

HASAN SELİM ÖZERTEM

POLITICAL ECONOMY OF ENERGY SECTOR RESTRUCTURING IN THE POST-SOVIET SPACE

Bilkent University 2019

POLITICAL ECONOMY OF ENERGY SECTOR
RESTRUCTURING IN THE POST-SOVIET SPACE:
RUSSIA AND AZERBAIJAN IN COMPARATIVE
PERSPECTIVE

A Ph.D. Dissertation

by
HASAN SELİM ÖZERTEM

Department of
Political Science and Public Administration
İhsan Doğramacı Bilkent University
Ankara
June 2019



To My Family

POLITICAL ECONOMY OF ENERGY SECTOR RESTRUCTURING
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COMPARATIVE PERSPECTIVE

The Graduate School of Economics and Social Sciences of
İhsan Doğramacı Bilkent University

by

HASAN SELİM ÖZERTEM

In Partial Fulfillment of the Requirements for the Degree of
DOCTOR OF PHILOSOPHY IN POLITICAL SCIENCE

THE DEPARTMENT OF POLITICAL SCIENCE AND PUBLIC
ADMINISTRATION
İHSAN DOĞRAMACI BİLKENT UNIVERSITY
ANKARA

June 2019

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Asst. Prof. Dr. H. Tolga Bölükbaşı
Supervisor

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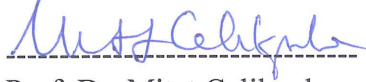
Assoc. Prof. Dr. Saime Özçürümez
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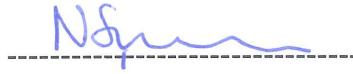
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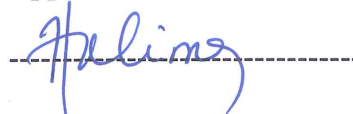
Prof. Dr. Mitat Çelikpala
Examining Committee Member

I certify that I have read this thesis and have found that it is fully adequate, in scope and in quality, as a thesis for the degree of Doctor of Philosophy in Political Science.



Asst. Prof. Dr. Nazlı Şenses Özcan
Examining Committee Member

Approval of the Graduate School of Economics and Social Sciences



Prof. Dr. Halime Demirkan
Director

ABSTRACT

POLITICAL ECONOMY OF ENERGY SECTOR RESTRUCTURING IN THE POST-SOVIET SPACE: RUSSIA AND AZERBAIJAN IN COMPARATIVE PERSPECTIVE

Özertem, Hasan Selim

Ph. D., Department of Political Science and Public Administration

Supervisor: Asst. Prof. Dr. H. Tolga Bölükbaşı

June 2019

This dissertation explores the political economy of energy sector restructuring in the post-Soviet space with a particular focus on the role of elite structure therein. After remaining under the same Communist regime for seventy years, ownership structures of energy sector in the post-Soviet countries diverged significantly during the transition period. All countries in this space maintained their state monopolies in the sector. In Russia, however, privately-owned national energy companies emerged to control the majority of the sector under Yeltsin's rule. Using *the comparative elite structure model*, I argue that during the transition period, elite structure, dimensions of which are political elite integration and elite capacity, shaped the Russian and Azerbaijani energy sector restructuring differently. Privately-owned national energy companies gained the majority of the energy sector's ownership in Yeltsin's Russia with weak political elite integration with and high elite capacity. I observed consolidation of the state's ownership in the energy sector in Putin's Russia with strong political elite integration and high elite capacity. I observed continuation/consolidation of the state's ownership in Azerbaijan with strong political elite integration and low elite capacity. I show that these processes are conditioned by the structural political economic context each energy rich country finds itself in. Thus, I also argue that country's status as a center or periphery shapes the levels of political elite integration and elite capacity in transitional periods after an exogenous shock. Furthermore, the dissertation explores economic and political repercussions of different ownership structures in Russia and Azerbaijan.

Keywords: Azerbaijan, Comparative Political Economy, Elite Structure, Energy Sector, Russia

ÖZET

ENERJİ SEKTÖRÜNÜN YENİDEN YAPILANDIRILMASININ EKONOMİ POLİTİĞİ: RUSYA VE AZERBAYCAN KARŞILAŞTIRMASI

Özertem, Hasan Selim
Doktora, Siyaset Bilimi ve Kamu Yönetimi Bölümü
Tez Danışmanı: Dr. Öğr. Üyesi H. Tolga Bölükbaşı

Haziran 2019

Bu tezin amacı, seçkin yapısına bakarak Sovyet sonrası coğrafyada enerji sektörünün yeniden yapılandırılmasının ekonomi politliğini incelemektir. Sovyetler Birliği'nin dağılmasının ardından, 70 sene boyunca aynı sistemin bir parçası olan ülkelerde, enerji sektörünün mülkiyet yapısında önemli ayrılmalar gözlemlenmektedir. Genel olarak enerji sektöründe devlet tekeli korunurken, Yeltsin dönemi Rusyası'nda özel-yerli şirketler ortaya çıkmış ve sektörün önemli ölçüde mülkiyetini ele geçirmeyi başarmıştır. Bu çalışmada *karşılaştırmalı seçkin yapısı modeli* kullanılarak, seçkin yapısının temel unsurları olan, siyasi seçkinler arasındaki entegrasyon ve seçkin kapasitesinin ülkeler arasında gösterdiği farklılıkların geçiş süreçlerinde enerji sektörünün yeniden yapılandırılmasında ayrılmalara neden olduğu savunulmaktadır. Siyasi seçkinler arasındaki entegrasyonun zayıf olduğu, ancak yüksek seçkin kapasitesine sahip olan Yeltsin Rusyası'nda özel-yerli şirketler ortaya çıkarken bunun tam tersi dinamiklere sahip olan Azerbaycan'da devlet enerji sektörü üzerindeki tekeli korumayı başarmıştır. Siyasi seçkinler arasındaki entegrasyonun güçlendiği Putin döneminde devlet sektör üzerindeki hakimiyetini yeniden tesis etmeyi başarırken ancak birkaç özel-yerli şirket önemli tavizler vererek sektörde tutunmayı başarmıştır. Yaşanan dış şokların ardından geçiş sürecinde ülkelerin merkez veya çevre ülke olması durumunun siyasi elit entegrasyonu ve elit kapasitesi üzerinde oldukça etkili olduğu görülmektedir. Bu açıdan ülkelerdeki ekonomi politığın yapısal dinamiklerinin seçkin yapısındaki farklılaşmada önemli bir paya sahip olduğu savunulmaktadır. Bu çalışmada ayrıca farklılaşan mülkiyet modellerinin gerek ekonomik gerekse siyasi yansımaları Rusya ve Azerbaycan açısından incelenmektedir.

Anahtar Kelimeler: Azerbaycan, Karşılaştırmalı Ekonomi Politik, Enerji Sektörü, Rusya, Seçkin Yapısı

ACKNOWLEDGMENTS

This dissertation is a product of ten years of study at Bilkent University. It took longer than expected to finish this journey, because I had to take a break of almost two years due to unexpected developments in my life. When I got the chance to restart, it was not easy to refocus and wrap up the dissertation after such a long break. Thanks to my advisor's sincere support and encouragement, I managed to overcome each and every barrier before the finishing line. That is why I would like to express my sincere gratitude to my advisor Dr. H. Tolga Bölükbaşı for his continuous help, guidance, patience, and immense knowledge. Without him it would be almost impossible to close this chapter of my life.

Besides my advisor, I would like to thank the rest of my thesis committee: Prof. Mitat Dr. Çelikpala, Assoc. Prof. Dr. Saime Özçürümez, Dr. Onur İşçi and Dr. Nazlı Şenses Özcan, for their insightful comments and contributions, which motivated me to widen my research from various perspectives.

My sincere thanks also go to Prof. Dr. Oktay F. Tanrısever who contributed to my academic studies from the beginning of my journey. I would also like to express my sincere gratitude to Prof. Dr. Eyüp Özveren and Dr. Berrak Burçak for their valuable mentorship.

I was lucky to be a visiting researcher at Carnegie Moscow Center for about three months and learned a lot from Dr. Natalia Bubnova and Mr. Dmitri Trenin. I would like to thank them for giving me the opportunity to be a part of the Carnegie Moscow during my stay in Russia. I would also like to thank my friend Mr. Zaur Shiriyevev for his great hospitality. He was so kind to open his house for me during my field research in Baku and helped me to feel like home.

Last but not the least, I would like to thank my family: my wife, my parents, and my son. They were all incredibly supportive and patient. My son, Hüseyin, joined to the club a little bit later, but became more curious than others to know about the destiny of the dissertation as he grew up in this process. My wife, Nihal, had to postpone so many things in her life, but never complained. I would like to thank her for her infinite tolerance and sacrifice.

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ABBREVIATIONS

AAR: Alfa-Access-Renova consortium
APF: Azerbaijan Popular Front
AZ: Republic of Azerbaijan
Bcm: billion cubic meters
CPSU: Communist Party of the Soviet Union
FSB: Federalnaya Sluzhba Bezopasnosti (Federal Security Service)
GKI: State Committee for Property Management
IPO: Initial public offering
KGB: Komitet Gosudarstvenny Bezopasnosti (Committee for State Security)
LDP: Liberal Democratic Party
LNG: Liquefied Natural Gas
RF: The Russian Federation
RSFSR: Russian Soviet Federative Socialist Republic
SOCAR: the State Oil Company of Azerbaijan Republic
SPC: State Privatization Committee (Azerbaijan)
USSR: Union of Soviet Socialist States
YAP: Yeni Azerbaycan Partiyasi (the New Azerbaijan Party)

CHAPTER 1

INTRODUCTION

1. INTRODUCTION

This dissertation explores the political economy of energy sector restructuring in the post-Soviet space with a particular focus on the role of the elite structure therein. After remaining under the same Communist regime for seventy years, all countries with exceptionally rich hydrocarbon resources of this geography other than the Russian Federation preserved their state monopolies in the sector. Remarkably, privately-owned national energy companies emerged in the Russian Federation that exclusively controlled the majority of the energy sector under Yeltsin's rule. Although some of these companies continue to remain active in Russia, the Russian state once again gained primacy in the energy sector with the early 2000s. As the energy sector ownership structure changed in Russia, the other states continued to consolidate their control on the sector over the past three decades. This differentiation in the ownership structure puts an interesting, yet unresolved puzzle before us. I propose a theoretical model in this dissertation to explain how different outcomes emerged in the restructuring of the energy sector in two key states in the post-Soviet space.

This chapter outlines the main framework of this dissertation in four parts. After this brief introduction, I discuss the significance of this research with reference to the significant gaps in the literature. Before summarizing the structure of the dissertation in the final part, I lay out the methodological issues, including the research design and the main questions of concern that will be addressed in this study.

2. Significance of the Research

The states have always had a predominant role in the energy sector in mono-crop, energy resource rich countries. State actors take virtually all decisions in the sector

from investment to production; from distribution of rent to negotiations with third parties at the international level. The cyclical nature of hydrocarbon prices in international markets along with the presence of a cartel organization, OPEC, naturally puts the state in a critical position. The state needs to adapt its policies depending on the fluctuations in the international markets for minimizing its impacts in national level. Transfers in the ownership structure, the central focus of this dissertation, have important implications not only on who gets what, when and how, but also on how state-society relations are structured. Thus, the nature of ownership transfer matters even more depending on whether the state starts to share ownership with a foreign or domestic actor. Foreign actors and domestic actors have different incentives, which would have different political and economic implications on state-society relations.

The conventional literature on the political economy of hydrocarbon resources largely focuses on the impact of hydrocarbon resources on political and economic institutions. It largely takes state monopoly as given. This structuralist literature is mainly developed around *the rentier state* debates where the state is seen as a black box. These debates largely overlook the emergence of privately-owned national energy companies and the role of agency of the elite in restructuring of the energy sector. There exists another literature on nationalization, expropriation and privatization which focuses on changes in ownership. This literature, too, underexplores the emergence of privately owned-national companies and the role of agency of the elite. It focuses on the role of the state in the processes of nationalization and privatization by looking at the dualistic balance between foreign oil companies and state-owned energy companies.

Thus, in both of these debates the unit of analysis is mainly the state with a particular focus on state owned energy companies and foreign oil companies in an energy rich country. In fact, there are few examples in the history where privately-owned national energy companies controlled the majority of the energy sector. Luong and Weinthal's (2010) database of "Variation of Ownership Structure in Developing Countries" shows that Yeltsin's Russia stands as the unique case among 47 countries under examination between 1980 and 2010. Russia is a successor of a superpower that depends on hydrocarbon rents and holds a bulk of hydrocarbon reserves. Thus,

examining how did privately-owned national energy companies gained the majority of the sector ownership in Russia will present crucial insights about the political economy of this country.

Social scientists systematically study changes in big structures and large processes to identify causes and effects and also to understand their consequences (Tilly, 1984: 11). In this regard, examination of Yeltsin's Russia as a unique case presents an interesting opportunity to analyze the emergence of privately-owned national energy companies following an exogenous shock like regime breakdown in a hydrocarbon rich country. I argue that only through opening the black box of the state and looking at the role of the agency of the elite can we understand the reasons behind the emergence of privately-owned national companies in an energy rich country.

The state is an abstract concept and it does not decide about policies itself. State-centered theories about political economy of energy overlook this change in ownership and falls short of explaining the determinants behind the emergence of privately-owned national energy companies in Yeltsin's Russia. Thus, opening the black box of the state requires looking beyond its transcendental presence and looking at other determinants in the society. Migdal, Kohli, and Shue (1994: 2-4) argue that states are not autonomous from social forces and they might mutually empower each other. I argue that looking at elite structure in a country we can explore changes in ownership structure in the energy sector. The elites are the main elements within the state and society that have power to shape policies and outcomes. I therefore focus on agency of the elite to explore how the privately-owned national energy companies became increasingly dominant over energy sector at the expense of state ownership. I argue that two dimensions of elite structure, elite capacity and political elite integration, effectively condition the outcomes of energy sector restructuring in times of transition. These outcomes are further shaped by the political economic context an energy rich country finds itself in.

This study explores diverging outcomes in the energy sector's ownership structure in two key states, in the post-Soviet space, which have remained under the same political regime for seven decades. In doing so, it hopes to present a new perspective to the dominant state-centered understanding of the literature on the political

economy of hydrocarbon resources. The study brings private national ownership under the spot light in a comparative theoretical framework to offer an original contribution to the scholarly debate.

3. Research Questions, Research Design, Research Method

In this part I explain the methodological choices I made in developing the dissertation. This part is divided into three sections. First, I discuss the research questions addressed in this study. Second, I develop the research design by defining the universe and presenting the rationales behind case selection. Finally, I elaborate on the research methods and data collection techniques in this dissertation.

3.1. Research Questions

Hydrocarbon rents effectively shaped the political economy of Eurasia starting from the second half of the 20th century. The dependence on oil revenues reached to a point where the state had to rely on oil rents to finance even the most vital needs of the society like provisioning of foodstuffs. The state had complete monopoly of the energy sector under the rule of the Soviet Union. At the time of regime transition, this monopoly was still prevailing in the post-Soviet states in Azerbaijan, Kazakhstan, and Turkmenistan. Only in the Russian Federation in the 1990s do we observe the emergence of privately-owned national energy companies. Interestingly, however, the state regained control of the sector in less than a decade crowding out the privately-owned national energy companies.

Azerbaijan, Kazakhstan, Russia, and Turkmenistan are offspring of the Soviet Empire. These states had been governed under an isolated political system with the same political ideology, and under the same economic regime for seven decades. Yet, different outcomes emerged in the restructuring of the sector in the transition period. This is the puzzle that I address in this study. This dissertation therefore addresses three questions: (i) How does energy sector ownership change after exogenous shocks (such as regime breakdowns) in a hydrocarbon-rich country?, (ii) Under what conditions the restructuring of the energy sector ended up with the state's relinquishing control of the most strategic sector in Russia, but not in other

post-Soviet countries? (iii) Under what conditions did the state sustain and regain control on the energy sector in the post-Soviet space?

3.2. Research Design and Delimitations

This is a sector specific study that aims to show how elite structure conditions restructuring of the energy sector in the post-Soviet space. The concept of energy sector, in general, covers all of the energy related industries from electricity to nuclear energy. However, in this study the main focus is on the sector that extracts, transmits, refines and markets hydrocarbon resources, i.e. oil and natural gas.

In exploring the political economy of energy sector restructuring I adopt a comparative research design relying on a *structured, focused comparison* (George, 1974). Migdal (2009: 189) argues that “[s]tructured, focused comparisons most often involve comparisons within a region but increasingly, comparisons made on the basis of other factors too”. In spatial terms, this dissertation focuses on the post-Soviet geography, but looks also at the financial dependence on hydrocarbon export rents in a given country. The reliance on hydrocarbon rents makes the sector even more critical for the state and the main expectation is maintaining state ownership in the sector. Nevertheless, the post-Soviet states shared a similar past and gained their independence with the dissolution of the USSR (United Soviet Socialist States), but ended up with different outcomes following the restructuring of the energy sector.

Restructuring of the energy sector was imperative after the dissolution of the USSR. Former Soviet capital, Moscow, lost its absolute control on the member states and ownership of the energy sector in the post-Soviet geography. Newly independent states and their administrations took the control of the energy resources within their borders and became the new owners. Subsequently, the new capitals became the new operators and different models of ownership emerged. As can be seen from the Table 1 there are four countries that represent the universe of this study that falls within the given spatial and economic delimitations. Thus, the universe is an example of *small-n* dataset.

Russia represents a unique case with the emergence of privately-owned national companies under Yeltsin's rule which controlled the majority of the energy sector. The state prevailed its dominance over the sector in other post-Soviet states. Thus, examining the Russian experience in depth and comparing it with other states will give us the necessary inferential basis to understand the reasons behind its uniqueness. I will have a comparative case study design to propose a theoretical explanation.

George and Bennet (2005: 8) argue that "interest in theory-oriented case studies has increased substantially in recent years, not only in political science and sociology, but even in economics...Scholars in these and other disciplines have called for a 'return to history' arousing new interest in the methods of historical research and the logic of historical explanation". Following their suggestion, this research design also draws on a historical analysis to understand the reasons behind the differentiation in ownership structure in the transitional period for comparative purposes.

Case studies are useful for theory testing and theory building purposes (Lange, 2013: 132). This study's main aim is to explain the differentiation of ownership structure in the post-Soviet space within a theoretical framework. In this regard, a research focused only on Yeltsin's Russia will give certain leverages for understanding the reasons behind different outcomes in the ownership structure. However, including additional cases, we will get further advantages such as testing whether the suggested causality explanations are valid for other cases or not (Levy, 2008: 7). I will be testing the validity of causal explanations for positive and negative cases. I suggest privately-owned national energy companies' dominance over the energy sector (Yeltsin's Russia) for the positive case, whereas I refer to the state domination (Putin's Russia and other post-Soviet states) for negative cases.

The decision to compare different cases brings up the question of case selection. For small-n populations random selection does not always provide us with valid cases for comparative purposes due to the limited nature of the universe. However, there are several techniques for case selection for avoiding selection bias. I used the *controlled comparison method* or the *most similar case method* for the case selection. In this method, "the chosen pair of cases is similar on all the measured independent

variables, except the independent variable of interest” (Seawright & Gerring, 2008: 304). One of the ways of controlling variables except the examined the independent variable is dividing a longitudinal case into two as *before case* and *after case* (George & Bennett, 2005: 81). I analyze Russia in two periods: (i) Yeltsin’s Russia (the 1990s), and (ii) Putin’s Russia (2000 onwards). This comparison helps us address the second question of “Under what conditions the state sustained and regained control on the energy sector in the post-Soviet space?”. Nevertheless, for a comprehensive answer about “Under what conditions the restructuring of the energy sector ended up with the state’s relinquishing control of the most strategic sector in Russia, but not in other post-Soviet countries?” we need to look at least one case in the set of Azerbaijan, Kazakhstan and Turkmenistan.

