Centralized Power and the Prospects for Sustainability in the Russian Arctic

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Introduction

Many observers have pointed out that Moscow is the key player in Russia’s centralized political system and Arctic policy tends to be made in the capital with very little participation from regional interests. This paper will examine the consequences of this centralization for promoting sustainability. It will do so by examining a case study of the Yamal Nenets Autonomous Okrug (YNAO). While there are several Russian Arctic regions that deserve attention, YNAO is important because it is the center of Russia’s natural gas industry and an area of burgeoning growth where 84.9% of the population lived in urban areas in 2010.

My central argument is that while, in theory, centralized decision-making could lead to sustainable development of the region, the current development process is not geared toward such a goal. Rather, decisions are made in Moscow for reasons that promote the ruling elite’s political and economic goals with results on the ground that do not always promote rational development. Environmental and social costs are primarily felt at the regional level and do not seem to influence thinking in Moscow.

The paper will proceed in the following way. First, it will lay out the interests of the key players at the federal level, the regional and local levels, and among corporations. Second, it will examine the evolution of center-periphery relations between Moscow and the regions. Third, it will examine the evolution of decision-making in YNAO. Finally, it will draw conclusions about these political processes for sustainable urban development in the region.

Defining the Interests of the Key Players

The key players involved in Russia’s Arctic policy-making and implementation are in the federal and regional levels of government and within the corporate sector.

Federal

At the federal level, there are a variety of players with a wide range of interests. The key figure in the policy-making process for Russia’s energy sector and Arctic policy is President Vladimir Putin. He sees energy development as central to maintaining the power and vitality of the Russian state and takes a personal interest in the development of the energy industry and the distribution of the money that it generates. He plays a personal role in all large deals and important decisions that are made.¹ Many of these decisions are made behind closed doors and for reasons that are not made public, in a system that Russians call “manual control (ручное управление).”

The interests of the president in energy and the Arctic are focused on ensuring his continuing political power. In difficult economic times and under conditions where the president’s popular approval rating is deteriorating, the government needs a large and reliable source of money to support its current

policies. Since gaining the presidency in 2000, Putin has centralized power in the Kremlin, significantly reducing the ability of the regional governors and energy business leaders to act independently of the Kremlin. A key aspect of this centralization process has been to gain much stronger federal control over the financial flows generated by the energy industry and redirect them away from regional governments and independent private companies and into Kremlin control to be redistributed according to priorities established by Putin and his closest advisers. Accordingly, any type of tax reform in the Russian energy sector that would change this basic system is unlikely as long as Putin remains in office.\(^2\) In particular, the government will want to maintain a high mineral extraction tax (MET) in order to ensure that it has the financial resources to support projects it deems important.

Regional
Regional and local leaders naturally protest against the centralization of resources and decision-making power in Moscow and try to bring as much back as possible. While the federal government may see the Arctic as a source of income that can be redistributed throughout the country, the regional leaders in YNAO have sought to keep as much of this money as possible at the regional level to improve the standard of living for residents there and to support their own client networks. In this regard, the regional governments must work closely with the federal government and relevant corporations while seeking to ensure that some of the profits from the resource development projects remain in the region. Tax revenues from oil and gas production account for more than 90% of regional revenue for YNAO and about 70% comes from Gazprom and affiliated companies.\(^3\)

During the period when citizens directly elected their governors, regional leaders could play a relatively independent role negotiating among the federal government and corporations. In particular, they could favor one corporation over another by providing access to land rights, using their influence to direct more resources to the regional level. With the YNAO governor now appointed by Putin, he has a strong interest in pleasing the Kremlin, rather than catering to the needs of local residents, in order to retain power.

Corporate
Corporations see the Arctic as a place to make large profits from developing resources. The 2008 law on subsoil resources defines a category of “strategic” hydrocarbon fields and allows only Russia’s state-controlled energy national champions – Gazprom and Rosneft – to develop the lucrative off-shore resources that are expected to provide the energy sources of the future. Novatek is an independent gas producer that is active in YNAO and is responsible for about 20% of Russian gas production. Its key owner has close personal connections to Putin, who seems to use the company as a lever for exerting pressure on Gazprom. Gazprom is crucial to the Russian government because its massive profits (on the order of $40 billion a year) provide a key source of funding for the state budget and most of this production comes from YNAO.

