. Thanks to this control, the population was primed by the nationalist “advertising” with an aim to create and support “new Russian

identity”. In addition, to evoke the “golden era” Soviet movies, Soviet songs, and remakes of TV programs are frequently transmitted (Lee 201, 173) and right in the beginning of Putin’s first term, the former Soviet anthem (with modified text) was restored as a national anthem of the Russian federation.

Simply, the Soviet Union remained a highly popular institution (White 2010, 2). The Soviet system of the elections and the traditional form of government under a monopolistic control have been rooted deeply in the society. Communist legacies remained high also because no real change of political space took place. Russia did not manage to remove the communists and their political influence (Kobstein and Reilly in Evans 2011, 46). Strong identification with such past legacies creates an obstacle for liberalization and democratic reforms. They are easily manipulated in favor of the elites (or the early winners in general), for the consolidation of the system favorable for their rent-seeking activities. This allows long term consolidation of PRE which is actually supported by the society (losers). Consequently, as Evans (2011, 48) argues, partial and distorted reforms are in fact legitimized and institutionalized, which became fully evident during Putin’s presidency.

## ***2.2 Open Implementation of Selective Norms on Certain Businesses and Importance of the Energy Sector for Putin’s Project***

According to Goldman (2004, 431), “it is misleading if not impossible to write anything about the Russian economy without making oil the centerpiece“. Truly, the state of Russia’s natural resource base<sup>9</sup> is influencing the whole economy, particularly its oil and gas sector (Gaddy and Ickes, 2010). The oil and gas sector have historical importance for the

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<sup>9</sup> Russia is among top world’s producers and exporters of and the world’s largest gas exporter. It is estimated that the country possesses seventh largest share of the world’s proved oil reserves and with 23.42% of proved gas reserves is ranking as the first (Moe and Kryukov 2010, 312).

Russian economy and this sector has shaped Russia since the 19th century, when the oil in Baku was discovered (Gaddy and Ickes 2010, 282). In fact, its influence is not just the economic sector; it touches as well upon the security and foreign relations. It is argued, that also the war in Chechnya has the oil in its background. Except from having a considerable resource base is Chechnya situated on the important transport line.<sup>10</sup> Therefore, Russia is highly interested in keeping this federal republic and since the breakup of the Soviet Union has fought two wars in Chechnya. The second started in 1999 and Putin acted as its main architect (Said 2007, 130, 153).

Out of obvious advantages emerging from the strong natural resources base, the country's dependence on this sector means high vulnerability of the economy to the international market. In like manner, the research of Gaddy and Barry (in Thornton 2009, 2) shows that the volatility of oil revenues was one of the reasons behind the fall of the Soviet Union (Lane 1999). The development of Russia confirms that the economic dependence on oil and gas in most of the cases has a negative influence on the economy. Even though, the availability of natural resources can have an influence on growth and development, fixing on natural resources in Russia was not this case. Having stable income from oil and gas revenues, modernization and resource diversification was pushed aside and foreign completion was restricted (Thornton 2009, 5, 12). Consequently, the revenue dependent economy is highly vulnerable to the external shocks (Ahrend 2005, 560). Despite huge consequences that this oil and gas dependence<sup>11</sup> had already revealed, surprisingly it has not triggered extensive market reforms or restructuralization.

The allocation of rents was central to the economy in both Soviet and post-communist era. After the centrally planned pricing system of the Soviet era, the weakness of the

<sup>10</sup> Rosneft gained in the mid 1990s 51% of the Chechen oil company – Grozneft (Said 2007).

<sup>11</sup> Especially oil dependence, gas rents remained stable and supported the economic structure (Gaddy and Ickes 2005, 570).

institutions during the 1990s led to the informal rent sharing (Gaddy and Ickes 2005, 570). The 1998 economic crisis in Russia was largely due to the weak rent management system (RMS) which did not sustain the fall of oil prices (Gaddy and Ickes 2010, 298). Later, the RMS system became crucial element of the changes introduced by Putin. In fact, Putin's success was largely dependent on the oil revenues that were the motor of the economy, especially during 2000 and 2007, as the positive development on the international markets provided imaginary stability and control for the federal government (Thornton 2009, 3).

Putin's main focus was aimed at the economic and industrial policies, and state control over "strategic" sectors (BTI 2008) which was presented as an effort to meet national interests (Desai 2007, 203-4). His promise for greater stability and prosperity and for the end of national humiliation by rebuilding the power of Russia gained popularity among the masses (Nodia 2009, 34-6), because after the misery and instability of the 1990s' neoliberal reforms, people were nostalgic for the past and long for a strong hand. According to McFaul (2004) people were in the first place longing for more security. Therefore they easily accepted Putin's political changes leading to increased power of Kremlin, instead of more liberalization. They were promised greater security for rollback of some democratic freedoms.

In order to proceed with his "state-building project", Putin needed to tighten the power of the most influential oligarchs, who emerged shortly after the regime change from the bank and energy sector elites and who were believed to have connections to the major executive offices<sup>12</sup> (Myant and Drahoukoupil 2011, 146). Moreover, they were the main beneficiaries of the rents coming from the oil and gas sector. During the Putin era, oil prices skyrocketed and provided high revenues, which further enhanced their importance for the interest of the state. Putin managed to centralize energy revenues by invading property rights (Gaddy and Ickes 2005). He introduced the so called "Protection Racket System", with the main aim to sustain

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<sup>12</sup> So called "seven bankers": Berezovsky, Fridman/Aven, Gusinsky, Khodorkovsky, Potanin, Smolensky, Vinogradov.



the profit that the energy sector may bring to his regime. His adjustment of RMS was based on a “protection racket and a protection service” which in fact created a system of mutual advantage for the state and oligarchs (Gaddy and Ickes 2010, 300).

Putin’s mechanism was aimed at the conflicting relations among the oligarchs (here the owners of the country’s major resource industries) while restoring the capacity of the state to collect rents (Gaddy and Ickes 2010, 298). Simply, to control the country, Putin needed to gain control over the flow of resources and prevent them from being used for supporting power structures independent from the center (Gaddy and Ickes 2005, 571). The system was based on the creation of a monopoly control of financial information. Subsequently, the information collected by the state could be used against the oligarchs. Before, oligarchs were trying to gain the information on each other, but while heading various agencies Putin managed to collect all this information. In 1996, when he entered politics on the federal level, he used the collected information to make a deal with the oligarchs who were forced to accept his monopoly of the information. In exchange, they were allowed to keep their relative positions and sustain their earnings, as long as they followed the rules established by Putin, who by that introduced steps towards the centralization of the oil and gas rents. Simply, the idea behind these steps was that the state collects rents, and the oligarchs would stop trying to buy protection against the state (Gaddy and Ickes 2010, 299).

In May 2000, shortly after Putin’s accession, were the most influential tycoons forced to sign an informal agreement, so called “*shashlik* agreement” of mutual non-interference. This step was aimed at restraining businessmen from engaging into the politics. This approach was not successful in all instances. Nevertheless, political strategy for state-building needed to restrain power of those not willing to comply (Myant and Dahokoupil 2011, 151). Property rights were used by the government to threaten the oligarchs (as had happened to Berezovsky, Gusinsky, and Khodorkovsky) and to force them to invest in the development of the energy

sector (Gaddy and Ickes 2005, 571). However, implementation of the norms was more or less selective, because widespread corruption remained, as well as an extensive shadow economy, and the judiciary capture by the executive branch remained also vulnerable to various interest groups (BTI 2008).

The most striking demonstration of Putin's selective policies was the YUKOS affair<sup>13</sup>. As a result, Mikhail Khorodkovsky served as an example of state power effect against those not willing to comply; it was a demonstration of the selectively targeted charges against those acting against "state interests". It confirmed that "private enterprises could amass vast fortunes only as long as the state allowed them to" (Myant and Drahokoupil 2011, 158). Except for the implementation of selective measures, this example shows also the importance of the energy sector for Putin's state building project.