Table 1: Energy Resource Exporting Countries in the Post-Soviet Space

		PONEC ¹ dominance (+) / SOEC ² (-)	Elite Structure		Center (+) / Periph. (-) ³	Foreign Company in the energy sector (+)	Post- Soviet State	Internal Military Conflict	Prevalence of perestroika period leaders after the dissolution	Predomi nance of hydrocar bon rents High (+) / Low (-) ⁴
			Elite Integration Strong (+) / Weak (-)	Elite Capacity High (+) / Low (-)						
Azerbaijan		-	+ ⁵	-	-	+	+	+	-	+
Kazakhstan		-	+	-	-	+	+	-	+	+
Turkmenistan		-	+	-	-	+	+	-	+	+
Russia	Putin’s Russia	-	+	+	+	+	+	+	-	+
	Yeltsin’s Russia (Unique Case)	+	-	+	+	+	+	+	-	+

¹ PONEC - Privately-owned national energy companies.

² SOEC - State owned energy companies.

³ Conditional variable.

⁴ The World Bank’s definition for *the mineral state* can be taken as a standard in the predominance of the hydrocarbon rent in a given country. According to the World Bank (Nankani, 1979 in Di John, 2007), “a mineral economy is one where mineral production constitutes at least 10 per cent of gross domestic production and where mineral exports comprise at least 40 per cent of total exports.”

⁵ Political elite integration was weak under Elchibey period and consolidated with Heydar Aliyev’s coming to power in Azerbaijan.

This dissertation focuses on Azerbaijan as one representative case of these three cases. Azerbaijan also has the most similar characteristic features with those in Russia. As can be seen from the Table 1, Azerbaijan has the most similar features with the Russian cases, except for the nature of elite structure. Azerbaijan underwent an internal military conflict and leadership change in the post-Soviet period whereas the political status quo prevailed in Turkmenistan and Kazakhstan. In this study, I claim that in explaining different outcomes in the restructuring of energy sector we should look at differences in the elite structure. Thus, *the independent variable is the elite structure.*

In terms of the time frame, the dissertation focuses on a critical period that starts in the 1980s and ends in 2019. Although I look at the post-Soviet experience in terms of energy sector restructuring, I claim that the historical legacy of a country has crucial implications on its social, economic and political dynamics. I draw on comparative historical scholarship when making this assumption. As Pierson (2004: 79) suggests “[m]any important social processes take a long time – to unfold.” Therefore, instead of analyzing the period that starts with the dissolution of the USSR in 1991, I also examine the Soviet legacy for Russia and Azerbaijan by looking at the political and economic dynamics in the 1980s. Enlarging the timescale of the study presents firmly grounded historical insights about different outcomes in energy sector restructuring processes in these two countries. As the cases will show the decisions taken in the 1980s had outcomes on the social structure in the center different than those on the periphery and this had important implications on the transition period.

3.3. Research Methods

In this comparative case study, I examine mainly three cases in an in-depth manner. Among these three cases, Yeltsin’s Russia with the privately-owned energy companies which control the majority of the energy sector represents the unique, diverging case. The most similar cases are Putin’s Russia and post-Soviet Azerbaijan.

In this dissertation I employ comparative historical analysis methods in analyzing historical processes. Comparative historical analysis is a research tradition that looks

for causal explanations and has a multi-disciplinary character. In operationalizing this method, Lange (2013: 19) advises that “comparative historical methods combine at least one comparative method and one within-case method”. I thus use *causal narrative* as a within-case method and Millian method as a comparative method.

Causal narrative “is an analytical technique that explores the cause of a particular social phenomenon through a narrative analysis; that is, it is a narrative that explores what cause something (Lange, 2013: 43). In this study, I show through narratives that the reason behind the different ownership models in the post-Soviet space lies in different elite structures. In these narratives, I emphasize that elite structure as a concept has two dimensions: (i) political elite integration, and (ii) elite capacity. Exogenous shocks and a country’s political economic development level also have impacts on these dimensions.

This dissertation is an example of small-n comparison considering the fact that there are mainly three cases under examination. Millian comparison offers *nominal comparison* to operationalize the variables dichotomously (Lange, 2013: 108). In this sense, the dimensions of the elite structure are also nominally categorized. There are mainly two categories for political elite integration as *strong* and *weak*, and similarly two categories for elite capacity as *high* and *low*. Thus, looking at *the levels of political elite integration* and *elite capacity* we can make comparisons about a country’s elite structure. Millian analysis also conforms to John Stuart Mill’s comparative methods (Lange, 2013: 108). Mill’s *indirect method of difference* that focuses on difference in an independent variable causing a different outcome in the dependent variable is an explanatory approach to understand the differentiation in ownership structures in the post-Soviet space when we examine the elite structure in a country.

The dissertation premises on different types of data I collected, which are of primary and secondary nature. In terms of primary data, the dissertation relies on a field research of two months in Russia (April-June 2013) and two weeks in Azerbaijan (October 2013). I had chances to conduct interviews in Turkey as well with Russian and Azerbaijani elite in different occasions apart from my field study in 2013. I conducted *semi-structured interviews* with 25 key informants throughout my

research. Among these informants were two former deputy ministers of energy (RF), one deputy minister (AZ), one former member of parliament (RF), one member of parliament (AZ), three former bureaucrats (two in AZ and one in RF), two former activists (AZ), one advisor (RF), and two high ranking officers in the energy sector (one in AZ and one in RF). As a check on official sources, I interviewed twelve observers who are university professors (two in AZ and two in RF), journalists (one in AZ and one in RF), and experts (three in AZ and three in RF). Their names are fully anonymized in this study. Before starting the interview, I asked the interviewees whether they prefer their names to be published or not. Some of these people asked me not to publish their names and I only wrote the day of each interview when I quoted from an interviewee for the sake of consistency. Even when they consented to publishing their names, I chose to keep all names anonymous, since this is a geography that still struggles with problems of democratization and transparency. Moreover, some of the interviewees chose to talk off the record, and I had to rely on my notes during the writing process.

I stopped carrying out further interviews after I reached a saturation point. After a while I started getting similar answers to my questions. At this point, conducting further interviews seemed to be too costly. There are certain parameters behind this cost-benefit balance. First, I faced difficulties when requesting appointments from sector representatives via e-mail. Only a few responded to my e-mails. Thus, I tried to reach out experts and sector representatives via snowball technique and this technique has its own biases. Furthermore, if the interviewee does not prefer to recommend another name, then I needed to dig in via other sources I had. Furthermore, if the interviewee does not prefer to recommend another name, then I needed to dig in via other sources I had. The dig in process requires reaching out to new contacts, but it takes time for them to arrange a meeting with an expert or sector representative. It is also possible to face with a dead-end after spending so much effort and in the field.

I chose to conduct semi-structured interviews during my research. In fact, there is a common understanding in qualitative analysis that semi-structured interviews are appropriate for explorative reasons and give chances of probing for elite interviewing (Leech, 2002: 665; Peabody, Hammond, Torcom, Brown, & Kolodny, 1990: 452;

Smith, 1975: 184). From this rationale, I had a common set of interview guidelines to ask the interviewees. The guidelines were composed of open-ended questions. These questions helped me to have a better understanding of the similar transition process as well as the peculiarities in Azerbaijan and Russia. Furthermore, I tried to probe during the interviews by asking some follow up questions depending on the responses. Considering the fact that the profile of my interviewees were highly qualified and highly informed individuals with key insights and experience on the topics of interest, the interview data helped me test my arguments and guided me when I was chasing after new strings during the research.

I used both primary and secondary sources while following these strings. Digging into legal documents was critical to understand the taken steps in legislative level. I mainly used three databases for this purpose. One of them is Azerbaijan's Ministry of Justice electronic archive – "e-qanun.az". This website has an archive of Azerbaijani legal documents since the state's independence. I took advantage of this website to reach necessary legal documents that shaped the Azerbaijani energy sector from the time of independence. I reached a similar archive from "old.lawru.info" for Russian legal texts. This website includes both Soviet and post-Soviet era documents. This is a user-friendly website that categorized the documents on yearly-basis. I also used "LexisNexis Academic" for reaching translated formats of Russian documents into English for a better understanding of the legal texts.

I used different sources to analyze the political and economic dynamics in Russia and Azerbaijan. Factiva presented a very valuable database for print media (newspapers, magazines, and news agencies) for a researcher like me who was curious about the developments in the region. This gave a chance to me when I made an in-depth research even following the developments in day by day basis when necessary. Moreover, company reports, policy briefs, and country reports helped me understand the economic and political transformation both in sectoral and country level. Among these Economist Intelligence Unit, World Bank and the IMF were prominent resources. I also collected, regrouped, and compiled statistical data about developments in the economy as well as the energy sector. BP Statistical Review's dataset and International Energy Agency's reports and data were useful for energy related data. Regarding economic indicators I used World Bank data along with

officially published national statistical data in Russia and Azerbaijan. These were mainly material that required analytical interpretation. The historical analyses in the case studies required detailed background information as well. In this regard, interviews were useful, but biographies, autobiographies, and elite interviews conducted by other researchers and journalists were equally valuable for in depth analysis. Apart from these sources, I made use of former dissertations, journal articles, and books. In the case of Russia, it was easier to find secondary data, but in the case of Azerbaijan available sources were relatively limited. In this regard, I believe and hope that the chapter on Azerbaijan is a crucial contribution to the available literature.

To sum, I used different types of data in an analytical manner to present a comprehensive picture of the post-Soviet experience in Azerbaijan and Russia. Comparative historical analysis provided me necessary tools to investigate my research questions and elaborate the data methodologically.

4. Structure of the Dissertation

This dissertation is organized around five chapters. After the introductory chapter, I discuss the conventional literature about the political economy of hydrocarbon resources. I present the overlooked areas in the literature and argue that there is a need for looking beyond the state centered analyses and focusing on the role of the elite. I develop a synthetic approach that I call *the comparative elite structure model*. I draw on the literature on elites and Shils' center-periphery divide to develop this model further.

After presenting the theoretical framework of the dissertation in the literature review, I look at the Russian and Azerbaijani cases in a comparative manner in the following three chapters. These chapters mirror each other in terms of structure for this purpose. They are mainly composed of three main parts. First, I describe the institutional legacy of the Soviet Union in these countries and how it affects the elite capacity. Second, I look at the elite structure based on the given theoretical framework in the Chapter 2. Third, I discuss the restructuring of the energy sector

and how the elite play role in the emergence of different outcomes in Russia and Azerbaijan.

Table 2: Findings of the Dissertation

		Political Elite Integration	
		STRONG	WEAK
Elite Capacity	HIGH	Consolidation of State Ownership (S ₁) ⁶ (Putin's Russia)	Private National Ownership (S ₂) ⁷ (Yeltsin's Russia)
	LOW	Continuity/Consolidation of State Ownership (S ₁) (Aliyev's Azerbaijan)	Continuity/Consolidation of State Ownership (S ₁) (Counter Elite Administration of Elchibey & Beginning of Heydar Aliyev's Rule in AZ)

As I mentioned above the chapter on Russia covers two different periods, the Yeltsin period and the Putin period. It is a within-case analysis that looks into mainly two different cases. Yet, this chapter starts from the 1980s and covers a period that comes till today. Yeltsin's Russia is the unique case with the emergence of privately-owned national energy companies, whereas Putin's Russia is the negative case with re-statization of the sector in the expense of private sector's interests.⁸

The chapter on Azerbaijan is the last chapter before the conclusion. This chapter covers a period that starts from the 1980s till today. The Azerbaijani case is a representative case (negative case) of the post-Soviet experience with the continuation of the state ownership in the energy sector. Since there has been no serious changes in the ownership structure since the independence, I did not divide the Azerbaijani case into different periods based on leadership change from Heydar Aliyev to Ilham Aliyev. Because there is a continuation of the same regime under the same family. However, I decided to discuss the 1991-1993 period under a separate

⁶ S₁: State ownership > 50% in the energy sector.

⁷ S₂: Privately-owned national companies ownership > 50% in the energy sector.

⁸ Even though Dmitri Medvedev was the president of Russia between 2008 and 2012, Vladimir Putin continued to be dominant in Russian politics as the premier. Observing no serious deviations, I chose to examine Medvedev period within Putin's rule.

subsection considering the fact that elite structure in Azerbaijan had different characteristics than those in the Aliyevs period.

Based on this structure, Table 2 summarizes the key findings of the dissertation. The table shows that political elite integration played a crucial role in restructuring of the energy sector in the post-Soviet space. Political economic context is an important determinant in the elite structure. A country's status as a center or periphery shapes the levels of political elite integration and elite capacity in transitional periods after an exogenous shock. Privately-owned national energy companies gained the majority of the energy sector's ownership in Yeltsin's Russia (center) with high elite capacity and weak political elite integration. I observed consolidation of the state's ownership in the energy sector in Putin's Russia with high elite capacity and strong political elite integration. I observed continuation/consolidation of the state's ownership in Azerbaijan (periphery) with low elite capacity and strong/weak political elite integration.

These findings show that only with the combination of high elite capacity and weak political elite integration we will see privately-owned energy companies' domination over the energy sector after an exogenous shock. Moreover, the strong elite integration will result with the state domination over the energy sector in the expense of privately-owned national energy companies' ownership in mono-crop economies. A more detailed version of these findings is available in the conclusion part with references to the available literature. As the last chapter, it also gives a comparative analysis of the cases studied throughout this dissertation.

CHAPTER 2

REVIEW OF THEORETICAL ARGUMENTS – OPENING THE BLACK BOX OF THE STATE WITH THE COMPARATIVE ELITE STRUCTURE MODEL

1. INTRODUCTION

The main aim of this chapter is to discuss the literature on the political economy of hydrocarbon resources. It consists of mainly five parts including the framing chapters of introduction and conclusion. This chapter elaborates the original theoretical framework of *the comparative elite structure model* that this dissertation proposes. I will use this model when comparing the cases of Russia and Azerbaijan to understand the differences surfacing in the restructuring of these countries' energy sectors.

There remain two bodies of literature on the political economy of hydrocarbon resources within the framework of this dissertation's focus area. First, the main body of literature on hydrocarbon resources developed around *the rentier state* debate. It discusses the political, economic, and social implications of hydrocarbon resources by focusing on energy rich countries. This debate takes the state and its dominance over the sector as a given. The role of agency of the elite is generally overlooked. Furthermore, in spite of the presence of some studies that focus on the ownership and control models' impacts on political economy of a country, the literature in general falls short of explaining how privately-owned energy companies exclusively control the majority of the energy sector in a given country. Second, the literature on *privatization and nationalization/expropriation* examines the reasons behind changing ownership structure in the energy sector. However, this debate mainly focuses on the dualistic relationship between the state-owned energy companies and foreign oil companies in changing ownership structure. Similarly, this literature also

overlooks the emergence of privately-owned national energy companies and the role of the agency of the elite.

The state may either lose or consolidate its control on the sector as in the cases like in energy-rich countries like Venezuela, Iran, Russia, Iraq and others. This creates a new dynamic in terms of the political economy of a hydrocarbon-rich country. The change in ownership does not have to be limited within the dualistic relationship between state and foreign oil companies. Available data shows that privately-owned national companies can also gain the majority ownership of the energy sector at the expense of state dominance following an exogenous shock. Based on these data, one may ask the following questions: “How does energy sector ownership change after exogenous shocks (such as regime breakdowns) in a hydrocarbon-rich country?”, “Under what conditions the restructuring of the energy sector ends up with the state’s relinquishing control of the most strategic sector?”, “Under what conditions does the state sustain and regain control on the energy sector?”. I argue that we need to look beyond the conventional state-centered debates on the rentier state and privatization and nationalization/expropriation to answer these questions.

The post-Soviet experience shows that the peculiarities of transitional period are important in restructuring of the energy sector. A change in the ownership model in the energy sector, however, depends also on other dynamics. During the transition, state institutions weaken and individuals or groups gain a broader maneuvering space that affect the nature of the transition period. These individuals or groups are part of the elite in these countries.

The elite have the capability of shaping policies and outcomes. Nevertheless, I argue that the limits of elite’s capability to change the state control on the sector is also linked with the elite structure and the socio-political context. In this framework, I integrate two approaches, “elite theory” and Edward Shils’ “center-periphery divide” to understand the elite structure in a given country and its capacity to shape the restructuring process of the energy sector. I call this theoretical framework *the comparative elite structure model*. I argue that this model offers an analytical framework to understand the dynamics of restructuring energy sector after an exogenous shock in a given country.

2. Review of the Literature on the Political Economy of Hydrocarbon Resources

The literature on the political economy of hydrocarbon resources mainly started to take shape in the 1970s. This is not a coincidence, because it falls into a period of foundation of OPEC, global oil crises, nationalization/expropriation of energy resources, and the rise of studies on development issues and the state.

The main body of literature on the political economy of hydrocarbon resources has a structuralist character, i.e. the state stands at the center of these analyses. One of the well-known theoretical frameworks is the rentier state debate. In the rentier state debate, the state dominance in the sector as given and overlooks a change in the ownership structure. Another debate on the change in the ownership developed around the privatization and nationalization/expropriation. Similarly, this debate is also state-centered and understudies the reasons behind the emergence of privately-owned national energy companies in a hydrocarbon-rich country. Rather it mainly examines the dualistic relationship between the state and foreign oil companies. In this part, I will focus on the main frameworks of these debates and discuss the shortcomings of the literature.

2.1. The Debate on the Rentier State

The rentier state theory has become the main body of literature that studies the institutional arrangements that help derive rents from indigenous resources. Actually, this is a state classification that categorizes the energy dependent countries under this concept just like others known as developmental state, predatory state, failed state and so on (Sune & Özdemir, 2013). In the beginning, the literature on the rentier state focused primarily on the Middle Eastern countries, due to the rapid socio-economic and political change in the region as a result of flow of petrodollars. In this sense, the region represented a good laboratory for the scholars. Later, researches on Africa, Latin America and the post-Soviet space also became popular within the theoretical framework developed around this debate. This debate is developed upon large-n data set studies as well as case studies focusing on one or more countries in a

comparative manner. These studies focused on social, political and economic impacts of oil revenues. In this part, the concept of the rentier state and its main study areas will be scrutinized. The main aim of this part is to show the theoretical characteristics, and the main focus areas of the rentier state debate.

Hossain Mahdavy (1970) is the first scholar to conceptualize the “the rentier state” as “those countries that receive on a regular basis substantial mounts of external rent”. Mahdavy’s, main unit of analysis is the state. His study focuses on the impact of oil revenues on development of oil rich countries, particularly Shah’s Iran after the nationalization of the oil sector. Mahdavy argues that the state’s monopolistic position in the sector is key in the rent.

Mahdavy’s concept of *the rentier state* became a “systematized concept” in time (Adcock and Collier, 2001) as broadly used by a group of scholars those study energy rich countries. In this respect, Hazem Beblawi and Giacomo Luciani’s book entitled *the Rentier State* (1987) brought a better-defined conceptual framework by taking Mahdavy’s concept as a basis.

Beblawi (1987, p. 51) argues that rent can be seen in different tones in each and every country, but to categorize a state as “rentier” it should have certain characteristics. While elaborating on these factors Beblawi uses the concepts of rentier state and rentier economy interchangeably and talks about four common characteristics of rentier states.

First, the situation of rent should predominate in the economy. Second, parallel to Mahdavy, Beblawi says that rentier economies rely on “substantial external rent”. Third, the dominance of the energy sector negatively affects other sectors in the economy. In other words, the reliance on external rent turns into a development problem. Four, it is mainly the state to redistribute the external rent accrued from the energy sector. Beblawi’s conceptualization summarizes the main strands in the rentier state literature. Most of the studies on rentier states are developed focusing on one or two of these elements of Beblawi’s framework namely; *state structure*, *development issues*, *regime issues*, and *social dimension*.