\(^3\) Julia Kusznir, Gazprom’s Role in Regional Politics: the Case of the Yamalo-Nenets Autonomous Okrug,” Russian Analytical Digest, no.1, June 6, 2006.
Because output is dropping at the traditional gas-producing fields of the Nadym-Pur-Taz Basin (and its three super-giant fields: Medvezhe, Urengoy and Yamburg), corporate attention is now focused on the Yamal Peninsula and its vast untapped gas fields. Gazprom launched production from the Bovanenkovo field on October 23, 2012, as part of its Yamal mega-project which includes development of the Bovanenkovo deposit, construction of the Bovanenkovo-Ukhta pipeline (which will feed into the Nordstream pipeline to Germany), and airport, the new 572 km railroad line Obskaya-Bovanenkovo, and social infrastructure. By 2017, the deposit is planned to account for as much as 115 billion cubic meters a year, 23% of Gazprom’s current output. Additionally, on July 20, 2012, Novatek began construction (with France’s Total, which holds a 20% stake in the project) to develop a $20 billion LNG facility to be fed by the South Tambayskoye field with a port near the village of Sabetta. Novatek has excellent lobbying connections to get support for its project from the government – in 2011 Putin claimed that the government would provide up to 1 trillion rubles for the Sabetta port. However, it remains unclear if Novatek will be granted an export license (only Gazprom has one now) and what level of mineral extraction tax it will have to pay.

Given the need to build new facilities north of previous production sites, all of the companies face rising production costs and naturally lobby the government to lower tax rates. Russian gas producers are also facing increased international competition from the development of shale gas in the U.S., more LNG production in the Middle East, the resulting drop in gas prices, and a lawsuit brought by the EU to force Gazprom to change the way that it prices its gas for sale in Europe. On the positive side, Russia hopes to open new markets to Asia and develop ways of using natural gas for the transportation sector.

Evolution of Center Periphery Relations in Russia Since 1991

Since the collapse of the Soviet Union, the relationship between the federal government, regional governments, and Russia’s largest corporations has evolved through a variety of stages. The main driver of change in this evolution is the strength of the federal government. Throughout most of the 1990s, the federal government was relatively weak and that allowed regional governors and corporations to play a much more autonomous role. After Putin’s election to the presidency, he was able to consolidate power relatively quickly and placed considerable constraints on the governors and corporations.

While Yeltsin had allowed the citizens of each region to elect their governors beginning (with some exceptions) in 1996, Putin overturned the system in 2004 and restored the president’s right to appoint governors. This changed the fundamental political calculus of the thinking among Russian governors – no longer was their main aim to please their constituents to win re-election; now they sought to please the Russian president so that he would continue to allow them to remain in their posts. However, the longer Putin stays in power, the less popular he becomes with the electorate. While declining popularity does not threaten his ability to hold on to his office, it does put into question his

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ability to rule effectively. In the wake of the December 2011 protests about the lack of fairness in the State Duma elections held that month, then President Medvedev announced that Russia would return to a system of electing governors. The first elections were held in five carefully selected regions in October 2012. While the restored regional elections are far from free and fair, they suggest that power is returning to the regions to some extent.

Control over the money flows between the federal government and the regional governments reflects a similar trajectory as the overall distribution of power. Accordingly, the situation of the regions depends heavily on the development policies adopted in the center, which determine how much money flows to which regions, the level of investments in those regions and the situation of the population.\(^7\) In simple terms, shortly after the Soviet collapse, the regional governments were able to control a substantial amount of the taxes generated on their territory. Through 2001, for example, the law on subsoil resources stipulated that the taxes collected from resource extraction would be divided so that 40% went to the federal government, 30% to the regional government, and 30% to the local government of the resource-producing region.\(^8\)