Afterward, an increased involvement of the state in the economy was operated mostly by introducing so called "state oligarchs", who were coming predominantly from the *siloviki*<sup>14</sup> background. These steps made the power of the oligarchic group much more diffused and less problematic to the state. It did not mean that the state became dominant over business, but the two became more interdependent (Myant and Drahokoupil 2011, 147). However, it is argued that Putin aimed to rebuild "Moscow's lost empire", in the main, by controlling the key energy resources (Szwedo 2010, 58). The power of the *siloviki* clearly rose with Putin. In the middle of 2004, they constituted 25% of the ruling elites and also more than half of Putin's "close circle" were people with the *siloviki* background (Dunlop 2005, 2). Similarly, they were placed in leading positions in energy companies under the heading of the protection of national interests in order to gain control over strategic resources (Nygren 2008, 3-4) The

<sup>13</sup> Further details provided in the YUKOS case study (see 3.2).

<sup>14</sup> The name comes from "*silovye ministerstva*" (power ministries), which had roots in the centralized Soviet apparatus. Thus, *siloviki* are the veterans from the security service and law enforcement who became the core of Putin's administration and served in many corporations' boards by which they emerged in the new political and economic order (Treisman 2007).

“property redistribution” shift in favor of Putin’s *siloviki* (Sim 2008, 68) allowed the strengthened control of the state over the economy. Based on the calculations of Olga Kryshtanovskaya (in Goldman 2004, 434), a specialist on elite studies at the Russian Academy of Sciences, by the end of Putin’s first term in office about three-quarters of his senior staff had *siloviki* background.

Especially from 2003, the governmental control over “strategic” firms was extended and the constraints on foreign participation in the energy sector became larger (Thornton 2009, 13). As Table 1 indicates, domestically tax and regulatory authoritative measures were used to renationalize assets of numerous companies (also the ones with foreign share holders Kovykta and Sachalin-2). The state-controlled companies have been advanced to purchase the stakes of important private companies. Consequently, the state controlled in 2007 about 40% of the stock market capitalization in Russia, compared to only 24% in 2004 (Estimates by Troika Dialog in Sprenger (n.d.)). In other cases, the state’s interests were pushed forward by Kremlin insiders (Thornton 2009, 33). As a result, Gazprom is currently in control of more than 65% of Russian gas reserves directly, and even more if we take into account joint ventures with other companies. In 2010 the company accounted for 90% of the total natural gas output in Russia, while independent producers in the energy sector remained limited, especially thanks to the legal underpinning helping Gazprom to maintain its monopoly in the market (EIA, 2010).

**Table 1: Major state acquisitions in the energy sector:**

<b>Year</b>	<b>Company</b>	<b>Buyer / percentage of stakes</b>
2000	Selkupneftegaz	Rosneft
2003	Severnaya Neft	Rosneft
2003	Veninsky bl. (Sakhalin-3)	Rosneft
2004	Tuaspe oil refinery	Rosneft purchased 40%
2004	Yuganskneftegaz	Rosneft purchased 76,8%
2005	Tambeyneftegaz	Gazprombank purchased 25%
2005	Northgas	Gazprom took over 51%
2005	Gazprom	Rosneftegaz gained 11% (direct stake exceeded 50%)
2005	Selkupneftegaz	Rosneft purchased 34%
2005	Sibneft	Gazprom gained 70%
2005	Verkhnechonskneftegaz	Rosneft purchased 25.9%
2006	Udmurtneft	Rosneft acquired 51%
2006	Sibneftegaz	Gazprombank purchased 51%
2006	Novatek	Gazprom purchased almost 20%
2006	Sachalin 2	Gazprom was provided with 51%
2007	Samaraneftegaz	Rosneft
2007	East Siberian Oil and Gas Company	Rosneft
2007	Tomskneft	Rosneft acquired 50%

source: Bradshaw (2010), OECD (2006), Rosneft (2008)

### **2.3 Diminishing Power of the Regions**

Except for dispersing the oligarchic power, Putin attempted to establish central power over the regions that gained a powerful position during Yeltsin's presidency. Diminishing the power of regions actually played a central role in the consolidation of the state (Myant and Drahokoupil 2011, 148, 155). In fact, by removing governors from power Putin aimed at restricting oligarchs' influence. It means that the informal rents-sharing was moved from the regional to federal level (Gaddy and Ickes 2005, 571).

Until 2002 regions largely profited from the oil and gas revenues. Taxes on mining operations were divided between regions and the federal government favorably for gas and oil producing regions. 60% of the taxes remained in the budgets of these areas (39 billion rubles in 2001) and 40% was transferred to the federal budget (26 billion rubles in 2001). This

situation created large revenue disparities between the regions, especially visible with the rise of oil and gas prices during Putin's era. It provided the federal government with an additional argument to change this situation.<sup>15</sup> Consequently, in 2002 the federal government introduced a change in the mining tax sharing ratio between the central authority and the regions in its favor. The budgetary revenues of oil- and gas-producing regions fell from 60% to 20%; in 2003, the share declined even more - to 15%, in 2005 to 5%, and by 2010 became 0%. In 2002 the federal government set up as part of the federal budget a Stabilization Fund, which was funded from oil revenues (15% of current revenues acquired by state were directed to the Stabilization Fund, 55% to the federal budget and 30% to sub-national budgets). Moreover, starting in 2004, tax revenues from natural gas production have benefited merely the federal budget (Kurlyandskaya 2007).

Subsequently, in order to distance business from politics at the regional level, Putin decided to implement a number of policies and also some other areas were reformed (for example, the system of taxation and licensing). This change was aimed at depriving the regional governors and large corporations of the means of potential political manipulation (Chebankova 2010, 25). Many uncooperative groups were simply removed, often through criminal investigations or by applying coercive powers of central authorities (Volkov 2002 in Myant and Drahokoupil 2011, 151).

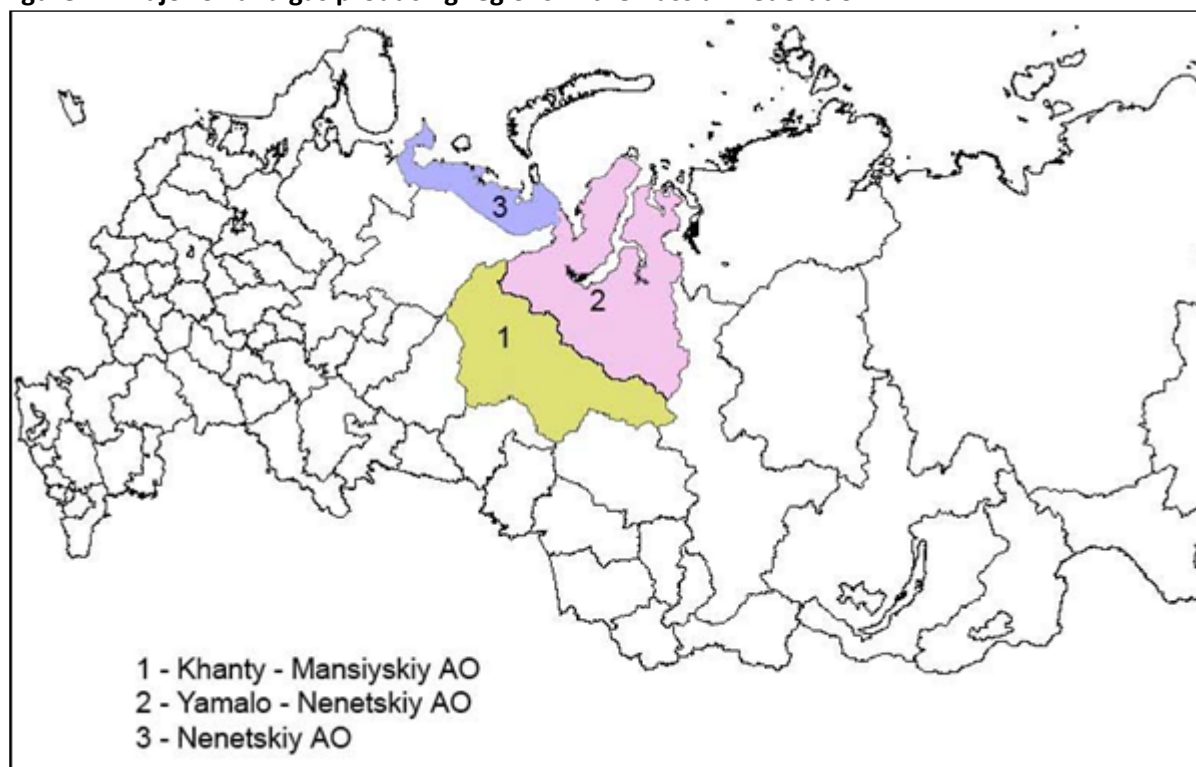
Regional reform was aimed to subordinate the regions to the state power; regions were basically eliminated from political life and so enforced the vertical power control (Myant and Drahokoupil 2011, 156). This transformation of the power structure has passed as respective regions are relatively small and without strong internal links which would allow them to engage in a collective action against the federal power. Moreover, the Figure 1 indicates, the three most important oil and gas producing regions are concentrated in one part of the