Luciani (1987: 69) argues that instead of the nature of income of the state, its origin matters more as being domestic or foreign. Based on this factor Luciani groups states under two categories as being *exoteric* or *esoteric*. The former relies on revenues from abroad whereas the latter raises revenues domestically. The exoteric states are described as allocation states as their main responsibility becomes allocation of the petrodollars in the economy. However, Karl (1997: 49) argues that the acuteness of the problem is deeper; these economies are export oriented, but it is only a small percentage of people are engaged in generating this wealth and mostly the cost of generating this income is limited when compared with the rent. Consequently, it is mainly the state to decide about how to allocate and use petrodollars, which causes some inefficient and biased decisions to be taken due to political and interest-based concerns (Losman, 2010).

In the literature several other concepts emerged around the debate on the rentier state. One of them is presented in Terry Lynn Karl's *The Paradox of Plenty: Oil Booms and Petro States*. Karl (1997: 47-48) uses the concept of *the petro-state* for countries that depend on mining revenues, in the sense that some natural characteristics like technical and market peculiarities of the commodity shared with mining states "are present in exaggerated form" in these countries. In fact, this exaggerated form is one of the main reasons that make energy rich countries so popular in the literature.

Another concept is the well-known *resource curse*. There is a broad debate around this concept that looks at political and economic development in a country (Ross, 1999; Robinson et. al., 2006; Humphreys et.al., 2007). Rentier states do not necessarily have to be merely oil rich countries. Economies relying on other natural resources like precious metals or mines can be rentier as well. Export revenues of these commodities mainly come from abroad in terms of convertible currencies (mainly dollars). This makes economy to depend on sustainable flow of foreign currency. In other words, the stability of the economy depends on the stability in the international markets, which directly affects demand for oil. Moreover, success of development policies started by a rentier state depends on the stable character of the oil price, which might show a cyclical character as the price determined in the free market. During the time of economic booms countries start big investments, but in

time of economic crises as the demand for oil decreases, oil revenues decline and these countries tend to borrow from international financial mechanisms. As a result, development of oil-rich economies has become open to fluctuations in the world market, which cause a problematic growth strategy.

Similar to the resource curse, the concept of the “*Dutch Disease*” also focuses on negative externalities of rents coming from abroad on development strategies from a financial perspective (Krugman, 1987; Corden, 1984; Torvik 2001). This concept appeared to define problems experienced in the Netherlands in 1960s. After the discovery of natural gas reserves, other sectors in the Netherlands suffered due to appreciation of Dutch guilder against other currencies because of export revenues received from abroad. This negatively affected the competition power of other sectors. As a result, the overvalued currency caused loss of market share for national competitors against imported goods in domestic and international market. This negative externality turned into an economic failure in the end.

The impact of hydrocarbon resources on development is not always negative. In fact, economists in the early 1950s believed that these resources might help these countries to close the capital deficit necessary for development (Ross, 1999, p. 301). Studies show that mineral-rich countries like Canada, United States, and Norway also used these resources for their development, but primarily for their own consumption purposes (Maloney, 2002). Decreasing costs helped these countries to take their places among the ranks of developed countries. In this sense, the key factor in terms of sustainable development is whether the energy resources are used for decreasing costs and promoting economic growth or to extract rent from outside.⁹ In this respect, the institutions and political culture play a crucial role. As Karl (1997: 74) argues “petro-states are built on what already exists” and the success or failure of a state’s development policies mainly rest upon its social, economic and bureaucratic capacity. Similarly, Bayulgen (2010) looks at the energy rich countries and argues

⁹ The price of oil and natural gas is subsidized in Russia, Venezuela, the Gulf and in many other hydrocarbon-rich countries. However, the reason of low-priced oil and gas is not a complimentary part of holistic growth strategy. Rather the low prices oil and gas strategy is determined on the basis of social responsibility of these governments and this policy serves to sustain regime legitimacy of the incumbent governments in these countries. For a better insight on this issue please refer to Donald L. Losman, “The Rentier State and National Oil Companies: An Economic and Political Perspective”, *Middle East Journal*, Vol. 64, No. 3, 2010.

that there is a correlation between pre-existing regime types (authoritarian or democratic) and development effects of foreign investment.

Some studies show that oil booms' negative effect might be offset by labor migration in oil exporting countries by creating a pro-industrialization environment, but due to remittance flow, the negative impact can be transmitted to the labor exporting countries causing appreciation of domestic currency and causing contraction in the industrial sector (Wahba, 1998). Considering all these negative externalities of oil booms, new policies were introduced in time. Stabilization funds are established as new institutions to overcome these shocks in the energy rich countries to smooth the side effects of volatility in the exchange rates and currency flow during the time of crisis (Carona et.al., 2010)

Income accrued from abroad affect not only the economic dynamics, but also the state culture and consequently state-society relations. External rent diminishes the need for extracting financial sources from the society by collecting taxes for covering the expenses of the state. Through patronage and less dependence on taxes the accountability pressure weakens in a given society for the government. This is called mainly *the rentier effect* (Ross, 2001: 326). This is explained as “no tax no representation” (Huntington, 1991; Diamond, 2010, Ross, 2004). Even though the direct correlation between taxing and autocracy is weak, the findings show a strong correlation between oil and democracy that it undermines a democratic system to emerge in autocratic countries (Ross, 2001; Sandbakken, 2006).

It is argued that fiscal systems in rentier economies are not as improved as in developed countries. The basic assumption contends that as the petrodollars received by the governments, it is not necessary to engage in painful process of tax collection or policies that will increase the tax base in the country. Tsui (2011) argues that the process, which also requires democratic development, is also perceived as a challenge by oil rich dictators because they will have more to give up from losing power when either the population or other non-democratic challengers overthrow them. Thus, the rentier states' main role becomes merely allocation of resources rather than extraction of revenues domestically. First, this serves to the interests of the political leaders. As being the main actor for resource allocation a symbiotic

relation between the bourgeoisie and the government is formed (Shambayati, 1994). In other words, the economic elite becomes dependent on the government sources.

Second, the state becomes more centralized and powerful as it becomes the sole actor to maintain the flow of money in the economy. Political actors act deliberately to preserve and even maximize their control in the political sphere. Subsequently, they give certain incentives to the public as well as to the business elite in the forms of sharing the rent. This consolidates the regime's position in most of the cases. The recent literature debated that there is no direct causal mechanism, but there is a correlation between oil rents and authoritarian regimes or slow transition to democracy (Tsui, 2011; Herb 2005).

To conclude, the main idea behind the rentier state literature is to look for the impacts of oil revenues on development, regime type, and state-society relations. There is an endogenous relation among these factors. As the state mechanism shaped by the revenues coming from abroad, they take a consolidated character, which hardly changes in time. Consequently, the phenomenon turns into a kind of a curse that creates a feedback mechanism in cultural, political and economic terms.

2.2. The Debate on Privatization and Nationalization/Expropriation

This literature is not specifically developed around the political economy of hydrocarbon resources. It has a broader perspective that also focuses on sectors like electricity, telecommunications and others. In general, the governing political majority's ideology and budget constraints influence the privatization decisions (Bortolotti, Fantini & Siniscalco, 2001). Thus, it is a political decision that is shaped by economic incentives. Recently there are some studies that specifically focus on the energy sector and tries to explain the reasons behind the state's decision to privatize or nationalize energy assets in a country. In this debate, privatized or nationalized assets mainly change hands between the state and foreign oil companies.

One of the main findings of this debate is the correlation between states' decisions to privatize or nationalize and the price of energy resources in the international markets. The states choose the strategy of privatization in time of low prices to bring extra

funds to the budget, whereas nationalization is the main tendency in times of windfalls in the energy market (Duncan, 2006; Guriev, Kolotilin, Sonin, 2011; Mahdavi, 2014). Nationalization/expropriation is a rational tendency that the state elite decide to take the advantage of rising hydrocarbon profits as the price of oil and gas increases. Privatization, on the other hand, becomes the main financial source to bring extra funds for the economy in time of economic decay. However, the former would bring further political handicaps like losing credibility in the international markets and declining foreign investments and deepening political fragilities depending on the character of nationalization/expropriation process.

Warshaw (2012) argues that the state leaders see the energy sector as an important source to derive political and economic benefits. They gain an advantage of redistribution of the wealth by taking the control of the sector. So that they can easily pursue favored goals to retain in power. Warshaw further finds a correlation between weak checks and balances and decision to nationalize. Warshaw's findings have links with the rentier state debate that find correlation between the regime type and oil rent.

Similar to the rentier state debate, the debate on privatization and nationalization/expropriation also has a structuralist approach. The state has a central role in decision privatization and nationalization/expropriation. Market dynamics, fiscal factors and the institutional constraints are important in shaping the decision to privatize or expropriate. The main focus of this literature is the dualistic relationship between the state and foreign oil companies.

2.3. Shortcomings of Literature on the Political Economy of Hydrocarbon Resources

The literature on the political economy of hydrocarbon resources presents a broad perspective that enables us to understand social, political, and economic dynamics in an energy resource rich country. Nevertheless, the main debate is built upon a structural approach (*state-centered*) and the state is seen as a black box. In general, the role of agency of the elite is understudied and emergence of privately-owned national companies overlooked.

There are at least two reasons of the state-centered approach to be dominant in the literature. First, the debate on the rentier state developed in parallel with the rising structural theories, particularly with the efforts of “bringing the state back in” (Skocpol, 1985). Secondly, the structural approach has advantages in explaining the status quo or a working mechanism (Schmidt, 2010: 2). Indeed, the literature on the state mainly looks at the impact of state structures and actions on the society and economy (Kohli, 2002). If there is a certain pattern that is preserved over time and the level of contingency seems to be less likely, then institutional analyses have better explanatory power.

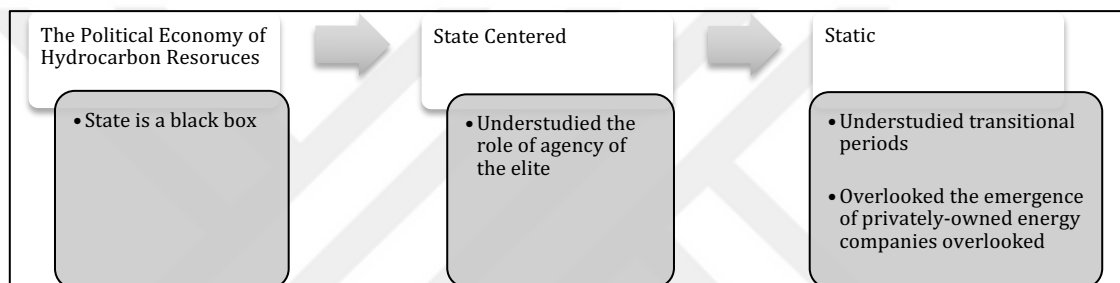


Figure 1: Shortcomings of the Literature on Hydrocarbon Resources

Luong and Weinthal’s (2010: 2-6) study is a good example to show the link between institutions and emergence of a rentier state. They argue that “weak institutions are both a direct consequence of mineral wealth and the primary reason that this wealth inevitably becomes a curse...[but] mineral-rich states are ‘cursed’ not by their wealth, but rather by the structure of ownership they choose to manage their mineral wealth”. Thus, Luong and Weinthal examine political and economic implications of different ownership and control models on post-Soviet states. They show in their study that there are different ownership models around the world and a country may fall into different categories of ownership in different periods of time.

One of the interesting cases is the post-Soviet Russia. The state’s dominance over the energy sector changed over time with the rise and fall of privately-owned national companies throughout the 1990s and the 2000s. However, the literature on the political economy of hydrocarbon resources understudies the reasons behind changing ownership models. Both the debates on the rentier state, and privatization

and nationalization/expropriation overlook the emergence of privately-owned national energy companies and take the state as a black box (Luong and Weinthal 2001, 2006, 2010; Ross, 1990). They rather focus on the balance between state owned national companies and foreign oil companies in the energy sector (Sarbu, 2014; Guriev et.al., 2011; Duncan, 2006; Warshaw, 2012). In this respect, several questions can be asked such as: “How does energy sector ownership change after exogenous shocks (such as regime breakdowns) in a hydrocarbon-rich country?”; “Under what conditions the restructuring of the energy sector ended up with the state’s relinquishing control of the most strategic sector, such as in Russia”; “Under what conditions did the state sustain and regain control on the energy sector”.

This study looks beyond these debates and addresses these questions. I argue that the state is not a black box and we need to integrate elite dynamics for understanding the change in ownership structure in the energy sector after a regime breakdown or crisis. Following an external shock, the state power will be challenged and this will lead to different outcomes in the restructuring of the energy sector depending on the elite structure of a given country. After such a crisis, state institutions lose power and the role of agency of the elite becomes more critical to redefine the dynamics of the newly emerging system. The elite has the power and capability of shaping policies and outcomes. Thus, actors or groups as the members of the elite gain an advantageous position to reshape, modify or sometimes to transform the energy sector as they get a broader maneuvering space in time of transition. However, the capability to change depends on capacity of the elite and this depends on political economy of a given society.

Skocpol argues that state-centered studies emerged as a challenge to the literature of pluralism and structural functionalism. In these studies, “[g]overnment’ was viewed primarily as an arena within which economic interest groups or normative social movement contended or allied with one another to shape the making of public policy decisions. Those decisions were understood to be allocations of benefits among demanding groups. Research centered on the societal ‘inputs’ to government and on the distributive effects of the governmental ‘outcomes’” (Skocpol, 1985: 4). According to Skocpol this sort of an approach is insufficient to explain political phenomenon in most of the cases.

Evans (1995: 18), in his *institutional comparative analysis*, similar to Skocpol he argues that “[t]he state cannot be reduced to an aggregation of the interests of individual office holders, the vector sum of political forces, or the condensed expression of some logic of economic necessity. States are the historical products of their societies, but that does not make them pawns in the social games of other actors.” Evan’s comparative political analysis has fair assumptions, but he mainly focuses on a functioning, developmental state.

On the opposite of the well-functioning state mechanism, Evan’s predatory state definition can be reexamined as a counter argument. “Predatory states lack the ability to prevent individual incumbents from pursuing their own goals. Personal ties are the only source of cohesion, and individual maximization takes precedence over pursuit of collective goals. Ties to society are ties to individual incumbents not connections between constituencies and the state as an organization” (Evans, 1995: 12). This definition also gives an insight about the characteristics of a state, which have problems of checks and balances in the system and lacking an operating, autonomous bureaucratic mechanism.

The characteristics of Evans’ predatory state can be seen in transitory countries. Following an exogenous shock such as regime collapse, the elite pursue the target of state-building to reestablish state authority. This includes building new institutions, bureaucracy and defending the society from various threats. Thus, I argue that as the state gets weaker, different actors gain broader maneuvering space. These actors and groups are mainly part of the elite of the society. Decisions of these people become vital to reshape institutions and policies during the transitional periods. Indeed, role of these do not become trivial even when the status quo is established. Rather their capability to shape policies and outcomes depends on the political and economic context.

Considering all these issues it is crucial to look beyond the state. For this purpose, I propose *the comparative elite structure model*. This model takes the elite structure as a concept that has two dimensions: (i) political elite integration, and ii) elite capacity. In this model, the state is not taken as a black box, rather the elite within the state and

society is examined in a sense that its structure defines the outcomes in restructuring the energy sector in an energy resource rich country. I draw on the literature on elites and Shil's center-periphery division to develop this model further.

3. Elite Theory

Literature on elite theory has started to take shape at the end of 19th century and reinvigorated in the 1940s and 1960s and later in the late 1980s. In this sense we can talk about three waves of elite theory. The first wave can be classified as *classical elite theorists* that try to answer the question of who is elite and what is their role in politics and society. This is a literature that mainly took shape and prevailed its influence in the first half the 20th century. The second wave focuses on the structure of the elite and tries to analyze recruitment dynamics and political implications of elite structures. This literature has a hybrid character. It tries to deepen the understanding on the elites by focusing on almost similar questions with the classical elite theory. However, scholars those belong to the second wave also try to integrate the concept of power into the debate and some of them adapt a pluralistic approach. In this study, the second wave can be called as *modern elitists*. The third wave leaves aside the conceptualization of the elites by taking it as a given characteristic of a political system like Gaetano Mosca. Third wave mainly examines the relation between the regime stability and the elite structure. Additionally, recent studies try to analyze the link between finance and elites.

3.1. First Wave: Dualistic Debate on Elites

Gaetano Mosca, and Vilfredo Pareto, Robert Michels are founding fathers of elite theory. They discuss the necessity of a ruling class and discuss the dynamics of social changes from an elitist point of view (Marger, 1982; Arslan, 2006). According to this approach elites are positioned in the higher echelons of society and differ from the rest of the society by having the distinguishing qualifications in their performance of activities.

Gaetano Mosca has a pioneer role in the classical elite theory. His book *Sulla Teorica dei Governi e sul Governo Parlamentare* was published in 1884. Mosca

stipulates that “[i]n all societies...two classes of people appear – class that rules and a class that is ruled. The first class, always, the less numerous, performs all political functions...whereas the second, the more numerous class, is directed and controlled by the first” (Mosca, 1939: 50). Dualism can be seen in Mosca’s conceptualization as he divides the society into the ruling and the ruled. He defines the elite as the “ruling class” who are assigned to carry out public duties. The ruling class is superior to the unorganized majority as being organized. Additionally, the ruling minorities generally consist of individuals, who are superior to the mass of the ruled in both material and intellectual terms (Hartmann, 2007: 9). Looking at Mosca’s work he uses the concept of ruling class, but the term of political elite.

However, Pareto uses the concept of elite in his writings. He uses “elite in its etymological sense, meaning the strongest, the most energetic, and most capable – for good as well as evil...the history of man is the history of the continuous elites” (Pareto, 1991). Like Mosca, Pareto also has a dualistic understanding of elite structure, but in a different way. First, he categorizes political elites as foxes and lions. Foxes tend to rule by gaining consent, whereas lions use force to govern. Both sides try to take the support of speculator or rentier economic elite in a way that cause a cyclical turn of an expansion of consumption or constraint, which cause elimination of foxes or lions respectively (Lyon, 2007). In this regard, we can see some implications of economics on political stability in Pareto’s finding. Second, apart from focusing on their behaviors, he divides elites into two as the old elite and the new elite. According to Pareto, there is continuous competition, which ends always in favor of the new elite. Nevertheless, this competition ends with revolution and the replacement of the old elite in the absence of a functioning mobility to the ranks of elite existing structure (Pareto, 1991). In this way, Pareto tries to explain political transformations like French Revolution within the frame of elite theory.

Michels have a similar argumentation to Mosca even though his work comes almost three decades later in 1911. According to him “the majority of human beings, in a condition of eternal tutelage, are predestined by tragic necessity to submit to the dominion of a small minority, and must be content to constitute the pedestal of an oligarchy” (1915: 390). He calls this as *the iron law of oligarchy* and summarizes it as “[w]ho says organization, says oligarchy” (1915: 401). In a way, he tries to show

that independent from the regime type the bureaucratic mechanisms and rule of minority over majority is inevitable.

Looking at the debate above it can be argued that elitist theory did not emerge independent from the political environment of the late 19th century and the 20th century. Classical elitists' thoughts were shaped as a reaction and alternative paradigm to Marxism's social analysis and influenced by the fascist tendencies rising in the 20th century. "The governing elite in the classical elitist formulation is assumed to be a cohesive group – a claim that is difficult to sustain empirically" in the upcoming periods (Evans, 2006: 40).

3.2. Second Wave: Variety within Modernism

It is hard to strictly classify the second wave of elitists. There are different tendencies in the post-1940s to analyze the elite and its role in the socio-political sphere. One group tends to analyze the elite similar to the classical elitists in a monolithic approach. Second group focuses on different elite groups and dispersion of power within the society. Third group draws a more comprehensive frame and focuses on the structure of the elite. This group also prepares a transition to the regime-elite structure debate that will emerge in the 1980s.