However, in the late 1990s, the federal government began to exert intense pressure on the regions. After 2001, tax and budget legislation, not the subsoil law, defined the distribution of resource rents between the federal and regional governments and since these were federally controlled, the distribution began to heavily favor the federal government. A new law in the late 1990s allowed Russian corporations to pay taxes in Moscow where their headquarters were located rather than the regions where they actually worked. This law had a major impact on the development of Russia because it drew money out of the regions and concentrated it in the capital. Beginning in 2005, federal law limited the rights of the autonomous okrugs, a change which required YNAO to sign an agreement with Tyumen Oblast that allowed it to preserve its ability to work with its own budget while also transferring money to the oblast.\(^9\) The government introduced the mineral extraction tax in 2002. Initially, the federal government received 80% of the revenue and the regional governments received 20%. Over the 2000s, the regional share of this income dropped.\(^10\) Since 2010 all funds from this tax flow directly into the federal budget. In order to compensate for this loss, Moscow began to provide subsidies to regions like YNAO. While in 2010 this income will almost fully compensate for the lost income, such compensation is being phased out over four years and will eventually end. As Natalia Zubarevich points out, the structure of the transfers from the federal budget to the regional governments and the criteria for making them are not transparent. YNAO in 2011 was one of the largest recipients of the most opaque form of federal subsidy, in the category “other grant income,” receiving 15 billion rubles (11% of the budget income). Also, at the same time that YNAO started to lose the income from the mineral extraction tax, the authorities changed the system of taxation for large corporations, requiring them to pay their taxes in

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\(^7\) Natalia Zubarevich, program director for the Moscow-based Independent Institute for Social Policy (Nezavisimyi institut sotsialnoi politiki), Мониторинг кризиса и посткризисного развития регионов России, http://www.socpol.ru/atlas/overviews/social_sphere/kris.shtml#no21


\(^10\) Kryukov, p. 276.
the areas where they work rather than where their headquarters are located. This new law went into effect at the beginning of 2012 and will be implemented over several years. Since Gazprom is one of the largest taxpayers, its payments in the YNAO should increase while cities like Moscow, St. Petersburg, and Tyumen, the home of many head offices, will be the main losers.\textsuperscript{11}

**Evolution of Yamal Politics**

The key player in YNAO politics during most of the 1990s and the 2000s was Governor Yury Neelov. He had a long history in Siberian politics, working his way up through the Komsomol and CPSU. Yeltsin appointed him governor in 1994 and he subsequently won reelection in 1996 and 2000. Although Neelov personally did not wield much political clout, he gained power by picking leaders to follow in Moscow.\textsuperscript{12} During the 1990s, he criticized Moscow’s role in the regional economy, complaining that the federal government made it difficult to attract investment to develop the region’s resources. He argued that the federal government abused its power to suppress the initiatives and activities of the regions (Segodnya July 4, 1997).

Given the scope of its wealth and activities in the region, Gazprom plays a major role in YNAO politics.\textsuperscript{13} In the 1993 State Duma elections, the region voted for a candidate critical of Gazprom because the company at that time had not paid salaries or made its social contributions. In order to regain its footing, Gazprom backed Neelov, the newly appointed governor, and made him a member of the Gazprom board of directors. When Gazprom registered in Moscow and began to pay the bulk of its taxes there, the reduction in income angered Neelov and he began to favor other companies and give them licenses to work in the region. Accordingly, Neelov’s relations with Gazprom soured and he was not reelected to the Gazprom board in 1999. Instead, he focused his attention on oil companies, such as Rosneft and Sibneft, and small independent gas companies. In particular, Deputy Governor Iosif Levinson helped nurture the development of Novatek, which went on to become a major player as noted above. Neelov’s victory in the 2000 gubernatorial election showed that he had a powerbase independent of Gazprom. After 2000 Gazprom bought up many of the other companies working in the region (including Sibneft), though Novatek remained independent. As a consequence of the Gazprom acquisition spree, the regional economy became dependent on the gas monopolist again, particularly as Gazprom’s share of taxes to the budget comprised over 70% of revenue in the mid-2000s. Putin’s return to a system of gubernatorial appointments substantially reduced Neelov’s leeway in appointing his own subordinates, and he had to dismiss Levinson. As Julia Kusznir has pointed out, the relationship between Gazprom and the governor is what determines the nature of the interactions between the other political and economic players. In short, between 1994-9, Neelov cooperated with Gazprom; between 2000-5, he tried to build relations with other companies, and between 2005-10, the close ties between Gazprom