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<sup>15</sup> Therefore, officially the renationalization was interpreted in terms of distributive justice, as just few regions (for the three major, see Figure 1) were gaining disproportional wealth.

Federation, and so was true for the revenues from mining. The major oil and gas producing areas are just few, but thanks to the oil and gas rents enjoyed compared to other regions an advanced position, and therefore have not been able to resist federal push for centralization. Shift was backed up by the dominant position of Putin's ruling party and was enabled by the Constitution (Kurlyandskaya, Pokatovich, and Subbotin 2010, 6).

**Figure 1: Major oil and gas producing regions in the Russian Federation**



*Source: Kurlyandskaya (2007)*

Changed power structure between the two entities was supposed to be strengthened by the introduction of various institutions and new laws. Special importance has the reformulation of the regional election laws. It was introduced with an aim to restrict the business-political electoral collaboration (Chebankova 2010, 26). The electoral law was titled “on the main guarantees of the electoral rights and participation of citizens of the Russian Federation in a referendum” (Myant and Drahokoupil 2011, 156) and basically it served Putin's efforts to abolish direct elections for regional governors. After the reformulation, governors are nominated by the president, and regional parliaments have just the role of

“approving” the nomination, but the assembly needed to be careful with not approving the candidate, because in case they voted twice against the presidential nominee, then a month-long consultation period was introduced. After this period, the president presents a new nominee, appoints a temporary nominee, or dissolves the assembly. If the president presents a new nominee, and the nominee is rejected for a third time, the president could simply dissolve the assembly without any further negotiations (EIU 2008, 9).

## **2.4 Strong State and National Identity**

Wilson notes that it was not just the legacy of the Soviet era, but also aspects of all-Russian culture that created cultural preconditions for the present situation: “Russians are used to venerating the state, but also to placing it at a distance, on a pedestal. They are therefore also used to an indistinct image of power, and to coping with the plasticity or viscosity of power” (Wilson 2005, 35). State-centered view of national development and top down introduction of national identity is based on the long tradition of messianism that has a power to turn myths into political program (Sakwa 2008, 203-6).

### **2.4.1 Definitions and Redefinitions of Russian National Identity: Economic Nationalism under the state’s baton**

During the postcommunist transformation, economic nationalism provided a tool to the ruling elites to legitimize their policies. On the other hand, it proved to be a useful discourse of the opposition forces, which helped to challenge the development of Russia. In the early years of economic transformation, Russia undertook radical liberalizing domestic reforms and the interpretation of economic nationalism was linked to pro-Western definition

of national identity. Crucial changes went far beyond the economic reforms and necessarily required additional redefinition of national identity - from identifications with the West to specific power configuration within Eurasia. These developments were necessarily reflected in economic policies and led to redefinitions of economic nationalism's meanings. In 1997/1998, redefinition of Russian national identity turned to more economic terms. It was followed by a desire to integrate the country into the global economy. This approach was fully articulated under Putin, as he introduced his state-building project and stressed traditional nationalist themes (Eichler 2005).

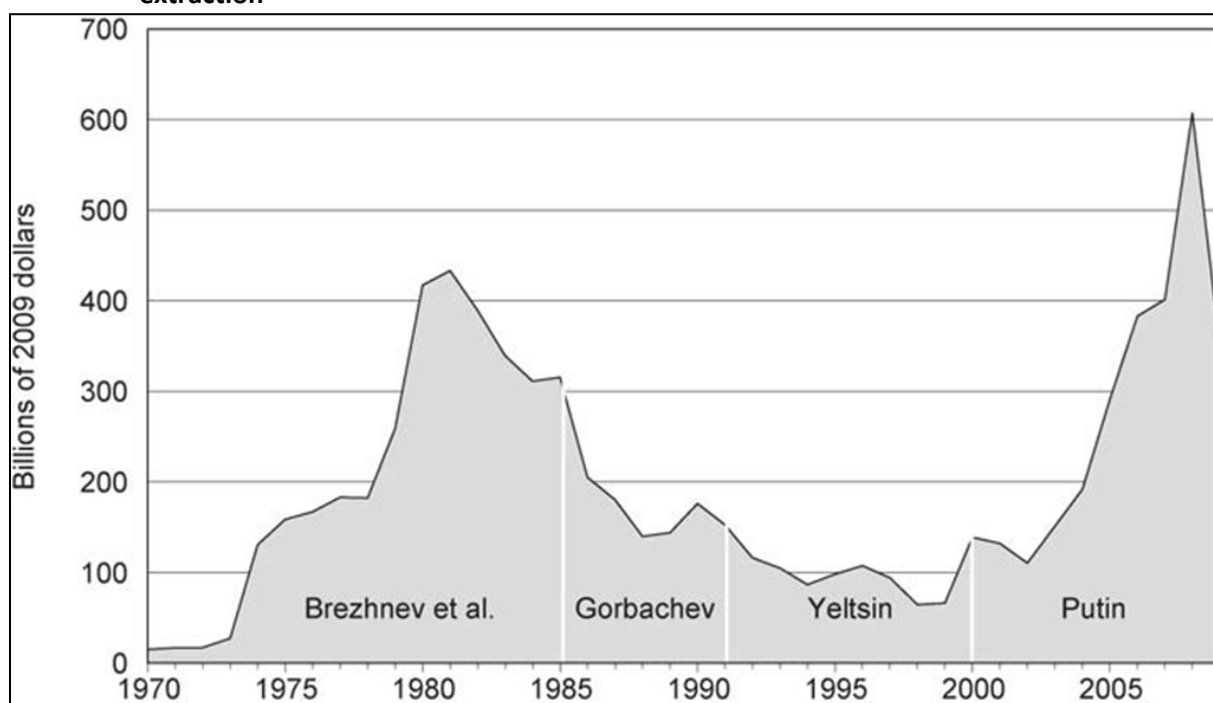
After Putin ascended to power, the state-business relations changed, but it did not mean a shift in favor of the interests of the nation even though it seemed that the state gained its autonomy and the oligarchs became subjected to it. Putin managed to impose the mandate of the state over the strategic industries, under the label of national interests (Desai 2007, 204), but he took advantage of nationalistic policies and endorsed further the most striking issues of Russian post-communist transformation: problematic privatization, keeping specific industries under governmental control, and specific treatment of strategic industries. Still, various opinion polls confirmed the success of his reinterpretations in the wide public. In 1997 over 70% of VTSION poll respondents agreed that "Russia is a special country alien to the West and in 2001 71% believed that Russia belongs to Eurasian Orthodox civilization and therefore cannot follow the West in its development" (Paschenko 2000 and VTSIOM 2001 in Tsygankov 2005, 57).