C. Wright Mills is one of the prominent names of the monolithic approach within the modern elitists with his book entitled *the Power Elite*. Nevertheless, Mill's approach contends a hidden pluralism by arguing that the power elite is composed of three influential groups in the society, namely political, economic, and military elites. He argues power elite is the driving force in the politics. He mainly focuses on the American society and tries to analyze the main characteristics of the elite in the US. For him elite has a cohesive structure, as there are nationwide interaction networks. According to Mills (2000: 3-4) "[t]he power elite is composed of men whose positions enable them to transcend the ordinary environments of ordinary men and women; they are in positions to make decisions having major consequences". Mills is not categorized under the classical school as he diverges from them by several reasons. First, he divides power groups into three and brings in the military sphere into the debate. This is because of the influence of the World War II, but this group

represents one of the main pillars of the elite in Mills' analysis. Secondly, Mills makes a clear emphasis on the dimension of the institutional links and defines this factor as one of the main reasons of power or celebrity. This is a crucial dimension as Mills points to the link between source of power and institutions along with personal networks and personal traits of the elite. Third, unlike the general tendency of classical elitists "who believed that elites and their organizations were temporary and prone to decay and challenge in the long run", Mills contends that power elite is "invulnerable to mass challenge, and that members of elites are continually refreshed because the bureaucracies recruit the ablest members of each generation" (Lachmann, 1990: 400).

The mainstream elitist approach perceives the social structure in a bivariate model of rulers and the ruled. The main criticism for this approach is mainly built upon the assumption that the elite is not a homogenous group of people. In this sense, modern elitist's pluralist strain argues that power is distributed among different power groups in a democratic society. They analyze the democratic systems and ask the "question of who actually governs"... "where nearly all adult may vote" (Dahl, 1989: 1). For them the society is composed of two spheres: political stratum and apolitical stratum. Political stratum is interested in politics, follows the political developments closely, and takes the necessary action. In this respect, political stratum, in pluralistic approach, has some similarities to the elitist approach, but "it rejects the stratification thesis that some group necessarily dominates a society" (Polsby, 1960: 476). In other words, instead of creating a pyramid of hierarchy, pluralists mainly focus on decision-making process and try to understand the process itself. Observing New Haven, Dahl (1989: 169) claims that "individuals influential in one sector of public activity tend not to be influential in another sector." Additionally, the integration of political stratum does not have a united structure as in classical elitist's or Mills' understanding. Dahl (1989: 92) argues that "there are many lines of cleavage. The most apparent and probably the most durable are symbolized by affiliations with different political stratum". Moreover, there is a reciprocal relationship between leaders and citizens in a pluralistic society (Dahl, 1961: 89). Thus, contrary to the monolithic approach pluralists rule out top down policies that is designed by the elite and implemented without the consent of the society. Pluralists mainly examine the politics in a democratic, pluralist society. For them elite's position is open to

challenge and there is one top-down political process as described by classical elitists. Elites have a heterogeneous structure in spite of having some common characteristics like following similar information channels or being active in politics. In this regard, it is better to talk about interest groups (Polsby, 1960).

Robert Putnam can be studied as the member of the third group that stands between the second wave and the third wave. He also starts from a classical understanding of elites. He says that “some people have more political power than others; they are political elite” (1976: 5). In fact, power has a central role in Putnam’s conceptualization and based on the political power he politically stratifies the society based on actor’s type of influence in decision-making. For him there is a hierarchical structure in the society in terms of political influence and there are six broad strata namely: proximate decision makers, influentials, activists, attentive public, voters, and at the bottom non-participants (Putnam, 1976: 11). For him elites are the ones who stand at the top of the pyramid. Further, he tries to map the main topics on elites like social structure, recruitment, motives, beliefs, structure, and transformation.

To sum, the modernists advanced the classical elitists’ conceptualizations by including the concepts of power, interest groups, and stratification into the debate. In this regard, the elitist school gained a more sophisticated character in the post-World War II period.

3.3. Neo-Classical Elitists

Classical elitists perceive elites as natural byproduct of organizational systems. Modernists make social analyses to understand the social and political dynamics of elites by using biographies, surveys, and interviews as part of their studies. They mainly focus on democratic regimes and come up with two different models as monolithic and pluralistic. Neo-classical elitists emerge as an offspring of these two approaches.

Neo-classical elitists emerge in the 1980s. They are both inspired by classical and modern elitists. Michael Burton and John Higley are prominent names in the neo-classical school. First, similar to classical school for neo-classical approach “elites

are inescapable consequences of conflicting interests in large and complex collectivities” (Higley, 2010: 163). Second, they try to examine the elite structures in terms of their integration just like Putnam. Their contribution to the literature is their argument that elite “configurations vary according to political and social circumstance” (Higley 2010: 163). Moving from this argument they examine the correlation between regime stability and elite unity. They argue that stable democracies are dependent on consensual unity of elites and in case of disunity in elite structure this leads to instability of the regime (Burton & Higley, 1987; Higley & Burton, 1989; Higley et.al. 1991). Moving from this point also we can argue that during the transition period as a natural consequence of instability there is a disunity among the elite groups. This causes an open power struggle and interest conflict between different constellations.

Considering the elite theory’s three waves this dissertation takes the advantage of the existing literature while trying to conceptualize the elite and discussing the issue of unity. In this project, I argue that the level of cohesion/integration among the elites determines the process of restructuring of the energy sector. In this regard, the project starts from assuming that elites are inescapable actors of any system. However, focusing on the level of political elite’s integration, I argue that this depends on the context of political economy as well as political stability.

4. The Elite Structure in Different Contexts

This project examines post-Soviet experience and how energy sector is restructured in Russia and other energy-rich countries. As described before, Russia represents an exception with the emergence of privately-owned national energy companies that controlled the majority of the sector for about a decade.

In this dissertation, I argue that the elite structure has a determinant role on the restructuring of the energy sector. However, it takes into account political economy of a country arguing that the elite structure has different characteristics in different contexts. Consequently, this differentiation also shapes transition period of a country.

In this project, elites are described as organized minorities whose actions or decisions have major political implications on economic and social spheres due to their personal virtues as well as institutional affiliations. The elite in a country does not have a monolithic structure. Looking at our sample in the post-Soviet space we can group elites as new political elite, old elite, economic elite, and counter elite.

1. **New Political Elite (Post-Communist Elite):** Members of the incumbent government represents new political elite, which controls the system after the fall of the communists. These people also come from the ranks of Communist elite, but favor reformist policies rather than having conservative tendencies. In this dissertation, *new political elite*, *new ruling elite*, *reformists* will be used interchangeably.
2. **Old Political Elite (conservatives):** Position of old political elite differs in energy-rich post-Soviet states. Old political elite succeeded to preserve power in some of the energy rich post-Soviet countries like in Turkmenistan and Kazakhstan, but its character modified if not transformed. Old elite weakened, but continued to be influential in political terms in Russia. Azerbaijan has a peculiar character where the old elite faced with the decline of power with the fall of Soviet Union. A group, who can be described as counter-elite captured the power, but could not survive. As a result, the old political elite recaptured the power, but modified if not transformed. In this dissertation, *established elite*, *old elite*, *conservatives* will be used interchangeably.
3. **Economic elite:** Considering the peculiar characteristics of the post-Soviet countries economic elite is mainly composed of oligarchs who control economic institutions and have strong links with the political elite. Oligarchs have a non-ignorable control on industrial and financial sector. Scale and power of economic elite differ in the post-Soviet space, due to changing dynamics of each country during the perestroika. It is argued that Russia has a peculiar position in terms of scale, diversity and power of oligarchs among other republics. The Russian economic elite emerged from the ranks of old nomenklatura due to their advantageous position in late 1980s and early

1990s. The economic elite in other energy rich countries had a mediocre position as they had limited resources compared to their counterparts in the USSR.

4. **Counter Elite:** Counter elite mainly emerged in the perestroika period from the ranks of people who were shown among intellectuals, media representatives and civil society organizations. They were against the Communist regime and mainly had nationalist tendencies. They hardly had strong links within the bureaucracy or government. This became their handicap in the post-Soviet period to survive within the power circles.

Power and influence of these four groups differ. As the state weakens, these groups get into a power struggle to maximize their interests. The elite structure is a more complicated issue than elite groups. Elite capacity and elite integration are important dimensions of the elite structure.

Character of the elite structure is linked with the level of development of a given political economy. The elite structure differed based on the center-periphery divide between Russia and other energy-rich post-Soviet countries in the transition period. In this regard, Russia, particularly due to Moscow, as being the center of the USSR had a more complex elite structure than the other energy-rich post-Soviet countries. This affected the transition process and also the outcomes of restructuring of energy sector. Following the collapse of the USSR, Russian economic elite and members of *nomenklatura* gained crucial privileges in the energy sector. Nevertheless, the state preserved its monopoly in other post-Soviet states.

Based on the discussion above, in this section I will elaborate on elite integration and later the differences between center and periphery in line with Edward Shils' conceptualization to present an insight about the elite capacity. These conceptualizations will form the basis for analytical comparison between the cases of Russia and Azerbaijan.

4.1. Elite Integration

Elite integration or cohesion is one of the main areas of focus of the modern and neo-classical elite literature. In this dissertation, elite integration is examined in parallel to Putnam (1976) and Mills along with Anthony Giddens's (1971), and Higley and Burton's framing.

Putnam argues that there are six key factors for the elite integration; these are social homogeneity, recruitment patterns, personal interaction, value consensus, solidarity, and institutional and social context. Emphasis to social origins is one of the popular features to elite studies. For Putnam (1976 : 109), "social homogeneity is neither a necessary nor a sufficient condition for elite integration." However, Mills (2000: 19) argues that "the power elite is composed of men of similar origin and education, in so far as their careers and their styles of life are similar". Depending on the context, social homogeneity serves to the elite cohesion and prepares a basis for interactions among the elites.

Elites from same educational or social backgrounds are likely to interact more than elites who are coming from different social backgrounds. Personal interaction helps to create certain networks that facilitate coordination. Personal interaction also correlated with geography, size of elite groups, and communication channels.

Value consensus of the elite is more ideological and related with the regime type and political stability. It is mainly linked with the questions of "what is to be done" and "how is to be done". Solidarity is more psychological and related with mutual respect, and trust. Putnam gives utmost importance to the factor of institutional and social context. According to him "if the institutions whose command posts the elite occupy have overlapping interests, the elite incumbents may be led to take complementary actions"...other factors "may have little impact on leaders' behavior" (Putnam, 1976: 122). In this respect as Mills (1976: 11) suggests institutional affiliation of the elite is vital along with the elite's personal features.

Considering the level of elite integration, Giddens' framework on the elite structure should be noted as well. Similar to Putnam, he indicates that while "analyzing the

structure of elite groups we have to be concerned with their level of both ‘social’ and ‘moral’ integration” (1972: 349-350). Social integration refers to character of relationship and contacts between elite groups whereas moral integration is referring to sharing common ideas and common moral ethos.

In parallel, Burton, Gunther, and Higley (1992: 10-11) offer three different elite types as *disunified*, *consensually unified*, and *ideologically unified* based on the extent of structural integration and value consensus. “*Structural integration* involves the relative inclusiveness of formal and informal networks of communication and influence among elite persons, groups, and factions”. In other words, structural integration covers Putnam’s factors other than value consensus and institutional context. On the other hand, “*value consensus* involves the relative agreement among elites on formal and informal rules and codes of political conducts and on the legitimacy of existing political institutions”. Higley and Burton (1987; 1989; 2001) looks at the relationship between political change and elite structures and argue that the united elite is correlated with stable regimes.

Table 3: Elite Integration - Based on Burton, Gunther, Higley (1992)

1) Disunified elite	Structural integration and value consensus - minimal	Irregular and forcible power seizures, attempted seizures, or a widespread expectation that such seizures may occur
2) Consensually unified elite	Structural integration and value consensus are relatively inclusive	Stable regimes that exhibit different configurations of representative politics
3) Ideologically unified elite	Structural integration and value consensus are seemingly monolithic	Stable regime, totalitarian elite and regime configuration

Based on the argument above, I offer a parsimonious framework by looking at three key components to understand the level of *political elite integration* in a country based on Giddens; Putnam; Burton, Gunther, and Higley. These three components are *value consensus*, *structural integration* and *institutional context*. Value consensus refers to existence of solidarity and similar aims or ideas for the future of the state (what is to be done and how is to be done). Structural integration is related with the geography, social homogeneity and personal networks. Institutional context is directly related with the level of accordance of interests of the political elite in different institutions such as the parliament, political parties, ministries, presidency and so on. One can categorize political elite integration as “strong” or “weak” by examining these components.

4.2. Center-Periphery Divide and Its Implications on the Elite Structure and Elite Capacity

As indicated above issues of value consensus, structural integration, and institutional context, driven by interests, shape the level of the political elite integration. Values are mainly shaped by cultural and intellectual context. Additionally, structural integration is related with the geography, social homogeneity and personal networks. If the context matters and elites are part of a social phenomenon then to have a better understanding about the nature of the elite structure, we should have a better insight about the society that the elite groups dwell in.

A modern society has a dynamic and non-monolithic structure. There are diverse groups in a society who are located in different areas with peculiar economic and political conditions. According to Shils (1975: 36-39) from a macro-sociological perspective dynamism in a society happens through the interaction between the center and periphery. He defines center and periphery as:

To be a society, a social system must have its “center of gravity” within itself, i.e., it must have its own system of authority within its own boundaries. It must also have its own culture...Center consists of those institutions (and role), which exercise authority – whether it be economic, governmental, political, military – and of those which create and diffuse cultural symbols – religious literary, etc. – through churches schools, publishing houses etc. The

periphery consists of those strata or sectors of society, which are recipients of commands and of beliefs which they do not themselves create or cause to be diffused, and of those who are lower in the distribution of rewards, dignities, facilities etc... The periphery is very differentiated: it may be said to cover a large area around the center.

Center has an active, lively character and periphery has relatively a passive nature. This dualism can be seen in every modern society. Territorial extension is a key factor here. The modern societies in a state extend through a large territory. On this territory the state mechanism has an authority and its role is determinant on various issues like producing the values to be dispersed, policies to be implemented and it has the power to use legitimate power. In Shils' model, this authority is used by elites "as ruling class and the state is the political arm of this class" (Migdal, 2004: 45).

Shils (1975: 39) argues that

[A]ll territorially extensive societies tend to have a spatial center as well, which is, or is thought to be, the seat of the central institutional and cultural systems. To this center or centers, much of the population looks for guidance, instruction, and commands concerning conduct, style, and belief. The center of a given society might also be in some respects the center of other societies – for example, Paris has been for several centuries the cultural and artistic center not only of France, but much of Europe and French-speaking Africa.

In all of the countries there are at least one spatial center as capital cities of the country. Along with capital cities, sometimes there are centers of culture and economy. These non-capital centers can be centers of a country or group of countries. As Shils suggests the institutions and roles played by these spatial centers are different than the ones in peripheries. These institutions are more sophisticated and innovative. Parallel to this, in the center, human resource is more qualified and more adaptive to the global trends. In a way, if the center is the main source of politics, and ideas to be produced and dispersed from here then these roles require stronger institutions and richer human source capacity. Thus, there will be diverse career fields, elite groups, and values in the center that give shape to these policies. This divergence creates differences in *the elite capacity*. The elite in the center have a higher capacity with higher qualifications and accessibility to more sophisticated

institutions than those in the periphery. Naturally, the higher the elite capacity the higher the capability of influencing policies in a given country.

This center-periphery divide is also applicable in macro level. As Johan Galtung (1971: 81) argues “the world [also] consists of center and periphery nations”. In other words, there are countries which play the role of periphery in the world system and there are countries those play the role of center. This brings up a two-level division that countries have their own centers and peripheries within their own boundaries. Thus, the same pattern can be seen for the center-periphery divide of each country for the sophistication and quality of human resources.

This debate indicates that social and institutional formation of center and periphery countries has structural differences as well as their elites. Elites and institutions in center are more sophisticated and more innovative as they create policies and ideas. Moreover, these people have better access to intellectual and financial sources. This creates a more diverse elite structure than in the periphery. In peripheries the elite are more receptive and the institutions have more simplistic structures. It is hard to talk about significant diversity within elite circles in the periphery. Thus, the transition process as well as the elite dynamics, follows divergent patterns in center and periphery countries.

The USSR, which was a gigantic political system, had its own center and periphery. On the one hand, the RSFSR, was the federal state which hosted the federal administrative institutions like the Supreme Soviet, headquarters of security and intelligence units, propaganda units, the Politburo of the Communist Party, best institutions for higher education and so on. The agency of the elite in the center had better access to the international system through the existing institutions. On the other hand, the remaining fourteen republics had autonomy from the center, but were also receptive, and obedient. There were local institutions occupied by local elites, those were mainly concentrated on the local political and economic dynamics. Propaganda, security and intelligence units were responsible of stability in national (republic) level. Local institutions mainly derived power from the center. They did not have an innovative role, but operational obligations. Moreover, they had access to Moscow as the center, but did not have a direct access to the international system

without the center's permission. Thus, the elite has a less diversity and capacity in the periphery than those in the center.

After the dissolution of the USSR, the member states inherited not only the institutions, but also the human capital within their borders. The elite structure in the center (Russia) had a more diverse character and higher capacity than those in the periphery. New actors, like oligarchs, who owned banks, emerged in the post-Soviet Russia as part of the economic elite along with different groupings in the political scene. Moreover, the elite in the center had better capabilities thanks to qualifications they had like better command in foreign languages, understanding of the rules of neo-liberal economy, and existing links abroad. In other post-Soviet countries, such diversity and capacity within the elite was not apparent. The diversity in Russian elite had important implications on the elite structure as well as the restructuring of the energy sector in the transition period. In this regard, the context of the political economy of each country should be considered examined closely to understand its implications on the elite structure.

5. CONCLUSION

In this part, I reviewed the-state-of-the-art in the literature on the political economy of hydrocarbon resources. I highlighted the leading two debates that I wish to engage with in this dissertation. One of them is the debate on the rentier state, and the other one is the debate on privatization and nationalization/expropriation. The former is the main body of the literature on the political economy of hydrocarbon resources. It looks at the implications of hydrocarbon revenues on political and economic spheres. Here, the state is taken as a given and it has a monopoly on the energy sector. The debate on the privatization and nationalization/expropriation is a state-centered theoretical framework that examines the reasons behind the state's decision to privatize or nationalize the energy sector.

These debates, I argued, have a narrow focus in two respects. First, mainly both of these focus on the dualistic relationship between the state and foreign oil companies. They overlook the cases in which the privately-owned national companies control the majority of the energy sector in an energy resource rich country. Second, these

debates take the state as a black box; as such the role of agency of the elite is not adequately developed therein.

I argue that we need to look beyond the state to explain the reasons behind different outcomes in restructuring of the energy sector such as the emergence of privately-owned energy companies. For this purpose, I propose *the comparative elite structure model*. In this model, I analyze the elite structure in a country based on two dimensions: (i) elite capacity and (ii) political elite integration.

Depending on elite capacity, the level of political elite integration determines the maneuvering space of actors or groups in a country. Countries with weaker political elite integration presents broader maneuvering space for actors seeking to maximize their interests in the transition period. However, in the countries with strong elite integration, the maneuvering space is controlled and dominated by the state itself. In the former, elite capacity has a primary role to play. The agency of the elite, with will and higher capacity, have a stronger leverage to maximize their interests in the countries with weaker elite integration.