\textsuperscript{13} This account draws heavily on Julia Kusznir, Gazprom’s Role in Regional Politics: the Case of the Yamalo-Nenets Autonomous Okrug,” Russian Analytical Digest, no.1, June 6, 2006.
and the federal government weakened the governor and expanded the influence of Gazprom in the region.\(^{14}\)

Medvedev replaced Neelov as governor with Dmitry Kobylkin in 2010. Kobylkin, in contrast to Neelov, came out of the Novatek hierarchy, having been the director of Purneftegazgeologiya, a Novatek subsidiary at the time. From October 2005 to his appointment as governor, he served as head of the Pur Raion. While Medvedev did not explain why he appointed Kobylkin governor, analysts speculated that the appointment was an effort to boost Novatek in a region dominated by Gazprom. In any case, Kobylkin continued the late-Neelov policy of working closely with Gazprom and continued to sign the annual cooperation agreements with the monopolist. Perhaps the federal authorities supported him because he did not have the lobbyist contacts in Moscow that his predecessor had developed over time and therefore would be easier to manage from Moscow. An October 2012 rating of the governors listed Kobylkin as one of the most secure governors in Russia.\(^{15}\)

YNAO is a donor region so its budget has its own sources of revenue and does not depend heavily on transfers from the federal government. Given the high level of energy production in the region, the main sources of revenue are the corporate profit tax (approximately one-third), income tax on individuals (approximately one-quarter), corporate property tax (one quarter), and others. Table 2 lists the expenditures of the YNAO budget, showing which areas it prioritizes. Crucial for our analysis of sustainability, direct spending on protecting the environment is particularly low.

Table 2. Expenditures in the YNAO 2012 Regional Budget (thousand rubles)

<table>
<thead>
<tr>
<th>National Economy (roads, agriculture, forestry, etc.)</th>
<th>28,479,707</th>
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<tbody>
<tr>
<td>Housing</td>
<td>20,623,037</td>
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<tr>
<td>Education</td>
<td>17,397,144</td>
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<tr>
<td>Healthcare</td>
<td>16,263,631</td>
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<tr>
<td>Subsidies to regions and municipalities</td>
<td>16,262,813</td>
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<tr>
<td>Social Policy</td>
<td>12,557,855</td>
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<tr>
<td>State administration</td>
<td>3,307,183</td>
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<tr>
<td>National Security and Law Enforcement</td>
<td>2,350,453</td>
</tr>
<tr>
<td>Culture, Cinematography</td>
<td>1,907,648</td>
</tr>
<tr>
<td>Physical education and sport</td>
<td>1,422,602</td>
</tr>
<tr>
<td>Media</td>
<td>1,245,092</td>
</tr>
<tr>
<td>Protecting the environment</td>
<td>627,927</td>
</tr>
<tr>
<td>National Defense</td>
<td>17,326</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>122,462,418</strong></td>
</tr>
</tbody>
</table>

Source: [http://www.xn--80ansfm8f.xn--p1ai/control_activities/budget/](http://www.xn--80ansfm8f.xn--p1ai/control_activities/budget/) (accessed May 18, 2012)


Conclusion: Implications for Arctic Urban Sustainability

Centralization of power in Russia makes it hard in practice to pursue urban sustainability because concerns about the local environment and social standards in cities are a regional rather than federal concern. The federal leaders are focused on preserving the power of the current elite. Regional leaders in the Arctic would like to devote more resources to regional development, but have little ability to do so because they lack financial resources, which are largely controlled in the center. Only a decentralization of power will improve the northern regions’ ability to address sustainability issues.