For Putin, nationalist policies in the energy sector played significant role (Desai 2008). Actually, based on the importance of the oil sector for the development of Russia, an additional explanation based on the correlation of the profitability of this sector and interpretation of the national identity is possible. Based on Gaddy's and Ickes' research (2010) it can be assumed, as Figure 2 on the oil and gas rents from 1970 to 2010 indicates,



that oil prices are interconnected with the political economy and policy track that Russia undertakes, which consequently influences the interpretation of national identity. As the graph illustrates, the peak prices were recorded during Brezhnev's and Putin's era. These regimes represented a strong stance (against the West) and expansionism. On the other hand, Gorbachev and Yeltsin faced the fall of prices and their politics was more "friendly" to the West and the national identity was framed as being connected with the West.

**Figure 2: Oil and gas rents calculated as quantity produced times market price less cost of extraction**



Source: calculations of Gaddy and Ickes (2010, 283), based on secondary resources.

Simply, the energy resources became during Putin's era a new "gold reserve", bringing welfare and the lost status of "Great Power" back to Russia. Policies implemented were aimed to keep foreign investors out and support the network of Putin's *silovarchs*<sup>16</sup>, under the official statements of the protection of the strategic national resources (Nygren 2008, 4). They were the interpretations of business activities presented in line with the nation's interests, but in reality did not aim at benefiting the Russian nation. This situation

<sup>16</sup> *Silovarchy*, according to Treisman (2007), refers to connection of *siloviki* with oligarchy.

resulted in the long-term persistence of PRE, in which the primary skew of benefits towards the interest of the oligarchs moved more towards Putin and his *silovarchs*, instead of benefiting the Russian society as a whole.

This outcome has been partly possible, as belonging to a country is an important part of an individual's identity (Desai 2007, 191) and as old reflexes of subordination and authoritarian tendencies in politics seem to remain (Rosefielde 2005), what led to the passive acceptance of the state's prescriptions. Moreover, Putin managed to gain wide support for his policies on behalf of his promise to make the country more stable, make the society prosperous, and end the "national humiliation"<sup>17</sup> that the Russian nation was facing during last decades (Nodia 2009, 35-6).

## 2.4.2 Economic Nationalism as a Means to Strengthen the State

As the first chapter indicates, the critical constructivist approach to the study of IPE is the most suitable one to see how economic nationalism shapes the economic policies as it reflects specific power relations. It considers the role of the dominant domestic elites in re-constructing the conception of national identity that may reflect their own interests. By framing the policies as the attempts to "cultivate the nation" they create an environment in which the society accepts "economic sacrifices" in the name of the nation. This social phenomenon was reinforced by emphasis on the shared legacies which provided the backbone for Putin's conception of a shared Russian national identity.

To analyze the application of the economic nationalism in support of some economic prescriptions, it will be useful to present a discourse analysis of the official discourse of the

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<sup>17</sup> That was supposed to be achieved by winning the war in Chechnya (at all costs), but it also implied a more assertive policy in the "near abroad" and beyond and most importantly it meant questioning the moral authority of the West (Nodia 2009, 36). Therefore in sum, it meant bringing back the greatness of the Russian nation.

Russian government. Based on the role of dominant domestic elites in the critical constructivist approach, in Russian settings it seems that the government is the driver of Russian nationalism and provides the supply side of economic nationalism. To capture the official discourse, I will follow the logic introduced in Panov's (2010) research and analyze Putin's annual speeches to the Federal Assembly<sup>18</sup>. Annual Addresses to the Federal Assembly are representation of the official stance of the Russian government as they are not prepared simply by the president, who is anyway the dominant player within the executive structure, but by a team of Kremlin analysts and need to be representative of the official Kremlin discourse.

The first crucial topic that is relevant for this analysis that played a dominant role in the addresses during whole Putin's presidency is the state building and the strengthening of vertical power. Another important topic, which is in fact helping to better understand the value the "strong" Russian state has, is the national identity underpinned by Russian culture and the shared values of Russian nation.

Putin was frequently using the notion of strong state in his addresses. It was amplified at most during the first years of his presidency: 5 times in 2000 and 6 times in 2003. In his 2000 Address to the Federal Assembly, Putin highlighted the need to strengthen the state as the main priority. Because, "if Russia remains weak... [it will have] to rely on others' advice, aid and loans." Protection of national (economic) autonomy<sup>19</sup> is one of the main issues for EN, and in order to achieve this target, it is necessary to make Russia "strong". "Only a strong,<sup>20</sup> or effective if someone dislikes the word 'strong', an effective state and a democratic state is capable of protecting civil, political and economic freedoms, capable of

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<sup>18</sup> References in this section are from the Annual Addresses to the Federal Assembly of the Russian Federation (2000-2007) and can be accessed from:

[http://archive.kremlin.ru/eng/sdocs/speeches.shtml?date\\_to=2008/05/06&stype=70029](http://archive.kremlin.ru/eng/sdocs/speeches.shtml?date_to=2008/05/06&stype=70029).

<sup>19</sup> Smith (2001, 25) stressed three components of nationalism: autonomy, unity, and identity.

<sup>20</sup> In 2001 Putin put emphasize on "effective" rather than "strong" state. He used "strong state" just once and it was in connection with his last year speech.

creating conditions for people to lead happy lives and for our country to flourish.” Putin reasoned that “ineffective state is the main reason for the long and deep economic crisis”. He thought that this problem came about because of the decentralized position of the regions, he said that “separate “islands” of power” have been created” (President of Russia 2000) what is undermining the idea of unity. But national unity is closely linked to economic sphere and preconditions the strong nation as it is one of the building blocks of nationalism (Smith 2001, 25). “The centre and the territories, regional and local authorities are still competing among each other, competing for power.” It created a power vacuum in which the “state functions [are] being seized by private corporations and clans”. Therefore, “federal power and the Russian President should have the legal ability to establish order here. And regional leaders should have the right to influence local power bodies if they make unconstitutional decisions and infringe on citizens’ rights” (President of Russia 2000).

Strong Russia, in Putin’s perception, does not mean just centralization of power, development of the country or economic strength, but also its international position. As it was noted earlier, with Putin in the Kremlin, the interpretation of national identity reflected Russia as a unique regional power. This idea was closely developed in his 2002 Address. Strong Russia was regarded as a precondition for the improved international stance of the country. “Russia needs to be strong and competitive” in order to gain political and economic influence (President of Russia 2002). Thanks to this relentless stance of the federal government, the first results came in the mining and extraction sector, which thanks to its high rents, had the primary importance for the regime. Putin stressed that “this result did not just come about all on its own, but is the result of carefully planned action by the state” (President of Russia 2006).

National identity appears to be closely linked with economic nationalism (Crane 1998). Putin repeatedly stressed the importance of shared national values (2000, 2003, and

2008). He reasoned that the common values are the “values which join us and allow us to call ourselves a single people”. He developed this idea further and stated that “the unity of Russia is strengthened by the patriotism inherent in our people, by cultural traditions and common historic memory” (President of Russia 2000). Based on the popular appeal of historical legacies and nostalgia for the Soviet era, Putin acknowledged “that the collapse of the Soviet Union was a major geopolitical disaster of the century. As for the Russian nation, it became a genuine drama. Tens of millions of our co-citizens and compatriots found themselves outside Russian territory“ (President of Russia 2005).