I further incorporate Edward Shils' "center-periphery divide" to have a consistent comparative basis considering the fact that there is a correlation between elite capacity and level of development of political economy a given country. Elite capacity is an important variable to explain elite's capability to manipulate and shape policies as well as elite integration in a country. At the center, capacity of the elite is higher, whereas it is lower in the periphery. Based on this suggestion, elite integration weakens more at the center during the transition period, since there is more diversity within the elite circles as well as more actors who seek to maximize their interests.

Thus, in *the comparative elite structure model*, the state is not taken as a black box. Rather, the elite within the state and society is examined in a comparative manner to understand the different outcomes in the restructuring of the energy sector. Using this model, I will examine the reasons of emergence of different outcomes in the restructuring of the energy sector in the post-Soviet space. I will comparatively examine three cases in an in-depth manner. Among these three cases, Yeltsin's

Russia with the privately-owned energy companies which control the majority of the energy sector represents a unique case that diverges from the other post-Soviet experiences. The most similar cases are Putin's Russia and post-Soviet Azerbaijan, in which the state dominates the energy sector.



CHAPTER 3

THE CASE OF RUSSIAN FEDERATION THE RESTRUCTURING OF ENERGY SECTOR IN THE CENTER

1. INTRODUCTION

Energy sector in Russia has a hybrid ownership structure. The state shares the control of energy sector with privately owned national companies and foreign corporations. The share of state control has had a dynamic structure since 1992. After the privatization of 1990s the private sector got the majority of the energy industry, but the picture reversed in 2000s.

After the regime breakdown, Russian political landscape presented a broad maneuvering space for different actors with will and capability to pursue maximization of their interests. These actors were mainly the legacy of Russian Soviet Federative Socialist Republic (RSFSR). A country, which had central characteristics in a closed-system, faced with a deep trauma with the liberalization efforts of 1990s. Once being strong, Russian state had a weak character throughout the transition period. Elite diversity gradually weakened and paved the way of a stronger political elite integration in the political sphere that led to restatization of energy sector in 2000s.

This chapter examines the causal mechanism behind the change in ownership structure in Russian hydrocarbon sector. In this framework I divided this chapter into three parts. First, I will scrutinize institutional legacy of the Soviet Union and Gorbachev reforms. These served to emergence of new elite groups and prepared a climate for them to reach to necessary means to capture state assets. Second, I will examine the political elite integration in the Yeltsin period and how the energy sector restructured throughout the 1990s. One of the peculiarities of this period is weak elite integration with strong confrontation. Under these circumstances, the ownership of

the energy sector has totally changed and new vertically integrated oil companies emerged. Yeltsin's successor, Putin came to power in a favorable scheme that this helped him to bring people from his network to critical positions and pursue policies of centralization. The stronger the political elite integration, the state control became stronger in the energy sector under Putin's rule. In this regard, in the last part I will look at the elite structure, and how it interplayed in restructuring of the energy sector in 2000 onwards.

2. Institutional Legacy of the Center and the Regime Breakdown (1980s-1991)

The RSFSR was one of the member states of the USSR, but as being the center of the union had some peculiarities that put it into a different category than others. These peculiarities affected the transition process as well as the elite structure in Russia. In this regard I divided this part into two. Firstly, I will describe the peculiarities of the center by focusing on its institutions and human capital. In the second part, I will look at Mikhail Gorbachev's reforms that was started to be implemented in the second half of the 1980s and shook the union from the very basics of its foundation. I argue that these peculiarities and reform process were influential on policy choices of 1990s, since these paved the way for Yeltsin to come to power in a setup of a weak political elite integration and actors with high capacity. This setup played a determinant role in an environment of weakening and even collapsing institutions.

2.1. Legacy of the Center: Russian Soviet Federative Socialist Republic (RSFSR)

The RSFSR was the political center of the USSR, but also it was the biggest and strongest member of the Soviet Union with its economy, territory, population and vast resources. These characteristics of the country also defined the political institutions as well as the elite structure during the Soviet rule and afterwards.

After the Bolshevik revolution the Tsarist Russia collapsed in 1917 and a new system was established based on Communist ideology. Russia was the center of the revolution and the regime. Bolsheviks established "...an extremely centralized

political system...(with) single party rule, communist ideology, state control over the economy and high degree of territorial centralization, and isolation from the outside world” (Tsygankov, 2014: 62). Territorial centralization also led to the emergence or consolidation of satellites around the center. 14 member states gained a more passive and reactive (not active) character towards the center. Gaining a peripheral character these satellites were looking up to the capital for receiving new orders to be followed, while the center was responsible of reconstructing of the ideology, making planning and governing of the USSR.

Bolsheviks changed the imperial capital’s name and moved the government from Leningrad to Moscow in 1918. After Peter the Great, once again Moscow became bureaucratic, political, and economic center while St. Petersburg lost its privileged status. The ministries, international airports, universities and many other institutions were located in the capital.

Centralized character of the political system and command economy made political institutions in Moscow distinctively capable and powerful. This was also related with the political economy of the socialist system. Kotz and Weir (2007: 188) argue that “the state socialist system was a very centralized one in which outputs, inputs and production processes were closely specified for enterprises all across the Soviet Union from the center in Moscow”. The USSR was like a big machine having branches or subsidiaries spread around 15 member states. In this regard, Moscow was acting with capability of a conductor and orchestrating the economy from planning to the last phase of production. In this set up, peripheral actors were rather passive compared to the center’s active position in planning and directing the areas of politics, economy and culture. To be able to perform such a big responsibility the Communist system built up a complex, bureaucratic system, which also became more elitist in time contrary to the main ideology’s principles.

The Communist Party of the Soviet Union (CPSU) was the political and ideological center of this gigantic structure, with its institutions like the Congress, the Secretariat, Politburo, the Central Committee and Komsomol (youth organization). The CPSU and its members were enjoying the monopolist position of the party since in this ideologically structured system the party was dominant in the political sphere.

As Mawdsley and White (2000: 241) suggest “there was no legal basis for another political party in the USSR until 1990, when the CPSU’s leading role removed from the constitution, and there was no challenge of this kind up to late 1980s, when a number of ‘informal’ movements began to erode the party monopoly”. This naturally made the party and its leader the strongest political actors in the USSR. Leaders like Joseph Stalin and Nikita Khrushchev were so strong in political terms since they were also occupying critical positions in the government. To prevent such a concentration of power, the Central Committee adopted a resolution in 1964, which brought the principle of the seats of party leadership and prime ministry to be held by different names (White, 1988).

Politically the party had a role of steering, shaping and overseeing of the policies, but the implementation of the policies was on the shoulders of governmental body. Among these there were institutions like Council of Ministers, ministries, and operational units like armed forces and industrial enterprises. Apart from political institutions there were also planning and financial agencies like Gosplan (the state planning agency), Gosbank (the Central Bank), Goskomtsen (the state price committee) and also the security institutions, which were performing under the umbrella of the government or in coordination with its branches.

There were two types of people in bureaucratic-political institutions; *nomenklatura* and *apparatchik*. Nomenklatura is a concept used for power elite in higher echelons of the socialist system with strong party links and approval, whereas apparatchik is a term to define lower ranked professional, full time career bureaucrats or politicians who had also possibility to become member of the nomenklatura if they perform within the terms of the regime. Distinguishing feature between the local elite and the elite in Moscow was that local elite had limited access to the world outside and limited access to the means and information.

Moscow was not only the capital of the USSR, but also the center of Communist ideology in the global scale and it had capability to conduct affairs with the socialist and the capitalist world. This was possible through well-trained people who were graduates of prominent faculties in Moscow. Unlike in other universities of the USSR, in universities like MGIMO, students had chance to learn foreign languages

and read textbooks including titles such as “International Currency-Financial Organization of Capitalist Countries, Currency-Credit Relations in the World Trade, Finances of the Capitalist States” (Hoffman, 2011: 304). After their graduation, these students became envoys of the system, accumulated experience and knowledge abroad.

The RSFSR was the center of the country and Communist ideology, but also had a federative character. There were many districts with different administrative levels under the umbrella of the RSFSR. Moscow had a peculiar position, but just like in other member states, regional unit under the RSFSR had their own Communist Party structure and institutions. In this regard, there were another group of local elite that composed of party members, administrative staff and directors of the industrial units known as red directors.

In time, the socialist system evolved into a bureaucratic and ideological giant with an elitist character in a sense that nomenklatura were enjoying some privileges in parallel with their positions. The privileged minority had access to special shops for their daily needs, holiday resorts, better housing, and so on. Nonetheless, the system had its own rules too; the positions of nomenklatura were not transferable to their children, rather they had some other alternatives like being trained as a journalist or a diplomat (Mawdsley and White, 2000: 260). In this regard, family members had an access to the outside world whereas the remaining of the society were facing restrictions of mobility.

The elite had so many advantages within the Communist system in parallel with their positions. Naturally, quality and capability of the elite, and the means they could access were peaking in the center. The RSFSR was the center of the USSR and its capital, Moscow, was hosting headquarters of the political and economic institutions. It was not only the heart of this gigantic system but also the portal to the outside world.

Up until mid 1970s the Soviet system was capable of keeping up with the US in the competition, but it started to give signals of sustainability problems in the last years of Leonid Brezhnev’s rule (Desai, 2006: 20). The need to address challenges of

corruption, economic inefficiency, and high expenditures for military industrial complex became more apparent when oil prices started to decline in the 1980s. Even though some cosmetic steps were taken by Brezhnev's successors Yuri Andropov and Konstantin Chernenko, it was not until Mikhail Gorbachev the elite in Moscow articulated structural reforms in the system. Yet, these reform attempts would fall short of preventing the dissolution of the Soviet Union.

2.2. Failure of Mikhail Gorbachev's Reform Attempts and Collapse of the Soviet Union

Mikhail Gorbachev became the Secretary General of the CPSU after the short reign of his two predecessors, Yuri Andropov and Konstantin Chernenko. When Gorbachev became the leader of the USSR the economic dynamics were not in good shape. The military industry became a big burden due to almost 40-year old Cold War, and inefficiency of the command economy began to be felt severely in daily lives of people. In fact, economic problems started to emerge in the final years of Brezhnev administration. Shortages of basic needs in the economy became one of the acute issues waiting to be addressed. Under these circumstances black market and interpersonal relations had already become important than ever. These were just symptoms of structural problems in the command economy. "Money played a little role as there was nothing to buy in the shops that ordinary people could access, while the elite enjoyed exclusive access to shops that were closed to the general population" (Ledeneva, 2013: 27-28).

Government's incapability to regulate supply chain to satisfy daily needs of Soviet people was undermining the legitimacy of the political system. Gorbachev was not as lucky as his successors who were using oil revenues as an instrument of compensation to import basic needs of the economy. Declining oil prices in the global market starting with the second half of 1980s put the new leader in a very hard position.

Under these circumstances, Mikhail Gorbachev chose a radical path to tackle these major problems. He decided to overcome these challenges via political and economic reforms. Gorbachev came up with an ambitious agenda and brought up concepts like

perestroika and *glasnost*. Perestroika can be defined as reformation or reorganization, and the glasnost as openness with political connotations.

Gorbachev's reforms were attempts of changing the system starting from its roots. The economy needed to become more competitive, open and regime more democratic. He started to use a tempting and ambitious discourse to explain his idea of perestroika. "Appearing almost daily in speeches and in the press, the word [perestroika] now sums up a range of new themes: openness, honesty, the need for harder work, more personal initiative, less talk and more action" (Bohlen, February 23, 1986).

This new discourse also had to be made with a new cadre, because the state and the Communist Party were not ready to embrace the reforms (Bradley, 1995: 15). Brezhnev built up a static system of elites and left a gerontocracy behind him. When Gorbachev came to power in March 1985 average age of the Politburo members was sixty-eight. Five of its full members were born before 1917 (White, 1990: 9). Thus, coming to power and facing with opposition just like his predecessors, Gorbachev chose to reshuffle the higher echelons of the elite structure, which gave him the chance to consolidate his position. Faces in the Politburo, party secretariat, and party leaders in the republics have changed noticeably between 1986 and 1990 (Mawdsley and White, 2000: 196). The inherited elite structure from Brezhnev shifted in a sense that Gorbachev appointed new figures by eliminating the old ones. "Almost two thirds of department heads in the Secretariat, 52 percent of the Central Committee members, and 40 percent of the USSR ministers were replaced" in a couple of years' time (McCauley, 2002: 389).

Soviet economy's structural problems were beyond to be solved with a tempting discourse. Yet, Gorbachev soon chose the easier path; political reform with a strong tone of democratization (Interview Anonymous, May 18, 2013). In other words, he focused on more political reforms than painful structural changes in the economy.

Starting from 1988 in line with Gorbachev's democratization discourse, character of the elections changed. Before, the CPSU was the only authority to determine the candidates and mostly there were no more than one alternative for a district. This

changed in the elections of 1989. The popular elections undermined prerogatives of the Communist Party and narrowed down the government's maneuvering space by setting up a presidential system and led to shift of power from the party to the state ("Key Sections of Gorbachev Speech Given to Party Conference", 1988; Tatu, 1995: 24). Making these changes Gorbachev managed to get the support of new comers among the nomenklatura and apparatchik, who wanted to get rid of Brezhnev style gerontocracy. Nevertheless, the pace of reforms also had controversial impacts on Gorbachev's power in Russia and in the USSR.

1989 constitutional amendments changed the political landscape in the USSR and the RSFSR. Up until 1990, Russia was hosting the meetings of Congress of People's Deputies in the Union level, and there were no party organs at republic level. The new reforms paved the way for Gorbachev's the presidency in the all-Union level and also a new legislative organ for the RSFSR, the Congress of People's Deputies of Russia. Gorbachev, weakened the party and the government with these reforms. Nevertheless, he could not prevent an opposition thrive against him. This opposition became more apparent after 4 March 1990 legislative elections in Russia.

The opposition groups in Russia gained an important platform with the establishment of a legislative body in the republican level. Supporters of democratization and market reforms found chances to become an actors in the center without the chains of the Communist Party. One of these figures was Boris Nikolayevich Yeltsin, who became a member of Congress of People's Deputies of Russia, in the elections of March 1990, from his hometown Sverdlovsk. Later he would sideline Gorbachev from politics and become the new leader of Russia in the 1990s.

Yeltsin was a member of the nomenklatura who managed to come to Moscow from Sverdlovsk. He became the member for the Central Committee of the Communist Party in 1981 and came to Moscow and then joined to the ranks of the Politburo in 1985. Being a supporter of reform process, Yeltsin was disappointed with the pace of reforms. He became a harsh critic of the regime and Gorbachev. Gorbachev politically sidelined Yeltsin in 1987, but not eliminated him totally from the political scene. Yeltsin resigned from the Politburo and was ousted from his post as Moscow mayor. Shortly Gorbachev gave him another position in Moscow rather than sending

him to exile. He was humiliated, pacified, but kept aside as an asset under control by Gorbachev (Scheer, November 12, 1997; Bohlen, November 19, 1987; Aron, 1990). However, Yeltsin turned back to politics as a challenger against Yeltsin with the new reforms.

Congress of People's Deputies were gathering twice a year and they were electing members of Supreme Soviet, which was a permanent legislative body. Yeltsin decided to run for the chairmanship of the Russian Supreme Soviet as a deputy. Yeltsin was a popular figure in Moscow and taking the support of rising opposition groups in the Parliament he was elected as the chairman of the Russian Supreme Soviet, which was a position equal to the president of the RSFSR (Peel, May 30, 1990; Rettie, May 30, 1990). This position confirmed by the people, when Yeltsin became the first popularly elected President of the RSFSR in June 1991. In both cases, Yeltsin won both of the elections against Gorbachev's candidates.

In June 1991 Nikolai Ryzkov was running for the presidency. He was an important political figure and the Prime Minister of the USSR under Gorbachev. There was also Vadim Bakatin, who was seen as a protégé of Gorbachev. Both of these runners lost the race against Yeltsin. Actually, this shows the dramatic change in the Soviet politics in parallel with the political reforms undertaken recently. Gorbachev's power as the leader of the CPSU was not as decisive as his predecessors and the system started slipping away from his hands. Moreover, political reforms were undermining the dominance of the party and the traditional institutions of the Communist regime. New actors had already emerged out of the CPSU's hierarchical reach and strongly integrated elite structure under Brezhnev period had already transformed.

Soviets and the communist system were in inevitable decline. With new reforms, republican Supreme Soviets at local level gained important political power, which had different implications in different states. The main debate shaped around democratization in the public level and Russian Supreme Soviet, whereas it was ethnic nationalism mainly in Baltic and Caucasian republics (Interview Anonymous, May 18, 2013).

Taking the advantage of the wind of change, the new Russian parliament issued the 'Declaration of Russia's Sovereignty' on June 12, 1990 in the First Congress of People's Deputies of the Russian Federation (Goldberg, June 12, 1990). The declaration asserted Russia's sovereignty and the supremacy of its laws over its territory (Russian Parliament Declares Sovereignty, June 12, 1990). After this decision the RSFSR took over the control of the institutions and economic assets within its borders and outlawed the Communist Party's leadership "in the state, in enterprises, the KGB and the army" (Sakwa, 2008: 18; Dunlop, 1993: 613).

This dramatic move encouraged other republics further as well as the autonomous regions in Russia. Following this political decision, "autonomous regions declared their sovereignty asserting the right to control their own natural resources" causing further pressure on Leningrad and Moscow due to shortages of supply (Olcott, 1991: 128). Gorbachev also encouraged autonomous republics' claim of sovereignty as a response to separatist moves and weakening power of the center with the intention that facing with political challenges the republics would in return ask for the center's assistance to preserve their integrity (Fowkes, 1997: 180). Yet, this strategy fell short of achieving this end while the political wheel continued rolling.

Ethnic nationalism gained ground against the Communist regime in the member states. Glasnost prepared a favorable environment for national movements to gain ground against the rule of the Communist Party, particularly in the Baltics and the Caucasus. Gorbachev started losing its authority on member states and this triggered atomization within the political elite circles in the periphery and the center. The first ethnic based revolt emerged in Kazakhstan to protest the Gorbachev's decision to appoint an ethnic Russian as the First Secretary of the Communist Party of Kazakhstan instead of an ethnic Kazakh as his successor Dinmukhammed Kunaev (Starr, 2006; Rousseau, 2010; Interview with Anonymous on May 18, 2013). Even if the revolt was taken under control, later the dynamics got even more complicated in the Baltics and Caucasus as the national groups started to gain power while the Soviet ideology losing hold in Eastern Europe and the USSR.

Popular fronts/movements in the Caucasus and the Baltics were looking for ways of seceding from the USSR. Starting from spring 1990, the Baltic republics declared

their independence and the dissolution started from the West. As Gorbachev losing the control at the federal level the atmosphere in the capital gradually became obscurer. The political cadres in the capital divided into different fragments as conservatives and radicals. The former was defending the virtue of preserving the regime while the latter was in favor of making changes that would bring freedom and democracy to the society. Radicals were also supporting the policies of perestroika and glasnost, but in time their position started to diverge from Gorbachev's (Hough, 1990: 639). They started to think that Gorbachev was so slow to implement reforms to make structural changes in the system.

Gorbachev was facing great difficulty to control the USSR in one piece. Yeltsin (1994: 35) argues that "[t]he USSR ended the moment the first hammer pounded the Berlin Wall" in 1989. As the Union was giving signals of dissolution, Gorbachev's popularity ratings were plunging (Remnick, April 2, 1991). In the elite circles he was in a great dilemma; he was facing with the opposition of the democrats when he acted slowly to make the reforms, but he was also accused of betrayal by conservatives when he continued with the reforms (Shevtsova, 1999: 7; Goldstone, 1998: 114). Failing to control the pressure coming from Yeltsin and radicals he came up with a political solution that could be seen as a compromise. Known as "the Union Treaty" the new formula would loosen the control of Moscow on other member states, but might keep the member states on board.

Gorbachev came together with heads of the states at a dacha in Novo-Ogaryovo in 24 July 1991 (Soviet Republics Approve Treaty, July 25, 1991). Six republics (Baltic States, Moldova, Georgia and Armenia) boycotted the agreement, but the representatives of the remaining nine republics agreed with the proposed framework that gave further autonomy to the republics. Parties decided to sign the treaty in three months' time expecting the ones who did not participated to become a part of this initiative.

This maneuver strengthened Gorbachev relatively in political level, but caused the conservative fraction in Moscow to blame him of ruining the country. The new framework worked as an icebreaker between Gorbachev and Yeltsin. Even after July 24, Yeltsin and Gorbachev continued to come together unofficially with the participation of

Nursultan Nazarbayev to talk about the term of references of the new system (Yeltsin, 1994: 38). After they agreed on the new framework and share of roles, Gorbachev left for his dacha in Crimea on 4 August 1991 and the signing ceremony of the treaty was scheduled for 20 August.

For the conservatives, the Union Treaty was the end of the USSR. This group with the collaboration of the security forces and the KGB attempted the infamous coup d'état on August 19, 1991, just one day before the signing ceremony of the Union Treaty. Tanks started to run in Moscow streets and sieged the White House (The Supreme Soviet). By the time Gorbachev was on holidays in Crimea, KGB was holding him in his dacha (Yeltsin Leads Fight Against New Leaders, August 19, 1991; Gorbachev Said to be Held Incommunicado Under KGB Supervision, August 20, 1991).

The main target of the coup attempt was to topple down Gorbachev by force and to reestablish the Soviet rule before the Union Treaty came into force. Yet, the coup faced with public resistance on the streets. Yeltsin became the symbolic figure of this resistance. As the military forces sieging the parliament, Yeltsin was yelling "clouds of terror and dictatorship are drawing over the whole country and they must not be allowed to bring eternal night" (Boulton, August 19, 1991).

Yeltsin came out of the failed attempt of coup d'état as a hero. Leaving behind the threat of coup d'état, Yeltsin issued a decree to suspend Russian branch of Communist Party as the President of the Russian Federation on 23 August 1991 and the police sealed the building of Soviet Communist Party (For Communists, the Party's over Series: End of an Era, August 24, 1991). Russian flag has changed and tricolor flag was adopted that was used by Peter the Great. Yeltsin went further and ordered the regime's newspaper Pravda's publication to be halted along with other publications of the Communist Party (Bohlen, August 24, 1991). The Party that ruled the country with an iron-fist was dissolved shortly with its important institutions, and Yeltsin was taking these bold steps against the Politburo.

The collapse of the Soviet Union also eliminated Mikhail Gorbachev from the political scene. The Soviet Union was officially dissolved with the agreement

between the leaders of Ukraine, Belarus and the Russian Federation in Minsk on December 8, 1991. As the signatories of the 1922 agreement, these countries declared the cessation of the USSR and establishment of the Commonwealth of the Independent States (“Text of Agreement By Slav Republics”, December 8, 1991; Dejevsky & Seely, 1991). 15 new republics emerged out of the USSR, and Russia was one of these newly independent states. Following the dissolution of the USSR, the struggle between the conservative politicians and the ones who wanted to get rid of the institutions of the communist system with any cost changed character. It was no more between the institutions of the USSR and Russia. Gorbachev left behind a chaotic political environment with diffusion of power between the Kremlin and the Supreme Soviet.

Yeltsin was the main actor to lead and survive the dissolution process and he did not wait so long before taking the office in the Kremlin from Gorbachev (Shepherd, December 27, 1991). Gorbachev left his office and the political arena before the New Year (Dobbs, December 26, 1991). Gorbachev, once a powerful figure of the Communist world, became an ordinary citizen of the Russian Federation. However, deputies elected in 1990 for the Supreme Soviet of Russia preserved their positions until the parliamentary elections and the referendum of the new constitution in 1993. The Supreme Soviet of Russia became the legislative power of Russia in line with the reforms took place after 1988. Even though Yeltsin was elected the President in June 1991, he had to share the power with the Supreme Soviet, and the Congress of People’s Deputies whose members getting together twice a year. Moreover, in economic terms the new state inherited the actors who emerged in the second half of 1980s as a result of experiments of market reforms. Anonymous (Interviewed on June 9, 2013) describes the political environment as:

Polycentric, pluralist, not well structured. After the collapse of the USSR and the collapse of the communist body rule, a lot of actors went into the public space. They started competing among themselves for economic and political power. 1990s in general terms was a period of when the political landscape in Russia witnessed the emergence of plethora of players without clear rules. It was a situation, which the powerful agents or actors could win.

These characteristics of the political environment also shaped the political economy of Russia throughout 1990s. Coming to power with the support of coalitions and the support of people, Yeltsin had bigger challenges ahead of him; a political system with deteriorated state structure, polycentric and under these circumstances he was supposed to make the necessary reforms to overcome economic problems and political challenges at home and abroad.

3. Weak Elite Integration with Strong Elite Confrontation (1991-1999): Weakening State Ownership in the Energy Sector

Yeltsin's period had so many controversial characteristics. Among these it is important to underline his commitment to integrate Russia to the global system and transform Russian institutions swiftly to prevent a possible setback. However, he had to deal with grave economic and political challenges. He had to overcome these challenges mostly by giving compromises, making changes in his team and putting the blame on others. Energy sector was one of these areas of compromise. In this regard, the political landscape definitely affected the restructuring process of the energy sector.

This part is composed of three sections. First, I will look at the political elite integration throughout 1990s. Second, I will elaborate on how the legacy of Soviet Union shaped elite capacity and what sort of means they had. Third, I will analyze the restructuring of energy sector in Yeltsin era.

3.1. Weak Political Elite integration with Strong Confrontation: Construction of the Yeltsin Regime

Yeltsin was a figure with no support of a certain political group or party with a homogenous structure. He became the leader of the country as a result of a series of events that ended up with the collapse of the Soviet Union. In fact, he had to integrate different figures to his team throughout 1990s based on necessity and compromises. This enabled different groups or actors to seek ways of maximizing their power through the corridors of Kremlin. Moreover, the institutions inherited from the RSFSR did not evaporated overnight. Under the circumstances of the

transition period, there was hardly coordination among the institutions that even turned into conflict from time to time.

This part seeks to analyze the political elite integration of the Yeltsin regime. First, I look at the institutional context with a particular focus on balance of power between legislative and executive bodies. The conflict between these two shaped the political landscape in Russia, and also preferences of Yeltsin. Second, I will have closer look at Yeltsin and personal networks around him. In the third section, I will examine up to what extent it is possible to talk about a solidarity and similar aims or ideas for the future of the state among Russian political elite in 1990s.

3.1.1. Institutional Context of Russian Elite Integration

Yeltsin inherited a system in transition from Gorbachev. Change in Russian society and politics had already started in 1980s with Gorbachev's reform process. Political system tumbled down in 1991, which Russian politicians enjoyed since 1920s. Before, the regime's leader had a dominant position with the support of the CPSU. Gorbachev undermined the power of the CPSU when he decided to change the election system in the USSR. the Central Committee's dominance with other institutions of the party had diminished and the soviets became stronger. Yeltsin's decision to abolish the CPSU just after the failed attempt of the coup d'état was the final nail in the coffin. The CPSU was gone, but there was no such an institutionalized party structure to substitute the created vacuum. There were some loose groupings acting within the Parliament that Yeltsin might coalesce, but these were not powerful or disciplined. Another option was controlling the system through the executive power with the leverage he had in the presidency, but this was not an easy task.

In the absence of a party discipline, Yeltsin had no direct control on the deputies, and they had no homogenous character in terms of its elite profile. The Communist rule came to an end in legal terms, but the new system was still working on the legal basis of 1977 constitution. The Congress and the Supreme Soviet had become important power centers after the popular elections. These legislative organs had political leverage on the system. The Congress had the power of vote of confidence on the

government and also could adopt legislations that would limit or expand Yeltsin's political maneuverability.

After the popular elections, former representatives of the CPSU or nomenklatura became deputies in critical positions (Kryshtanovskaya, 1996: 24). More than half of the Congress' members were former communists, but there were new faces in the legislative bodies with different backgrounds (Cooperman, April 6, 1992). These ran for the popular elections without seeking the approval of the CPSU and inevitably different groupings emerged in the legislative organs (Lane & Ross: 446, 1994). The profile in the Supreme Soviet was not that different. The majority did not hold high positions under the soviet regime rather they had middle-level positions (Lane & Ross, 1995: 57).

In this diversity and weakening party discipline, political atmosphere in the second half of the 1980s were rather chaotic and new comers were not hesitant to share their views in the public sphere with a critical tone. As described in the previous part, this turned into an advantage for Yeltsin while taking down the Communist system and Gorbachev, but later turned into a great obstacle. Yeltsin had to perform under the pressure of the legislative organs in the new setup after 1991.

Yeltsin did not invest in political groupings in the legislative organs. Having a loose link with the democrats in the Supreme Soviet, he chose to ignore the balances in the legislature and to govern the state by decrees thanks to the authority he obtained in 1991., Yeltsin and democrats had limited interaction and weak links. As a result, they started to drift away from each other. Having problems to reach out to Yeltsin, one of the influential groups in bringing Yeltsin to power, DemRossiya, started to lose momentum in the Parliament. Some members of the new elite in the legislature, which comprised of intellectuals with liberal views, lost their trust in Yeltsin. These people started to pass to the bureaucracy or opposition. While liberals and democrats losing momentum, the legislative organs gained a more conservative character. They were standing aloof to Yeltsin's and his team's efforts of market liberalization. In the end, the lack of harmony between the legislative bodies and the government evolved into a spiral of tension.

The tension had already started even before the 6th Congress of People's Deputies, which took place in April 1992. Khasbulatov gave the message that the 6th Congress was not going to be an easy ride for the president and the government. He even did not hesitate to use a dramatic discourse that indicated Russia was in the edge of collapse due to the complicated situation in the entire country (Chairman of Russian Congress Says Country Near Collapse, April 6, 1992). It was indeed hard times for Moscow. Yeltsin was trying to keep the federation together, while some autonomous republics like Tatarstan and Chechen-Ingushetia looking for independence. He managed to negotiate and sign a new federation agreement with the regions in an uneasy atmosphere, but Tatarstan and Chechen-Ingushetia refused to sign the agreement on May 31, 1992 (Burke, April 1, 1992). Tatarstan even held a referendum on sovereignty ten days before the deal (Sneider, March 25, 1992).

In addition to the troubles in the federation's periphery, Yeltsin was not politically comfortable in Moscow due to deepening divide between the legislative and executive powers. Yeltsin was hardly getting the support of the legislative body. He tried to increase the control of the center by taking some executive level measures. For instance, he appointed his special representatives to the local administrations to increase the center's control on the periphery, but the Supreme Soviet undermined his moves at legislative level (Shevtsova, 1999: 38). In fact, there were political and economic reasons behind the divide. Seeking to maximize his power, Yeltsin also chose to work with young technocrats after 1991 to be able to implement economic reforms rapidly. This young group of people had no necessary political experience to manage the relations with the legislative organs in a delicate manner. Yeltsin also did not pay the necessary attention to the matter. Mismanaging the communication policy, Yeltsin and his team chose to take advantage of presidential institution's powers and used decrees to bypass the Parliament rather than communicating and seeking its approval in critical issues. While implementing harsh steps of the shock therapy with a great pace, the government started to face with rising discontent at public level due to worsening economic situation. The speaker of the Supreme Soviet, Ruslan Khasbulatov, was aware of this fact and he was playing both on the Parliament and the society's discontent.

Yeltsin managed to survive the 6th Congress. Gaidar's cabinet threatened the Congress with a resignation and helped Yeltsin to gain some time. After the Congress, Yeltsin took some additional steps like dismissing the Minister of Fuel and Energy, Vladimir Lopukhin, and appointing names like Vladimir Shumeiko, Viktor Chernomyrdin and Georgi Khiza as deputy prime ministers. The new deputy prime ministers were former industrialists and mainly favored by the Civic Union (Kotz and Weir, 1997: 203). These were steps of concession to the conservatives in the legislative organs. Nevertheless, these concessions fell short of establishing a harmony within the system. The divide between the legislative organs and Yeltsin peaked in December 1992, during the 7th Congress of People's Deputies.

Conservatives with communist and nationalist tendencies were so strong in the Congress and Yeltsin was not so popular due to ongoing economic problems. Gaidar's reforms had hardly positive results as the inflation skyrocketed and the economy was shrinking. In the end, the president decided to make a bigger compromise. Still this was more of a changing the profile of the government than making big shifts in his conduct of politics, but very symbolic. Yeltsin took Gaidar out of the government in the 7th Congress and appointed Viktor Chernomyrdin as the new prime minister.

Yegor Gaidar, who was the architect of the economic reform program known as the shock therapy, was the main target of the Congress again. His position was a matter of great dispute in the 6th Congress, but Yeltsin managed to keep him in the government then. Chernomyrdin was a member of nomenklatura and had the respect of the old political elite. However, this sacrifice was not enough for the opposition. Khasbulatov, and Yeltsin's Deputy President, Alexander Rutskoi were acting in tandem against Yeltsin (Interview with Anonymous, June 27, 2013). Polls in the summer were showing that Rutskoi had a rising popularity within the society even becoming more popular than Yeltsin (Campbell, August 23, 1992). Gaidar's discharge helped Yeltsin to gain some time, but still there was a problem of power struggle in Moscow.

Both sides started to negotiate a new plan to adopt a new constitution that would be based on division of power. But the opposition had other plans. They wanted to take

down Yeltsin rather than compromising in sharing power with the presidential government as proposed by Yeltsin's draft constitution. The 8th Congress of the People's Deputies gathered in March 1993 and curbed Yeltsin's extraordinary powers given in 1991. This meant no more decrees for Yeltsin to continue his economic reforms (Gray, March 13, 1993). In return, Yeltsin came up with the solution of emergency law and declared that he did not recognize the Congress' decision to cancel presidential decrees. Rather he decided to go for a referendum. He also managed to take a neutral support from power ministers; Defense Minister Pavel Grachev, Security Minister Viktor Barranikov and Interior Minister Viktor Yerin (Verbin, March 21, 1993). But Yeltsin could not get the Secretary of the Security Council, Yuri Skokov; head of the constitutional court, Valery Zorkin; and Rutskoi on his side (Yeltsin, 1994: 206).

The tension between the Kremlin and legislative body reached to a next stage when the impeachment of the president and dismissal of the speaker came up to the agenda. The impeachment's success could have meant Rutskoi to assume presidential power. But these initiatives failed to take place as the voting did not reach to the necessary two third majority threshold (Verbin, March 28, 1993).

In the end, the Congress and the president agreed to go for a referendum in April 25th, 1993. 58 percent of the voters supported the president and 52,88 percent his policies. Support for early presidential or parliamentary elections were less than 50 percent (Yeltsin's Support Put Officially at 58 pct., April 27, 1993). Yeltsin had the support of the majority of the voters, but more than 40 percent of the people did not participate in the referendum. In the end, the support was politically crucial, but fragile.

Deciding to put an end to this tension, Yeltsin chose to resolve the problem by dissolving the Parliament in September 1993. He got the support of the Prime Minister Viktor Chernomyrdin, the Foreign Minister Andrei Kozyrev, and security ministers Viktor Yerin, Nikolai Golushko and Pavel Grachev. Subsequently, he signed a presidential decree to dissolve the Parliament (Yeltsin, 1994: 246). The Parliament decided to respond by convening the 10th Congress and Rutskoi sworn as the President. However, this ended up with blood and troops managed to take the

control on October 4, 1993. Yeltsin was the winner, and figures like Khasbulatov, Rutskoi eliminated from the political scene (Victory for All the President's Men, October 5, 1993).

A draft constitution prepared by Yeltsin's team shared with the public in November. It was a draft of the winners and the new system was designed to establish a super presidency. The legislature would be composed of two chambers; the Federation Council and the State Duma. According to the new constitution, presidents of autonomous republics or executives of the administrative units would become members of the Federal Council. Considering the fact that president would be appointing these figures, the split between the legislative body and the executive would be minimum. 58.4 percent of the voters supported the constitution in December 1993 (Russian Constitution Formally Approved by Referendum, December 20, 1993).

The constitutional change was a milestone in Russian politics. It ended the supremacy question in the political sphere by making the Kremlin the strongest political center in Russia. However, reformists could not get the control of the Duma in the elections of December 1995. There was a big surprise for both Chernomyrdin and Gaidar. Their parties, Russia's Choice and Party of Russian Unity and Accord in total could hardly get 20 percent of the votes, whereas Zhirinovskiy's Liberal Democratic Party (LDP) and Zyuganov's Communist Party respectively received 23.9 and 13.6 percent of the votes. This result would be influential on formation of new coalitions in Russian politics, and make Yeltsin to feel insecure. The fragmented structure in the Parliament would be shaping politics and economy in Russia. Yeltsin would be facing pressure, from the Duma throughout his presidency and he would be taking tactical measures to balance the pressure. He would be forced to make reshufflings and changes in the government as concessions. The imbalance would be reaching its peak in 1998 after the financial crisis when Duma asked his resignation (Felkay, 2002: 178).

To sum up, the elite integration in the institutional level was not in favor of Yeltsin in 1990s. Inherited a broken system from the Soviet period, Yeltsin had to act within the limits of 1977 constitution up until 1994. The ideological split in the Congress

and the Supreme Soviet turned into a political challenge for Yeltsin and his government. In fact, the destructive character of the economic reform process also played a role and gave crucial leverage to the legislation. This forced the president to make concessions in the political sphere such as making frequent changes in the government, which undermined structural integration around Yeltsin and led to chaos as in the crackdown of the Parliament in October 1993. Moreover, the meetings of the Congress twice a year evolved into a vicious circle of blame game between the executive and legislation. The chaotic environment postponed a functioning state order to be established, in return opened a maneuvering space for the actors who tried to maximize their interests. This search for interest maximization will be discussed in Section 3.3. within the framework of restructuring energy sector in Russia.

3.1.2. Structural Integration among Russian Elite

Moscow was the epicenter of the collapse of the Soviet Union. Naturally, elite integration in the capital was different from the other republics in 1992. To begin with, elite capacity was high in the center. There were many highly capable people in different institutions. Moreover, Moscow has had a cosmopolitan character. The urban culture in Russia had a long past compared to other Central Asian republics. In this regard, it is hard to talk about influence of any clan structures based on ethnic divisions in Russian politics. Instead, clans emerged in Russian politics based on factors like social homogeneity and personal networks. In other words, people coming from similar backgrounds or/and having acquaintances started to act in synchronization and different groups appeared in Moscow politics (Gaman-Golutvina, 2008: 1039). Still, in this diversity it is hard to talk about domination of a certain group in the transition period. Considering the Yeltsin's background the structural integration was weak in the Yeltsin period which created a favorable maneuvering space for many actor in the 1990s.

It is possible to see people with different ethnic groups and regional belongings in Moscow circles. The picture was as colorful as today in the soviet period. Moscow was the hub of nomenklatura with diverse backgrounds. People in the bureaucracy, academia and politics were the *crème de la crème* of the society, who came to

Moscow as a result of a natural selection process. White and Kryshatanovskaya (1998: 129) describes this process as:

The traditional nomenklatura career trajectory began with study in Moscow and then went on in the soviet, Komsomol (Young Communist League), economic or party apparatus at district level, followed by a recall to Moscow for a one or two year stint in the Central Committee headquarters and then return to the provinces to a higher level post (often a regional party first secretaryship).

Outstanding party members also summoned to Moscow to take part in the Central Committee and the Politburo like in the cases of Gorbachev, Yeltsin and Aliyev. Elections in 1989 and 1990 further contributed to that diversity as the Congress and Supreme Soviet gained a more pluralist character with recent reforms. New faces got access to these institutions.