In 2003 he praised the Russian people for accomplishing “a truly historical feat, a great work performed in the name of our country’s integrity and in the name of bringing it peace and a stable life. Maintaining a state spread over such a vast territory and preserving a unique community of peoples while keeping up a strong presence on the international stage is not just an immense labor, it is also a task that has cost our people untold victims and sacrifice” (President of Russia 2003). Simply, in line with economic nationalism, the nation needs to bear the “economic sacrifices” in order to achieve the great societal goals.

As the attitudes of the society indicate, noted in previous sections, possible influence of the demand side of economic nationalism seems to be insignificant. People did not feel that the change can come from bellow, they resigned to the politics. It is not likely that the people trapped in nostalgia would initiate the “internal realignment” of national identity (Smith 2001, 20). In the harsh times of economic transformation, they value “ethno-symbolic” legacies of the great past and the strong state providing them the stability.

### **Chapter 3: State – Business Compromise and the Role of Economic Nationalism**

Regardless of the high corruption and bad investment environment, Russia was growing rapidly during 2000-2008. This development may be surprising, as well as the consensual relationship between the state and business tycoons, especially because of the fact that the rents which were fuelling growth were moved under the control of the state from the interest groups. Therefore the following sections are oriented toward the effects and outcomes of Putin's partial renationalization and changes in the legislation. Case studies of YUKOS and Rosneft demonstrate changed patterns in ownership (private, foreign and state shares) and subsequently how it is interrelated with the expressions of economic nationalism in regard to Eichler's (2005, 69) notion that national identity can be used as a "tool for legitimatization of the particular economic strategies of transformation". Case studies are approached through historical institutionalism approach with an aim to facilitate findings and explanations of the policy outcomes.

The era of the Putin's presidency shows that the private and state interests can meet and it can be in the interest of business groups to support the state. Strong state can also benefit business and various private actors. Even though, their actions are limited now (e.g. they need to pay taxes), but if they can use the state to support their business interest and gain benefits, then the strong state could be in their interest. Thus, private interests provide favors by granting some resources to the governing elites/state and receive back some support for their business. Accordingly, there can be a new collusion of some private and state interests leading to the persistence of the Partial Reform Equilibrium, and economic nationalism then became the manifestation and the tool of the strong state.

### ***3.1 Strengthened State and the State-business Relations: State over the Business Influence or Mutually Benefiting Compromise?***

The mainstream literature presumes that with Putin's presidency, the state capture of the Yeltsin era was replaced by the business capture. The state consolidated its power and overtook business. Contrary to this perception, Myant and Drahokoupil (2011, 151- 52) have recently introduced their position that neither state capture nor business capture defines adequately the situation in Russia during Putin's presidency. They believe that it was so because there were limits of the state's actual capacity to engage in business capture.

Truly, Putin's state strengthening was not developed along a democratic direction. The state gathered some of its functions, but bureaucracy was not reformed and institution building process did not take place. In addition, the state maintained the "capture" of the legal system. The presidential system during the Putin era was often informally referred to as "super-presidency", as it was granting strong positions to the president. For instance Putin introduced number of laws without consulting the parliament, through presidential decrees and the judicial system was responding to the president. Therefore, his state building approach allowed consolidating the partial reform equilibrium.

The notion of strengthened state seems especially accurate, if put into wider settings, in comparison with the collapse and disintegration of the state during Yeltsin's era. But, once again, the institutional environment is weak, corruption is high and the influence of some interest groups is large, and therefore it is impossible to speak about democratic consolidation of state power, but one should rather talk about authoritative strengthening. Particularly as the civil society, free media and elections, rule of law, and independent judicial branch are missing. Therefore, one may argue that Putin's perception of the strong state is far from the democratic state enforcement, but it is rather about the centralization of authority and resulted

in the increased capacity of the state to contest business – based in diminished property rights, criminalization, persecutions, coercive powers (*siloviki*)... But, without introducing further democratization the Russian society will remain in the position of the loser of the transformation process. Even though, raising oil prices and the changes connected with the 1998 crisis led to the strong increase in domestic demand (OECD 2009, 3) which triggered economic growth, strong increase of productivity and real wages, sharp fall of unemployment and poverty rates, people still, as the early losers, had to bore the cost of consolidated PRE.

Returning to the Hellman's (1998) conceptions of early winners and early losers, it appears that the early losers remained the same, but there was a shift in power structures and the early winners changed.<sup>21</sup> Thus the initial state capture of the 1990s was overcome, but strengthening the state did not diminish the power of the business in general. As it was noted, the greatest oligarchs of Yeltsin's era lost their dominant standing, but Putin's era introduced a new business elite. In contrast, these new elites, the so called *siloviki/silovarchs*, were closely linked to the state. The state, in the end managed to reinforce its position, but as it was noted, it did not lead to democratic transition. Similarly, Aslund (2007 in Thornton 2009, 6) argued that Putin's state model is a model of so called "state capitalism", which is based on various implicit taxations and subsidies<sup>22</sup>. However, as business in general preserved its capacity to pursue vested interest and lobbying regardless of any official efforts to strengthen state, Myant and Drahokoupil (2011) are probably right rejecting the emergence of the business capture. Similarly, as Chebankova noted, implementation of laws and policies, as well as the business and state relationship remained predominantly in its informal channels. Interest and lobby groups were well established in both chambers of the parliament (Chebankova 2010, 42- 43). But state consolidation meant that the business groups lost their

<sup>21</sup> But based on socialization experience problem is that people are used to the authoritative rule.

<sup>22</sup> e-g. Putin required Abramovitz to subsidize Chukhotka.



dominant position. For maintaining their stakes, business needed to some extent sustain its cooperation with the Kremlin.

As Table 2 on the Corruption perception index<sup>23</sup> in Russia during Putin's Presidency shows, the perception of corruption raised with Putin's "state-building" policies. His steps led, among others, to insecure property rights and weak institutions, which triggered resource dependence and corruption. North and Baumol (in Esrin, Aidis, and Micjiewicz 2007, 3-4) stress the importance of institutional settings for the development of the business environment. Russian weak institutional settings allowed the prevalence of making business "po znakomstvu", which means that acquaintances and connections are the way of doing business. The worsening environment could indicate that the strengthening of state led to the business capture, but at the same time one can make a similar line of argument that it represents the state-business compromise. This corrupted environment could have been an advantage to both entities.

**Table 2: Corruption perception index in Russia during Putin's Presidency**

	2000	2001	2002	2003	2004	2005	2006	2007	2008
CPI	X	x	X	2.7	2.7	2.8	2.4	2.5	2.3

• where 10 is the best score

source: TI

Even though, informal state coercion and informal way of conducting politics prevails in Russia and institutions remain weak, it is important to take into account that already during the first term of Putin's presidency, a wide range of institutions for functional co-operation between business and politics at the national level were established, e.g. Council of Entrepreneurship, Russian Union of Industrialists and Entrepreneurs; the Delovaya Rossiya association; and the Union of Russia's Entrepreneurial Organizations (Chebankova 2010, 42).

<sup>23</sup> Even though corruption is difficult to measure, index provides reference on the situation in the various countries and reflects on their accountability.

They may serve as a basis for improving the institutional cooperation between state and business. However, as Roland (2006 in Chebankova 2010, 26) argues, there is little chance for dramatic improvement in the near future and it is so, as Thornton points out (2009, 34), because of institutions prolonging some of the worst features of the previous command system and so their centralization led to the creation of settings that are incapable of the efficient administration of a larger economy (Gaddy and Ickes 2005 in Thornton 2009, 2). The reason is that “in weak institutional environments, the creation of large state companies is likely to be associated with high levels of opacity, corruption and rent-seeking by insiders, who will be tempted to run the companies for their own benefit and will face strong incentives to resist increased transparency and accountability” (OECD 2006, 4).