A similar pattern can be seen in the executive level. Headquarters of the executive organs were located in the capital city and they were responsible of designing, implementing, and coordinating policies between the capital city and other parts of the USSR. The human capital composed of highly qualified people, who had access to abroad, different resources and information that could hardly reached in the periphery, which formed a similar level of diversity in the bureaucracy. In the post 1985 period, as the opening and liberalization gained momentum, these people became interest seekers who got engaged in politics and became entrepreneurs the liberalizing economy. Yeltsin found himself on the top of this system in 1991, which was already under transformation. Naturally, this setup was influential in his way of doing politics throughout the 1990s.

Yeltsin's background should be revisited before analyzing structural integration around the first President. His past is a reflection of a person who managed to become member of nomenklatura and succeeded to come from the periphery to the center. He was not a Muscovite, but recruited by the regime to be a member of nomenklatura in Moscow. He was chosen to come to Moscow from Sverdlovsk due to his own merits in parallel with the changing political dynamics in 1980s. Yeltsin was an open-minded practical leader as the first secretary of Sverdlovsk, and a good fit for Gorbachev's reform process while changing the elite structure in Moscow.

After coming to Moscow, he hardly enjoyed the existence of factors like geographic links, personal networks and social homogeneity while forming his government in the post 1991 period. The quality of his personal network and political balances in the capital city forced him to operate with a heterogeneous elite structure throughout the 1990s.

Yeltsin was born in a village, Butka, Sverdlovsk (Ekatarinburg) in 1931 and trained as an engineer. He joined to the Communist Party when he was 30 years old and then climbed stairs of his political career in the regional party committee and became the First Secretary of the Sverdlovsk Regional Party Committee in 1976. He was summoned to Moscow in 1985 and shortly after he was appointed as the First Secretary of the Moscow City Party Committee. This was an important post and equal to the mayor of Moscow. Following this appointment, he also became the candidate member of the Politburo in February 1986. When he came to the capital he had to operate within the rules of the Communist Party. As a new comer, primarily he needed to adapt to the dynamics of politics in the center and then become a member of a network in this sophisticated environment.

Yeltsin was one of the supporters of Gorbachev's reforms, but expected to implement changes rather rapidly. He became an opponent rather than an ally for Gorbachev shortly. His position was not tolerable anymore when Yeltsin harshly criticized Gorbachev due to slow progress of reforms in the 70th anniversary of Bolshevik Revolution in 1987 (Taubman, October 29, 1987). This was a non-traditional action and he lost his position as the Moscow mayor and then his seat in the Politburo. However, he managed to make a quick return to politics when he was elected as a deputy to the USSR Congress in 1989 thanks to Gorbachev reforms. He lost the chance of being a member of Gorbachev's close circle, but his critical tone and confrontation with Gorbachev made him a public figure shortly. Moreover, his particular way of living such as taking public transportation or visiting market places contributed his popularity even further (Aron, 1990: 41).

Yeltsin played his cards right in the late 1980s and early 1990s as a political figure. The political context also played an important role in his career. He came to Moscow while everything was about to change and he found himself as the new leader of

Russia in 1991. This was not a planned outcome, and even a surprise for Yeltsin himself. Yeltsin's (1994: 131) description summarizes this phenomenon very well:

Something happened; something I myself wouldn't have believed before August 19, 1991. Overnight, a new Russia – "Boris Yeltsin's Russia" – took place of the Soviet Union...I had not fully realized the significance of the change that happened when the first telephone calls came from Western leaders.

Yeltsin took bold steps like resigning from the CPSU in 1990, or deciding to dissolve the CPSU and rejecting to continue with Gorbachev and coming up with a new political framework just after the August coup in 1991 (Porubcansky, July 12, 1990). While taking these decisions he was not acting with a homogenous group of people, rather following his instincts. He was good at reading the expectations of people, changing dynamics of the society and seeing political opportunities.

The elite around Yeltsin were hardly coming from a similar background. They took their positions around Yeltsin or Yeltsin admitted them to his team as a result of a political concession, obligation or practical reasons. In most of the cases, people, whom Yeltsin met after coming to Moscow in 1985 or even later, became members of his entourage. His choices of people around him affected the political atmosphere in the first half of the 1990s. In this framework, his relationships with the Speaker of the Parliament, Ruslan Khasbulatov, and the Vice President, Alexander Rutskoi present good examples. Yeltsin decided to work with these people not because he had close relations with them, but due to pragmatic reasons.

When he first thought about Ruslan Khasbulatov, Yeltsin was the speaker of the Parliament. In the nomination process of deputy speaker of the Parliament he faced with a deadlock. From Yeltsin's perspective, he decided to nominate this unknown Chechen academic among 15 potential candidates as a compromise thinking that he could get the support of different blocs and non-Russians in the Parliament (Yeltsin, 1994: 186). So that he can be a solution to the existing deadlock. In fact, Yeltsin hardly knew Khasbulatov before. He became the new speaker of the Parliament after Yeltsin's election as the President in 1991. He had potential to play the role of a mediator between the president and the Parliament in the transition period. After

turning into a public figure from an unknown politician, he became one of the opponents of the president with Alexander Rutskoi until the autumn of 1993.

Rutskoi's case also has similarities with Khasbulatov. Rutskoi was a former combat pilot, a war hero, and the leader of the Communists for Democracy group in the Parliament in 1991. Yeltsin nominated Rutskoi as the vice president just in the last minute by taking into account his speechwriters' recommendations (Yeltsin: 1994: 31). Before his nomination, Yeltsin also did not know him at all, but thought that it could be a good political move to take a war hero as his companion in the elections. The relationship between the two was smooth in the beginning, but Rutskoi demanded more power in the transition period and being disappointed soon he took a position next to Yeltsin's opponents.

During his presidency, the mobility of Yeltsin's entourage was really high and there was no certain pattern while recruiting people to the government or presidential administration. He was open to recommendations rather than choosing his own staff himself. There were at least two reasons behind this tendency. First, he had a big pool of human capital; second, he was summoned to Moscow in his own capacity, not with a team, from his position in the periphery. He hardly became acquainted with Moscow politics after 1985. Not long before the dissolution process began, he suddenly found himself on the steering seat of the transition process. He had to act fast and while establishing his team he did not have enough time to act delicately. Rather he acted in a pragmatic manner. Parallel with this Yeltsin says that "I simply did not know them [people working in Kremlin]. Life was turbulent that there was no time to study someone thoroughly" (Interview with Boris Yeltsin, Moscow News, October 22-28, 2003 in Desai, 2006).

One of the influential figures on Yeltsin in the early 1990 was Gennady Burbulis. He was one of the few people around Yeltsin who was from Sverdlovsk, but they met each other in Moscow as being part of the Interregional-Deputies group in 1989. Still Yeltsin (1994: 151) says that "common roots, the memories of Sverdlovsk, also meant a great deal" in their relations. Interregional-Deputies group was the first opposition group in the Congress and Burbulis was an influential politician. As Yeltsin was acting as a harsh critique of the Communist regime and turning into a

public figure, he managed to attract people from the political opposition and took their support. Burbulis was one of them. After being elected as the President, Yeltsin appointed Burbulis as the secretary of state (a critical position within the presidential administration) and then as the first deputy prime minister of the government. Even though Burbulis stayed in these positions less than two years, according to Yeltsin he was the person, who recommended Yegor Gaidar as the new conductor of economic reforms in Russia (Yeltsin, 1994: 155).

Burbulis met Gaidar in August 1991, and he thought that Gaidar and his team could be the new group to design the economic policies under Yeltsin (Aven & Kokh, 2015: 52). After his proposal Yeltsin agreed to work with Gaidar and his team in 1991. Gaidar was coming from an elite family. His father was a former admiral and contributor of Pravda. Gaidar was 35 years old when he met Yeltsin and he was the director of Institute of Economics in Moscow. He was not an ordinary Soviet economist, rather a person who was open to new ideas and western economic theory. When he met with Yeltsin, he had already formed a network of economists from Moscow and St. Petersburg in the late 1980s. Among these people there were Anatoly Chubais and Pyotr Aven, and they were studying dynamics of economic transition and neoliberal economics. Even though they were working at different cities sharing similar ideas about the basics of economy. Gaidar explained his draft program, which he drafted with his team, in a special meeting with Yeltsin (Interview with Burbulis in Aven & Kokh 2015: 55). Listening to him and seeing his qualifications, Yeltsin decided to work with this young economist just after the August coup. Choice of Gaidar was a pragmatic move. Grigory Yavlinsky's name also discussed among alternatives, but he was thought to be closer to Gorbachev and more conservative in terms of economic reforms (Interview with Burbulis in Aven & Kokh, 2015: 52). Shortly Gaidar became the new face of the government and the acting Prime Minister in June 1992 before his visit to the U.S.

Yeltsin wanted to have a dynamic name with a clear program because he wanted to move fast since the window of opportunity would not be open forever after the August coup. Yeltsin and his team wanted to rule out the possibility of revival of communists and grab power (Interview with Anonymous on June 25, 2013). He picked up people for his "kamikaze team" led by Yegor Gaidar who will replace the

Communist economy with a capitalist market system (Desai, 2005: 87). This required primarily taking down the system and then building new institutions. Yeltsin (Moscow News, October 22-28, 2003 in Desai, 2006: 80-81) describes his position in 1991 while picking up his team in an interview as::

I realized that the transition could not be painless. That meant that unpopular measures were inevitable. What was needed was a kamikaze crew that would step into the line of fire and forge ahead, however strong the general discontent might be...In the early 1990s, though, I had no other option. I had to find men capable of tackling the knottiest problems without a thought for their own political future. I had to pick a team that would go up in the flames but remain in history...[old figures] would not have been able to solve those problems [in Russia]. New people were needed to cope with the job. I purposely selected those with a minimum of Soviet-time experience. People without mental, ideological blinkers. People who did not have the ingrained habit of resorting to command methods but habitually used arguments, facts, and figures to achieve their goals. Young, knowledgeable, talented people. Others would not cope with the task.

The priority in economic reforms of Yeltsin's "kamikaze team" was not to create robust institutional basis, rather the main aim was to finishing off the Soviet system (Interview with Anonymous on May 30, 2013; Desai, 2006: 26). However, Yeltsin's strategy to overturn the system was a complicated task. This mission turned into a challenge and rapidly depreciated his and Gaidar team's popularity within the society and political circles. Apart from the discontent on Gaidar's economic reforms of the government, some of the political elite was not happy with Foreign Minister Andrei Kozyrev's new pro-Western policies (Tsygankov, 2006: 60-61).

Yeltsin chose scapegoats instead of taking the responsibility on him and Gaidar directly. He harshly criticized Gaidar team's performance, Minister of Foreign Trade Pyotr Aven, Minister of Economy Andrei Nechayev, Minister of Industry, Alexander Titkin, in his speech to the Parliament in October 6, 1992 (Hiatt, October 7, 1992). In fact, this attitude was a reflection of weak elite integration. In strongly integrated elite networks, mostly these kinds of debates happen within the group itself and the members hardly criticize each other at public level. However, Yeltsin rather than trying to protect the whole group, as a tactical decision, decided to make some

compromises for the sake of some members. Still his efforts were not enough to keep Gaidar as the Prime Minister. The conservative groups and industrialists harshly criticized Gaidar's policies and did not support his cabinet (Schemann, October 7, 1992). In the 7th Congress, Yeltsin had to sacrifice Gaidar and substitute him with Viktor Chernomyrdin, to obtain the advantage of going to a referendum for a new constitution in return (Shergadorsky, December 14, 1992; Schemann, December 15, 1992).

Before being appointed as the first deputy prime minister in 1991, Chernomyrdin was a former refinery director and head of the Gazprom. Chernomyrdin did not revoke Gaidar's reforms as the prime minister, but acted delicately while taking steps in the economic sphere and he was careful about the interests of his power base. He had good links with "the directors' corps" (Yeltsin, 2000: 76). He had a stronger support of the Parliament than Gaidar, but he did not have full control of the cabinet during his premiership. There were different groups in the cabinet with diverse interests. This was a natural reflection of Yeltsin's political choices as explained above. One of the influential groups was the trio of Oleg Soskovets, Mikhail Barsukov, and Alexander Korzhakov. Chernomyrdin and Soskovets hardly went along well, but Chernomyrdin could not persuade Yeltsin to get rid of him since he was part of the *banya* (sauna) team of Yeltsin with Barsukov and Korzhakov (Gustafson, 2013: 90). Soskovets was also an industrialist and the first deputy prime minister. Barsukov and Korzhakov were former KGB officials and respectively were the heads of the KGB and Yeltsin's bodyguard team. They were influential in the decision of Chechnya's invasion whereas Chernomyrdin hardly supported the idea (Aslund, 2007: 152). Later, this group took a firm position during the second presidential elections within the network. They challenged the group of Anatoly Chubais and Boris Berezovsky, who were influential actors in 1996. In the end the *banya* group was sidelined by Yeltsin himself.¹⁰

It should be noted here that even the collaboration between Chubais and Berezovsky had an ad hoc character at the dawn of second presidential elections. They were not

¹⁰ For further information please refer to Hoffman, D. (2011). *The oligarchs: Wealth and power in the new Russia*. New York: Public Affairs.

coming from similar backgrounds. Chubais was a technocrat, whereas Berezovsky who was a former Mathematics professor, became an influential figure in the second half of the 1990s as an oligarch with his control over media and proactive role in Kremlin level. Later, Nemtsov and Chubais made lobby to get rid of from Berezovsky and managed Yeltsin to sign a decision to fire Berezovsky from his position of deputy head of Security Council (Interview with Boris Nemtsov in Desai (April 2000), 2006: 120).

Table 4: Prime Ministers of Boris Yeltsin

Prime Minister	In Office	Background
Yegor Gaidar (Acting)	June 1992 –December 1992	Reformist, technocrat – Moscow
Viktor Chernomyrdin	December 1992 – March 1998	Statist, Industrialist – Orenburg
Sergei Kiriyenko	March 1998 – August 1998	Reformist, technocrat – Nizhni Novgorod
Viktor Chernomyrdin (Acting)	August 1998 – September 1998	Statist, industrialist – Orenburg
Yevgeny Primakov	September 1998 – May 1999	Statist, bureaucrat – Moscow
Sergei Stepashin	May 1999 – August 1999	Technocrat – St. Petersburg
Vladimir Putin	August 1999 – December 1999	Statist, bureaucrat – St. Petersburg

Chernomyrdin and Yeltsin did not have a close relationship, but as an industrialist and technocrat, Chernomyrdin was loyal to Yeltsin. Chernomyrdin stayed in the office until March 1998 and succeeded by another reformist Sergei Kiriyenko. Kiriyenko was a member of the club of young reformists. He was 36 years old when he became the prime minister. He came to Moscow from Nizhni Novgorod with Boris Nemtsov (Felkay, 2002: 174). Yeltsin thought that he could be a good choice to continue with the economic reforms, but Kiriyenko's premiership did not last

more than 5 months. He resigned after the devastating financial crisis in August 1998. In fact, he was hardly responsible of the collapse of Russian economy. He took over an economic system that had already got out of control in financial terms and it failed to resist the tsunami coming from Asian markets.

Between March 1998 and August 1999 Yeltsin appointed five prime ministers. Beyond the constitutional constraints, his health after the heart surgery would not let him to run for another term in 2000. Under these circumstances Yeltsin was searching for a confidant, both for stability and a safe exit. After the failure of Chernomyrdin, the Communists came up with alternative; the Moscow Mayor, Yuri Luzhkov. It was a risky option for Yeltsin. He was a rising star in Moscow and it would be harder for the president to keep him under control (Felkay, 2002: 186-187). Rather he chose Yevgeny Primakov, who was a lower profile candidate and had potential to be accepted by different factions in the Parliament. He was a career apparatchik, worked under Brezhnev and then in the Politburo under Gorbachev's rule. He had been the foreign minister since 1994 and pursued a rather nationalist policy rather than Kozyrev's pro-western stance. He had the support of both the presidential administration and the Duma (Yeltsin 2000: 199). In fact, he was a candidate of compromise. Yeltsin's administration knew that he would not get the support of armed forces again in a possible a clash like in October 1993 (Russia's Spiral for Decline, 1998: 2). Thus, rather than increasing the tension they opted for Primakov. After taking support of the Duma, Primakov established a coalition government by recruiting people from different parties, like the Communist Party, the Yabloko, and the LDP (Heritage, September 30, 1998; Volk & Volk, November 6, 1998). Yeltsin once again faced with the threat of impeachment in May 1999 after the NATO operation in Kosovo. As a political maneuver he chose to sack Primakov and replace him with Sergei Stepashin as a temporary solution, knowing that both Primakov and the Duma would support his appointment (Granville, 2000: 26; Yeltsin, 2000: 284). However, as a transition candidate he was soon replaced with Vladimir Putin in August 1999.

Looking at the frequency of changes of prime ministers in the second half of 1990s, it can be easily seen that Yeltsin's position continued to be remained in constraint due to continuation of fragilities in political and economic spheres. Under the

transition period the power dispersed rather than accumulating in the same hands. This made it possible to maneuver easily in political circles for many actors to maximize their interests.

Different groups had different backgrounds. Lane and Ross (1995: 69) divide Yeltsin's ruling elite into three different categories. These were career officials, intermediates (who became members of state bureaucracy recently) and people with no government experience. Looking at the whole decade this categorization remained to be valid. But before Yeltsin's second term oligarchs also took a position within Yeltsin's ruling elite. The new economic elite became an integral part of "the family"¹¹ (Graham, 1999: 336).

Coming from different career paths, individually or by forming some groupings, members of Yeltsin's elite tried to maximize their interests in economic terms while occupying official positions or acted as power seekers in the expense of each other's interests. This undermined a strong integration to thrive within Yeltsin's entourage, rather a sort of coalition established among different interest groups. Yeltsin was like a balance figure among these groups, but after the heart attack in 1996, Yeltsin's balancing role weakened. As a result, his capability of controlling the flow of events started to decline with the condition of his health.

In this section, I did not discuss all these issues in detail, but in a nutshell, I wanted to present the context of political environment that shaped political elite integration under Yeltsin's rule. His past as a politician coming from Sverdlovsk, along with the transitional dynamics played, a crucial role in the formation of weak structural elite integration. Yeltsin tried to remain in power throughout the 1990s and he made some pragmatic decisions by coalescing with different actors or giving concessions. Frequent changes of cabinet and prime ministers reflect weak or fragmented political elite integration in Moscow along with the existing fault lines between elite groups in different institutions. Opposition actors managed to infiltrate into the government and presidential administration, thanks to the weakness of the political institutions and instability in the country. This paved the way for different groupings to emerge

¹¹ The family is used to refer to people (mostly oligarchs) around Yeltsin who were close to his daughter Tatyana Yumasheva.

within Yeltsin's entourage. As can be seen in the next sections, Yeltsin's poor health condition and the rise of the opposition made the presidential elections of 1996 even more critical that new actors, known as oligarchs, came into the picture as political actors. This had further implications on restructuring of the energy sector in the second half of 1990s.

3.1.3. Lack of Value Consensus

Transition periods have a chaotic nature and mostly a fertile environment for new ideas and values to emerge that would find place in mainstream politics. Looking at the late 1980s a similar atmosphere can be observed in the USSR, but in different tones. Among other cities, Moscow had a peculiar place. The capital city had a lively intellectual environment. Policies of the glasnost and the perestroika were like opening a dam's shutter. The ideas that had thrived underground for years were not taboos anymore. Dissident publications, known as *samizdat*, once again became popular. Publications like *Novy Mir* and *Znamya* adopted a more critical stance against the Soviet government and articles started to appear that discuss liberal economy in comparison with the communist system (Pittman, 1990). Talking about market economy or liberal economy was still a taboo in the periphery, even in a city like St. Petersburg. But the atmosphere in Moscow was totally different. Chubais' observation summarizes the difference between Moscow and St. Petersburg bluntly (Interview with Chubais in Aven & Kokh, 2015):

We lived in the isolated world of St. Petersburg, which was, let's say, ideologically sterile... Glazkov returned from the seminar and said, "Hey, listen, you know Moscow was really awesome. Do you know how they feel about market economy advocates?" I asked "How?" St. Petersburg banned the word "market," because it sounded anti-Soviet. And Moscow treated them like the West treats homosexuals. A market-economy advocate speaks, and someone asks "Who's that?" The answer is "Not one of us." That's all! No persecution, no party inquiry, nothing. That really stunned me. The atmosphere was completely different in St. Petersburg.