Business un-friendly settings are naturally discouraging the much needed investments. Although, based on Table 3 on the Foreign Direct Investments (FDI), one may argue that investment grew robustly. Still, it remained low in relation to GDP (Table 4), when compared with other rapidly developing economies (OECD 2009, 4). Even though oil and gas rents were at the core of the Russian government’s interest, from his ascending to office Putin stressed the importance of attracting foreign investment as a key priority of Russia’s foreign policy (Kashin 2010, 4) and for advancing economic development.

**Table 3: FDI inward and outward flows in mil US \$**

	2000	2001	2002	2003	2004	2005	2006	2007	2008
FDI	2,714	2,748	3,461	7,958	15,444	12,886	29,701	55,073	75,461

source: UNCTAD STAT

**Table 4: GDP in current mil US \$**

	2000	2001	2002	2003	2004	2005	2006	2007	2008
GDP	259,71	306,6	345,11	430,35	591,02	764,0	989,93	1299,71	1666,95

Source: World Bank

Although the FDI level did not reach the desired amounts, it achieved notable increase. However, regarding the widespread corruption and questionable property rights this rise could be regarded as astonishing. In fact, according to CPI, the corruption level was rising during Putin's presidency and the business environment did not improve. Surprisingly, actual data predict a strong negative relationship between the perception of corruption and foreign direct investment in years 2003-2008<sup>24</sup>.

The inadequate level of FDI had an important consequence, because it enhanced the importance of the dominant oil and gas sector, which provided major a boost in terms of the revenues (oil and gas rents are illustrated in Table 5), which were important for the power consolidation and strengthening of the state. As the prices of energies were growing it had a positive impact on the revenues as well. These positive changes in the prices received for the energy industry outputs are illustrated in Table 6.

**Table 5: Oil and gas rents (% of GDP)**

	2000	2001	2002	2003	2004	2005	2006	2007	2008
<b>Oil rent</b>	20	15	15	16	17	20	19	16	17
<b>Gas rent</b>	24	19	12	18	14	18	14	10	12

*Source: World Bank (2011)*

**Table 6: Producer price indexes as of the previous year, in percentages:**

	2000	2001	2002	2003	2004	2005	2006	2007	2008
<b>Fuel industry</b>	155	102	124	101	165	x	x	x	x
<b>Natural gas</b>	163	142	130	77	188	x	x	x	x
<b>Mining and quarrying of energy producing materials</b>	x	x	x	x	x	139.7	119.2	106.7	125.6

*Source: CIS Statistics*

<sup>24</sup> Regarding the unpredictability of business and political environment the correlations are reflecting both data in a given year as businesses cannot rely on some long term analyses of the corporate environment. Therefore, neither this correlation can be predicable for the future, just depicts situation in a given era (results are statistically significant,  $p < 0.05$ ,  $r = -0.8525$ ).

Policies disadvantageous for the FDI inflow turned, in many cases, into the benefit of the domestic business. Holding the foreign companies out could be an advantage for Russian firms as they do not need to deal with concurrence. Missing proper legislation meant an opportunity to make decision in line with some specific situation (allow foreign companies where it can mean an advantage and restrain in other cases) and therefore dealing with investors in the strategies sectors have been for years murky. The energy nationalism of Putin's era eventuated in Sakhalin-2 case. Sakhalin-2 was the first Russian project, which was operated under the Production-Sharing Agreement<sup>25</sup> without any Russian participant. Therefore the project came under the critique of Putin's government. High environmental risks and cost overruns were the main points of campaign against Sakhalin-2, which started in 2006. By the end of the year, Kremlin announced that the shares of foreign companies (Shell, Mitsui, Mitsubishi) would be reduced by half in favor of Gazprom, which became major share holder with 50 percent and one share. In return, the foreign companies were promised \$7.54 billion (Bradshaw 2010, 351-2).

Sakhalin-2 measures were not representing a rare step. Together with the action against British Petrol in Kovytko they served as a base to redefine the terms of foreign companies investing in the strategic sectors making them the minority partners to Russian companies (Bradshaw 2010, 352). These policy measures gave rise to Rosneft and Gazprom. They have been granted privileged access to the natural reserves in Russia and have been elevated to the position of national champions. Missing clear legislation allowed the government for ad hoc decision. Naturally, investors were demanding more clarity and in response to that, in 2008 a protective law was passed. It restricted foreign investment in sectors defined as "strategic", which included the energy sector and 40 others. Foreign companies need to gain permission in order to gain more 25% of the shares in these strategic

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<sup>25</sup> International contracts under the PSA framework had to be confirmed by the parliament, which brought in domestic content (Thorton 2009, 19).

companies, but they could not be allowed to take a majority stake. However, this law is still leaving the government some possibilities for maneuvers, because it allows accommodating the list of “strategic sectors” (Buckley 2008).

Thus, Putin’s approach to state building was problematic as it endangered property rights and so confused the foreign investors. Yet, FDI is truly important for the development of the country. Despite the profitability of the oil and gas business, this sector is also lacking sufficient capital, technologies, and know-how, especially regarding some advanced projects and offshore drilling, as is the case of Sakhalin. Therefore to some extent it was an advantage for Putin (his popularity and legitimism) that the global economic crisis hit Russia just at the beginning of 2009 when his term in the presidential office was over.<sup>26</sup>

### **3.2 Case Study of YUKOS**

Putin’s efforts to strengthen and consolidate the authority of the state went hand in hand with an attempt to impose a collective identity from the top. With this aim Putin started a systematic consolidation of political authority at the federal level, reshaping the relations with the business sector, and rethinking neo-liberal economic reforms. The YUKOS case study represents how redefinitions of Russian national identity served Putin’s interventionist efforts and straightforward imposition of the state’s power over the business was smartly hidden behind the national interests (consolidation of big business in order to fulfill national interests) (Desai 2007, 197–204).

YUKOS, a Siberian oil company, was created in 1992 through a virtual integration of holding oil companies, just before and on behalf of the upcoming Russian large scale

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<sup>26</sup> Hardening of economic conditions in 2009 noted in: World Bank report no18.

privatization (Gololobov 2008, 712).<sup>27</sup> By the end of 1995, Khodorkovsky's Menatep owned over 85% of YUKOS by paying just a fraction of YUKOS' real market value. Afterward, Khodorkovsky focused on restructuring the company and consolidating YUKOS' subsidiaries, gaining almost full control over YUKOS and its subsidiaries by 2000. This further increased the value of the company and by 2002 it became the most valuable listed company in Russia (Sim 2008, 49-65) that if the initial pro-western and pro-market sentiments had remained could have been presented as one of the national champions representing the Russian nation.

Khodorkovsky employed aggressive business strategies to expand YUKOS's international profile and build its own pipeline network with an aim to reduce the possibilities of control the state had over privately owned oil companies. Moreover, he was attempting to sell around 40% of YUKOS to foreign investors. Like other tycoons, Khodorkovsky signed in 2000 an informal agreement with Putin that restrained business from interfering into politics. In fact, Putin maintained a smooth relationship with the oligarchs and attempted to preserve the status quo of state-powerful business political and economic power (Han 2005, 20-21). Oligarchs remained the base of the regime, but as YUKOS case shows, just those who were willing to cooperate. Putin did not manage to restrain the activities of YUKOS. Khorodkovsky tried to strengthen his position and strove to establish close relationships with influential Western personalities with an intention to create a protective network for his activities. Such behavior was directly threatening Putin's legitimacy and power as the president, because both were based on the efforts to establish Russia as a leading actor in world oil politics (Sim 2008, 69-73).

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<sup>27</sup> However, 15% of YUKOS was transferred to private hands even before loans-for-shares privatization program started in 1995 (Sim 2008, 14). In loan-for shares program, beginning of December 1995, Menatep Bank gained 45% of YUKOS. Another 33% of the oil company was transferred to same group in return for the promise of future investment of \$150 million in YUKOS (Salter 2001, 4).

Selling the strategic industry to foreigners was easily interpreted as an activity that will harm “Russian nation”, especially based on the anti-western construction of the national identity. Moreover, after the 1998 crisis, the nostalgia for the past era, especially the socialist “welfare” programs rose. Yeltsin’s radical neoliberal measures, followed by the recession and insecurity about the future led to the grievance for the loss of the USSR and the Russian position in the world as a global economic player (Myant and Drahokoupil 2011, 150). Putin based on these feelings and presented the recovery which was connected with the importance of the energy sector. Therefore the idea of selling one of the biggest Russian oil enterprises to foreigners was an easy trigger for Putin to recall economic nationalism and depict oligarchs as harming the Russian nation.

Confrontation between YUKOS and the state started in 2003 and in the end, Khodorkovsky was sentenced for huge tax claims<sup>28</sup> by the Tax Ministry (Gololobov 2008, 716; Sim 2008, 66). Consequently, the government organized a forced sale of shares. Almost 80% of YUKOS was sold to Rosneft, a state owned company, which by then had become Russia’s major oil producing corporation and reversed the privatization process of the oil sector (Sim 2008, 66). All other companies, as well as western banks, were prohibited from participating in this and following auctions, and thus almost all shares of YUKOS were acquired by the state owned Rosneft and Gazprom (Gololobov 2008, 717-18).

In Putin’s “New Energy Policy“, natural resources were presented as a means to regain the economic and political position of Russia and so to rebuild “Moscow’s lost empire” (Szwedo 2010, 58). To gain control over the strategic resources, Putin could not allow the sale to foreign investors, rather under the heading of the protection of the national interests placed

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<sup>28</sup> YUKOS gained various tax cuts, used transfer pricing, ect. and being the most influential lobby in the Duma, it managed to impose delay on various tax policies aimed at the oil sector. But regarding the inherited gaps in Russian legislation on taxation, YUKOS is argued to behave legally, and the YUKOS affair is more often described by the “property redistribution” in favor of Putin’s *siloviki*. Alternatively, for Putin’s plan of Russia as energy superpower, increasingly independent behavior of Khodorkovsky was threatening this ambition of Putin (Sim 2008, 66-68).

in leading positions in energy companies a number of *siloviki*, closely related to him (Nygren 2008, 3-4). They became a new dominant group and in the YUKOS case have played a central role. The critical constructivist approach seems to provide much better implications than other approaches, because as the case study depicts, power relations played an important role in constructing national identity and presenting the interest of the ruling elites in line with the conception of national identity. By constructing the sense of the “Russian people” and profiting from the anti-market sentiments that emerged during the 1990s, it was easy to legitimize the activities against the oligarchic group which was depicted as not acting in national interests. But as after the re-nationalization, leading positions were granted to Putin’s close group of *siloviki*, as Eichler (2005) pointed out, material interests of the ruling elites clearly prevailed. Moreover, based on sentiments in the wide public, these efforts of the elites were not contested, quite on the contrary, they were easily manageable in order to legitimate their steps to fit the perception of national interest – the nation was depicted as more important than private property – and therefore the re-nationalization project was perfectly fitting the construction of the nation.

### **3.3 Case study of Rosneft**

Rosneft was established in 1993 as the assets state enterprise and in 1995 was transformed into an open joint stock company. Rosneft is currently included in the Government’s List of Strategic Enterprises and Organizations and at the same time it belongs to the world’s top publicly traded companies in the oil and gas sector. The state is the major holder of the company (with 75.16% through OJSC ROSNEFTEGAZ) (Rosneft 2008).



The company was highly unprofitable in years 1995 to 1998 (Rosneft 2008) and therefore there were few attempts to privatize it, which however failed because of the misunderstandings between politicians and top managers. Generally, in the 1990s owners and general managers of key enterprises cooperated with each other with aim to advance their preferences. The role of the state was reduced and often used for self-enrichment (Sim 2008, 119). Another constraint for successful privatization emerged with Putin's presidency: Rosneft proved to be a useful tool for him. However, in 2004 Putin agreed on partial privatization of Rosneft for gaining additional shares of Gazprom, in order to enhance the overall control of the state over the energy sector. The YUKOS affair changed plans for the Rosneft-Gazprom merger. General Manager Sergey Bogdanchikov, tried hard to avoid this arrangement. Rosneft managed to gain shares of Yuganskneftgaz and raise its power standing (Sim 2008, 99-113). Consequently, "retaining Rosneft as a separate entity meant that there are two national champions, instead of just one, instead of just one, each run by Putin's trusted associates" (Sim 2008, 114).

One year after the inclusion of Yuganskneftgaz, Rosneft became the second largest producer of oil and gas in the country. The company further focused on a strategy of acquiring new assets and managed to develop and modernize production in Eastern Siberia and by 2007 became the leading Russian crude oil producer (Rosneft 2008). This highly positive development of the "national giant" helped Putin to develop further and validated his legitimacy in the eyes of the Russian society. He managed to use the energy sector for his populist appeal, presenting the re-nationalization as an opportunity for the Russian people to "own" one of the most valuable Russian companies (Sim 2008, 114).

The Rosneft case, contrary to that of YUKOS, demonstrates the possibility of business gains. In the first case, the state managed to use economic nationalism to its advantage, here it is business, which was employing economic nationalism. The General Manager used the

situation to his/corporative benefit. However, in the end it was not a zero sum game, but mutually benefiting arrangement. Successful development of Rosneft reinforced the image and legitimacy of Putin. Moreover, the state did not expect that the planned sale of Rosneft would advance its self-interest (Sim 2008, 112,117).

### **3.4 Implications**

The literature assuming the existence of state capture being followed by the business capture under Putin's presidency seems to be misguided, because as this thesis indicates, relations are more complex and it is unlikely to frame them in either way even in the short time framework. Out of questioning the capacity of the state to actually engage in the business capture, it is necessary on the other hand to consider the capacity of the business sector to maintain the state capture, because there have been numerous internal discrepancies, especially the power struggles between general managers usually representing the former nomenklatura and newly established oligarchs.

Based on the attempts of the power holders to link the economic prescriptions with the national identity, in order to create legitimacy for economic policies undertaken, it seems that economic nationalism plays an important role in the problematic Russian transition. It provides an explanation why PRE persisted even after the power shift from oligarchs to state. Ruling elites managed to restrain the interpretation of national identity that legitimates the policies of Putin's "strong state" that led to satisfaction of interests of the few groups under the label of protecting the interest of the "Russian nation" (in the energy sector it happened because it was interpreted as crucial for Russian development). In Putin's second term in office, government policy became more interventionist (especially starting with the YUKOS

affair) and clearly aimed at increasing control over the oil sector by expanding state-owned oil companies (EIU 2008, 36). The YUKOS case made the importance of energy for Putin's project crystal clear. It displays also a consequence of infringement of the "*shashlik* agreement" of mutual non-interference, which was supposed to bring mutual benefits for both parties. Then from another angle, the Rosneft case study indicates that business had the opportunity to achieve its ends against the initial reasoning of the state as it managed to frame their performance in a way that was at the same time benefitting the state. The success was connected with the interpretation of the case in terms of national benefits, which was favorable for the government as its holdings in the oil and gas industry increased. Both case studies indicate the changed setting in business-state relationship, but at the same time also the opportunities for the compromise between state and business actors that results in the consolidation of the PRE.

This chapter depicted various policy measures that represent the regime's use of economic nationalism. Even though some of them did not lead to the mutual benefit of the state and business and actually, one may argue that this compromise is working under the overview of the state. State has the opportunity to nominate Kremlin insiders to the controlling functions (Thornton 2009, 33), who in most cases came from the *siloviki* background and therefore companies can be forced to reflect state's interest. Nevertheless, there are numerous examples in which business benefited from the actions and policies implemented by the state under the label of economic nationalism. Restricting foreign companies from entering the market and gaining the majority shares in the strategic sectors, control over their actions, as well as unclear/missing legislation was an advantage for the national companies. Sakhalin-2 measures represent such steps, state clearly restricted foreign investors in order to secure the interest of domestic business. In fact, thanks to the policy measures with the character of economic nationalism Gazprom and Rosneft became the

dominant players in the energy market (Thornton 2009, 13), “national champions” representing the strength of nation and being an object of national pride. This trend of negative measures against foreign investors was affirmed in 2008, when the law on strategic sectors was passed. It restricted foreign companies from gaining the majority share in the key enterprises (but problem is that the list does not have the final number of strategic fields, it can incorporate more key industries when needed).

## Conclusion

The thesis focuses on the dynamics of the state-business power relations during Putin's presidency and the main outline for this study is given by the importance of the oil and gas sector, which has been in fact sustaining the development of the country. The analytical framework driving this study was based on historical institutionalism and the critical constructivist approach to economic nationalism. Introducing these theoretical tools to drive the research should help to eliminate any potential shortcomings brought in by the subjective nature of discourse analysis. Historical institutionalism's central goal is to understand and explain "specific real world political outcomes" and is interested in "deep and contextualized understanding of the politics" (Steinmo 2001). The critical constructivist approach allowed encompassing the power relations into the study of economic nationalism. It helped detecting the role of economic nationalism, which served as a tool for legitimating the interests of ruling elites. However, explanation of the economic nationalism just in power terms, as a dictate or as a statist ideology, in line with the realist approach, would not help to find the core conjunctures. Not the state, but the nation is the most important element. Despite the past failures, wrong institutional settings of the state, the belief in the greatness of the nation endured. The reference to national identity has proved to be crucially important. National identity was created in the relation to external interests and cultural influences, in order to support commercial and security interests of the country, and maintain the economic interests of ruling elite. It has been used for the political purposes and therefore it reflects the economic and political tendencies of the leaders.

The preliminary findings of the thesis seem to support the hypotheses, however further research is needed in order to gain additional evidence and develop the conclusions more precisely, or provide some arguments for its falsification. The shift from the state

capture that was followed by Putin's state-building project did not introduce the second generation reforms. The strengthened state directed its efforts to weaken oligarchs and consolidate its power. Therefore it seems that by the consolidation of the Russian state, PRE is maintained and further reproduced. Many people, especially after the immense changes of the 1990s, were longing for a "strong hand" and felt nostalgic for the "great past". In fact, it is not correct to think that legacies had an influence just over the specific part of society. The past institutional legacies influenced all actors in their actions and decision-makings. Russians, regardless of their status have been socialized into the positive affiliation with the strong state, which is understood as a guarantee of order and historically has played an important role in the life of the society (Sim 2008, 130). Persistence of past legacies is demonstrated also by the presence of *siloviki*, coming from the former Soviet apparatus, in the leading functions. *Siloviki* constitute one special element of Putin's system. Actually, they have played a crucial role in maintenance and stabilization of the strengthened state. By granting them the top position in the most important enterprises, Putin managed to disperse the power of former tycoons. An additional element of Putin's system represents the importance of the oil and gas sector. Strengthened state benefited from the centralization of oil and gas revenues. However, dependency on this sector meant the avoidance of restructuralization and diversification. Putin's centralization of the state decreased the power of regions and created more vertical power structure. Subsequently, the capture of the legal system, electoral frauds, insecure property rights, and coercive powers are additional specificities of the system that emerged under Putin.

Power shift of Putin's era influenced at the most the positions of the early winners, it accounted for a shift in the dominant position within this group. On the other hand, the situation in Russia meant restricted options for the early losers, because the electoral frauds discredited Hellman's initial idea, which considers the role of the elections as the possible

“voice” for the early losers, possibility to trigger the change, further reforms, and democratic consolidation. People were lacking opportunity to initiate changes and most of them believed that they cannot have any impact on the country’s development. Therefore, they became easily subjected to the state’s interpretation of economic nationalism, which actually aimed at keeping this group in its disadvantageous position. The appeal of nationalist discourse helped to justify the interests of elites and ask for economic sacrifices “in the name of the nation”. Economic nationalism provides popular legitimacy for Putin’s system and by that helped to maintain and reproduce PRE. The stability of the Putin’s system was maintained in a great part by the interpretation of national identity in a line with political economy.

Russian government is the main driver of economic nationalism and so naturally economic nationalism is represented in its various actions and policy measures. As the definition indicates (see 1.3), economic nationalism “in action” can take form of the discourse as well as various policy measures, which are based on national purposes. The state uses this concept for the legitimization of regime and the stabilization of the state-business compromise in the discourse. Discourse analysis of Putin’s Annual Addresses to the Federal Assembly (which are representing the official Kremlin discourse) depicts functioning of the economic nationalism by building on the collective sentiments, which helps to rationalize policies and actions of the government and in turn to sustain the PRE.

Strengthening of the state was to a certain extend connected with the oil and gas sector. Importance of this sector can be easily translated into the national purposes that were represented in various policy measures. Even though, some policies have not lead to the mutual benefit of state and business, but to the power reinforcement, as clearly indicates the nationalization of YUKOS. On the other hand, there are numerous examples in which business benefited from the state’s actions and policies, which were implemented within the scope of economic nationalism. Engagement in Chechnya helped securing the business

interests. Independence of this federal unit would imply a loss of important transport route of energy supplies and elevate the costs on the side of Russian business. Unclear legislation concerning the foreign investments to the energy sector, which is allowing reinterpretations of the contracts or restrictions of ownership of foreign businesses, is consequently benefiting Russian companies. They are advanced in the market as the concurrence is reduced. Measures of the state, aimed against the foreign businesses, which helped to secure or strengthen domestic business interests represents the case of Sakhalin-2. With an appeal to environmental issues, Kremlin reduced the shares of foreign companies by half, making Gazprom the major share holder. Later, in 2008, this practice of economic nationalism was confirmed by a law restricting the foreign companies from gaining the majority shares in the strategic sectors and so reinforcing the companies in Russia. Economic nationalism made Gazprom and Rosneft the “national champions”. “National champions” as well as the oil and gas sector in general have the power to influence not just the economic strength of the country but subsequently also its international position.

In fact, the business-state compromise profits from economic nationalism and therefore it seems that economic nationalism is what reproduces and maintains PRE. However, the difficult balance between business environment and the state’s power weight has necessary implication in terms of insufficient foreign investments. Moreover, with the lack of the expertise and authoritative policies that brings a risk of international isolation, current problematic business environment could create a bad position for Russia in the international competition.

The role of legacies may influence the chances for future development. Positive memories of the Soviet rule do not predict a successful democratization and liberalization of the country. The supply side of economic nationalism and the top down introduction of national identities seems to fit the beliefs of Russian society, which have been created by the



powerful historical legacies and socialization experience. Current “national values” are, however, dependent on the profitability of the oil and gas sector, the “motor” of the economy. The energy sector has shaped Russia since the 19<sup>th</sup> century and during positive development of the international market provided the necessary stability of the regimes in Russia. But without reforms and diversification of the economy, this dependence has a risky nature. Regarding the role this dependency had in the collapse of the Soviet regime, the future of the current regime may also be fragile.

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