The lively debate in the intellectual circles reflects the atmosphere very well that Moscow was passing through. However, it would be a reductionist approach to claim that the atmosphere took shape merely as a result of Gorbachev's policies. There was

a fertile base for these ideas to be embraced and synthesized. Moscow was the capital and it had its own flexibilities such as having access to abroad, foreign literature, and markets. Having these advantages and the best qualifications, the elite in Moscow were more dynamic and innovative. In the end, the actors were responsible of designing policies for the USSR in bureaucratic or political level and they had their own relative autonomy in terms of using or accessing to different sources. Within this context, perestroika and glasnost reforms made it possible for new or “marginal” ideas to be articulated out loud. This atmosphere led new adversaries to appear in intellectual and political level. “Soviet literary journals...transformed into a forum for debate between the reformist, conservative and reactionary factions, each embracing a diversity of opinion groupings” (Pittman, 1990: 111). Different groupings had already emerged in political circles in 1991 and these people were not anymore idle intellectuals. New groups emerged in the Supreme Soviet and then the discourse evolved into policies in the early 1990s. The implementation of these policies was not systematic or linear. Lack of a well-defined division of power among legislature, judiciary and executive branches and presence of different groupings with different stances hardly prepared a well-functioning political basis in 1992. In the end, the transition period was shaped within this chaotic environment in economic and social level.

The dissolution of the Soviet Union created a power vacuum in local level and instability in Moscow. As discussed earlier, in regional level nationalism gained ground and demands for independence and further autonomy turned into a challenge for Yeltsin administration. Yeltsin had tendencies of centralization, but slippery state in the political level forced him to give some concessions to regional units like further political autonomy, control on budget and so on (Tanrisever, 2009: 340). In the center, the discussions took shape around economic debate and Russia’s relations with former Soviet republics and its role in global politics. There was hardly a unified position about “what is to be done and how is to be done” throughout 1990s. Rather certain groups’ capability to find a place in executive power determined the rise and fall of political approaches. In this struggle, Yeltsin played the role of an arbiter and tried to find a common ground between different interest groups, institutions and actors, while also pursuing his own agenda of establishing a new

state that would leave behind the legacies of the Soviet regime as soon as possible without any possibility of turning back.

Table 5: Elite Networks between 1991-1999

	Economy	Foreign Policy	Elite groups	Public support
Reformists	Rapid transformation	Westernist	New elite + counter elite	Low
Statists	Gradual transformation	Realist	New elite + Old elite	Medium
Conservatives	Preservation of the old system	Anti-western	Old elite	Medium

Elite networks can be divided into three different categories between 1991 and 1999 in terms of values and ideologies. These are reformists, statists and conservatives. In these groupings, the majority of the elite were former members of the CPSU and the leading actors were member of the nomenklatura. Yet, this was a natural outcome of a one-party rule and elite recruitment system of the communist rule. In this regard, the party membership was one part of the identity of the elite, but was not the only determinative factor in formation of values and ideas among the elite. In fact, the profile of the elite was more deterministic in their worldviews. The reformists were the youngest among others and mostly comprised of the new elite, who mainly became part of the mainstream politics in the late 1980s or the 1990s. Among them there were people who can be described as the counter elite. These people were against the Soviet system and managed to have access to mainstream politics thanks to semi-free elections in 1989 and 1990. After being elected they became members of non-Communist Party groupings in the Congress as in the case of DemRossiya. They were supporters of a rapid pace of transformation. One of the members of this group, Anatoly Chubais says that

“[r]apid privatization creates problems, but a slower pace would create more problems. We have had a narrow window of opportunity. The Parliament started to accept the idea in 1991, but their support faded entirely by the end of 1992” (Nelson & Kuzes, 1995: 127).

Among the statistes there were faces from the new elite, but also the old elite. Some members of the old elite were agile enough to adapt to the new rules of the game. They were the members of the nomenklatura. This fraction of the old elite had means to preserve and even extend their privileges in the post-Soviet period. In a sense, they were the ultimate survivors. They had capability to understand the changing dynamics of the new system. Thus, they chose not to resist, but to modify the change according to their own interests. Moreover, they were cautious about rapid implementation of economic reforms and having close relations with the West.

The last group can be categorized as conservatives. They paid the highest price of the collapse of the Soviet Union. They were the members of the nomenklatura, but had limited means to enjoy the blessings of the market economy. Relatively their members were older and they were not happy with Yeltsin and his team’s rapid implementation of policies. They even had revanchist tendencies and its constituency had nostalgia for the Soviet Union (Mudde, 2000: 18; Ozerava et.al. in Kiewiet & Myagkov, 2002).

In the Yeltsin’s first term, his entourage was composed of statistes and reformists. After the August coup, Yeltsin decided to recruit reformists and appointed people like Gaidar and Burbulis to the higher positions to implement reforms in a rapid pace. In fact, this was a sort of an unwritten pact between Yeltsin and reformists. Both wanted to make structural changes within the system in a short period of time. They believed that liberalization of the economy and getting rid of the institutions inherited from the communist period were the only options for a reform process. Neo-liberal economic approach started to be implemented by Yegor Gaidar and his team just after the August coup. Gaidar’s main aim was liberalization of the market. For this purpose only he supported the leader, Yeltsin, as a guarantor of the market

reform (Interview with Anonymous on May 30, 2013). However, Gaidar could not survive the pressure coming from the Supreme Soviet and the Congress. In the end, Yeltsin substituted him with Chernomyrdin in 1992.

Chernomyrdin belonged to the statist camp and became the longest serving prime minister of Yeltsin. After coming to the office, he did not abandon the reforms, but slowed down the process (McCauley, 2002: 414). Yeltsin also substituted his pro-Western foreign minister with a more conservative name, Yevgeny Primakov in 1994. Following this change Moscow adopted a new policy, in which it focused more on the “near abroad” and made some fine tunings in its relations with the West (Cohen, 1997: 5).

Yeltsin and his team carved out a new economic system out of a 70-year-old command economy in a very short time. “[B]y 1997, Russia had privatized 120000 enterprises, which accounted for more than 70 percent of the country’s GDP” (McCauley, 2002: 414). The rapid change was a big shock for the society and the old elite. The society faced with negative externalities of the privatization and transition to the market economy. The unemployment and inflation became new “popular” concepts in new Russia as the society’s living standards plummeted. Consequently, people started to question the dissolution of the Soviet Union. On the other hand, problems of hyperinflation, unemployment, and economic hardships and the disappointment in pro-Western policies in the early 1990s made populist and nationalist ideas to echo more than reformist policies. Zhirinovsky’s LDP and Zyuganov’s Communist Party of the Russian Federation respectively became the first runners in the 1993 and 1995 parliamentary elections. The latter was not communist, but rather revanchist, whereas the former was not liberal, but a nationalist party (Mudde, 2000: 18).

Throughout the 1990s, none of the political parties had the political support to gain majority in the State Duma. The Parliament had a fragmented structure, but it had the power of impeachment of the president and approval of the government. Being challenged by conservatives in the Parliament Yeltsin mostly had to make concessions while forming the government. After the 6th Congress in 1992, this

political tactic created hybrid governments as Yeltsin appointed ministers from different camps.

Policies of concession fed the fragmentation among the elite groups and vice versa. Rather than a value consensus to emerge, there were competing and even conflicting agendas of actors and institutions. However, Yeltsin managed to keep some core elements of his *kamikaze* team in the government. For instance, Anatoly Chubais, who was appointed as the head of the State Committee for Property in November 1991, remained as the chief person responsible of the privatization. He worked with his team from St. Petersburg in the government up until the end of the privatization process in 1997 (Hough, 2001: 72). He remained to be one of the influential figures and was appointed as the chief of presidential staff in 1996 (Anatoly Chubais, Privatizer and Organizer (Анатолий Чубайс, Приватизатор И Организатор), July 17, 1996). Looking at Yeltsin's policies between 1991 and 1997 it can be said that he preserved its position about the economic transformation and managed to keep the core team while giving concessions in other areas.

Differentiation in worldviews of the elite groups coupled with the deterioration of political and economic dynamics and paved the way for struggle for power to turn into a zero-sum game. As described in previous sections the elite groups looked for power maximization in the expense of the other as in the case of the August coup in 1991 or the White House's crackdown by Yeltsin in 1993. In the absence of value consensus, actors found a maneuvering space to pursue their own interests via different channels. This prevented a consistent and transparent political agenda to be implemented and new coalitions emerged to face challenges or overcome the resistance. All in all, lack of transparency and interest maximization shaped the dynamics of privatization and energy sector's structure in Russia.

3.2. The Center: Cradle of New, Capable Entrepreneurs

In the previous part, I schemed the political elite integration. As I described, the political elite had a diverse structure with different values, backgrounds and aims.

This created a weak political elite integration under Yeltsin's rule. Economic elite took the advantage of this weak integration to maximize their interests in the restructuring of the energy sector throughout the 1990s. However, their capabilities and sources were definitive in this process. In this section, I will particularly scheme the dynamics behind the emergence of economic elite in Russia. I will explain which factors played role for a new economic elite to appear in Russia and what capabilities they had and developed starting from the second half of 1980s. This part demonstrates how the center presents comparative advantages in the Soviet Union in comparison with the peripheral states.

Dynamics in the center was different in economic and political level. Political and economic design was made in Moscow and then implemented in the entire Union. The policies implemented primarily in the RSFSR since the *lag effect* was minimum in the center. The designers were in position to have a better understanding about the implications of new reforms. They were both pro-active to shape these reforms by having access to the central institutions and reactive to take the advantage of the adopted changes. In this regard, after the collapse of the Soviet Union, Russia was ahead of other countries in terms of implementation of Gorbachev's perestroika reforms. Some members of the Soviet elite were more capable and advantageous to the extent that they had already accumulated capital, developed instruments, and established links both at home and abroad.

The USSR was not fully integrated to the global market economy. The foreign trade was under the control of Moscow. Main trade partners of the Soviets were primarily socialist states, and up to a certain level there was economic relations with Western economies. The level of interaction gained momentum as of 1970s to obtain new technology and satisfy the grain demand in the Union in exchange with oil (Ermolaev, 2017; Perović & Krempin, 2014). Even though this trade helped the economy to survive for a while, declining oil prices put the USSR in a fragile position (Gaidar, 2007: 109).¹² In the second half of 1980s the supply chain distorted and economic problems in the country became more visible. The command economy

¹² Dependence on oil revenues has always put Russia on a fragile position since 1970s as in the case of rentier states.

was not efficient to satisfy the needs of the Soviet people and Gorbachev administration's reaction was perestroika reforms to get out of the vicious circle.

Within the framework of the perestroika, gradual economic reforms took place to tackle with the problem of economic inefficiency. Among these, two crucial laws can be noted here, which were adopted in 1986 and 1988 with the Law on Individual Labor, and the Law on Cooperatives (Taubman, November 20, 1986; Law No. 8998-XI of the USSR on Cooperatives, May 26, 1988; Kotz and Weir, 2007: 89). Based on the former law the state allowed part time labor activities in people's free time. This was a revolutionary decision in the Communist system, which tried to prevent the commodification of labor for decades. However, the Law on Cooperatives was more significant in two levels. First, cooperatives were acting like private enterprises and they became prelude to private entrepreneurship of 1990s in Russia. Second, following the approval of the Law on Cooperatives, the Council of Ministers adopted the Decree on the Further Development of the Foreign Activities of the State, Other Social Enterprises, Associations and Organization in December 1988 (Timmermans, 1989: 454). This decree allowed both the cooperatives and state enterprises engage in foreign trade by taking permits from the Ministry of Foreign Economic Relations.

Moscow started to remove the barriers before the private entrepreneurship in the second half of 1980s. However, Muscovites was in an advantageous position compared to the rest of the Union. Central bodies of the party were located in the capital. As expected, people close to the party organs and strategic institutions in Moscow gained certain privileges and even patronage for engaging private business in 1980s. Presence of a banking system, and international airport, having easier access to bureaucratic mechanisms were among other advantages.

The economic terrain was evolving. Two types of people managed to adapt to the change and became big players in economic level, who later identified as oligarchs. The first group of people had close relations with the CPSU, and some of them were members of the nomenklatura. The second group were not members of the nomenklatura, but had both luck and capability to adapt to the situation. In the beginning they had limited access to the political channels. As their operations

expanded, they started to establish stronger political links. Members of this group are categorized as 'Soviet Mafia' by some observers (Vaksberg, 1991).

After the adoption of the Law on Cooperatives, party organs like Komsomol or members of the nomenklatura supported cooperatives during the perestroika period. One of the well-known stories of this period is about Mikhail Khodorkovsky who started his cooperative adventure by running a cafeteria with the permission of the Komsomol. Shortly after he became an entrepreneur who imports computers from abroad, and undertake contracts from state enterprises. Khodorkovsky who started his entrepreneurship career in his 20s became owner of one of the biggest private banks in Russia, Menatep, in 1990. As a former Komsomol member, Khodorkovsky became one of the powerful oligarchs in a decade. In one of his interviews conducted in 1991 he says that "All the ventures that were started this time succeeded only if they were sponsored by or had strong connections with high-ranking people...It wasn't the money but the patronage. At the time you had to have political sponsorship" (Interview notes of Peter Slevin in Hoffman, 2011: 101). A former intelligence officer Anton Surikov (Belton, 2005) acknowledges Khodorkovsky:

It was impossible to work in the black market without KGB connections and without protection from the KGB...Without them, no shadow business was possible. There was a conscious creation of a black market...The creation of the oligarchs was a revolution engineered by the KGB, but then they lost control.

Similar to Surikov and Khodorkovsky, Dawisha (2014: pp: 21-31) also argues that in 1990s some commercial links established between KGB officials and oligarchs and the money was used to control privatization process, establishment of banks and so on. Different figures who had links with the CPSU gained advantages. The party elite and members of the KGB established some links, channeled certain funds to abroad or to some actors at home, and gave some privileges to some proxies as an insurance to preserve their power. One of the reasons behind this was the perception of threat from Gorbachev's reforms. The CPSU decided to spare money for the sake of party, before the full transition to a multiparty system, as an assurance. Particularly, the operations carried out in cooperation between the party and the KGB. But after the failed coup d'etat the party was closed and the KGB took the

control of money itself. It seems that big amounts of money got lost after the collapse of the Soviet Union.

Russian oligarchs who established these links became heavyweights of Russian economy and politically influential figures in 1990s. Among these there were Alexander Smolensky, Vladimir Gusinsky, Vladimir Potanin, Mikhail Khodorkovsky, and Mikhail Friedman. Both Smolensky and Gusinsky were at the bottom of the pyramid in 1980s, but playing their cards right and reading the new dynamics of the perestroika process they became very rich in a short period of time. Potanin was coming from a well-established Soviet family. His family background helped him to become one of the biggest members of the club of oligarchs in 1990s. Khodorkovsky was a member of Komsomol, youth organization of the Communist Party, which helped him to establish links while taking his entrepreneurial steps.

Even before the adoption of the Law on Individual Labor, Smolensky had another job. He was printing bibles and selling them in the black market. He was a capable man who understands the very basics of the entrepreneurship. After the adoption of the law, Smolensky was summoned by the Communist Party's city committee and ordered to establish a cooperative in 1987 (Hoffman, 2011: 40). Smolensky proved to be a talented contractor and even started to construct dachas for the nomenklatura. To have a dacha in the Soviet system was a problematic issue, even a high-ranking officer had to wait for years. Smolensky's business was filling the gap of the planned economy. Using his organizational skills, he managed to overcome the limits of the system and started to establish good links with high-ranking officials by providing them what they look for in a shorter period of time. Construction business means orchestrating a big number of employees and flow of cash. At some point Smolensky decided to establish Bank Stolichny to make the payments easily and keep his money safe. Another banker, Vladimir Gusinsky, had a similar story with Smolensky. He was mediocre stage director who managed to make a small fortune in the perestroika period by starting a small cooperative. Gusinsky acted wisely and established links with officials shortly. One of these figures was Moscow Mayor Yuri Luzhkov. Working together with Luzhkov, Gusinsky made a fortune from real estate business (Ignatius, February 13, 1995; Grove, April 7, 1995). Later Gusinsky became a banker and a media tycoon.

Potantin's story is different from Smolensky and Gusinsky. Rather than starting from petty business, Potantin directly set up a foreign trade company in 1990. Before he was an apparatchik in the Ministry of Foreign Trade, but became one of the biggest bankers of Russia shortly after taking his banking licenses in 1992. He established Oneksimbank with Mikhail Prokherev who was a former employee of the International Bank of Economic Cooperation (IBEC), which was a state-owned bank during the Soviet period. The IBEC faced tough times after the collapse of the Soviet Union and facing risk of bankruptcy stopped its operations and turned over its accounts to Oneksimbank (Freeland, 2001: 124). Naturally, Oneksimbank became the holder of accounts which worth 300 million dollars. The selection of Oneksimbank, as the new fiduciary of IBEC's former clients, was based on personal links. Both Prokherev's and Potantin's backgrounds played a crucial role in this selection. Consequently, Oneksimbank group thrived on this huge capital, which was a big amount of money in the 1990s' post-Soviet Russia.

In the 1980s finding a patronage was a critical factor, which brought protection and also helped overcoming certain barriers within the system with innovative solutions. In the center, the institutions and officials were more capable in patronage. The party and the state officials might ignore and even help someone's illegal activities, or crackdown these operations overnight.

There were certain loopholes within the system. Having patronage was one part of taking the advantage of these loopholes. The other one was *beznalichnye* (non-cash money) and *nalichnye* (cash money) divide. *Beznalichnye* was used for accounting purposes during the Soviet period, but it was a tenth of *nalichnye* in daily life (Rothkopf, 2008: 113). Komsomol allowed the use of *beznalichnye* along with *nalichnye* for cooperatives in 1987.¹³ Getting this privilege gave important advantages to the cooperatives. However, so few were capable enough to understand

¹³ "The separation of *nalichnye* (cash money) and *beznalichnye* (non-cash money) into the dual monetary circuit represents an important and often overlooked component of the Soviet banking system. For instance, an enterprise allocated *beznalichnye* money in the planning process could use the credits in its *beznalichnye* account to purchase inputs from other state enterprises, but could not take this money out of the bank as cash (*nalichnye*) to pay wages or make purchases from private firms. This dual monetary circuit, which has still only partially broken down in Russia, allowed Gosbank to give soft credit to enterprises with few adverse macroeconomic consequences". (Johnson, 1994: p. 976).

how to utilize this privilege. Khodorkovsky and Mikhail Fridman (Hoffman, 2011: 111; Freeland, 2001: 110) were among those who figured out how to use non-cash money. They started to provide services in exchange of *beznalizhnye*, which turned out to be a profitable activity for both cooperatives and enterprise managers. Khodorkovsky and Friedman earned a serious amount of non-cash money in 1980s. The problem was turning the earned money into cash, and without getting the necessary patronage under the Soviet regime it was a difficult issue. Khodorkovsky managed to turn his *beznalichnye* into *nalichnye* most probably establishing necessary connections (Hoffman, 2011: 111).

Playing with the loopholes of the system also meant being aware of the fragilities under the Soviet regime. Some players like Mikhail Friedman pursued a similar path like Khodorkovsky, but with a less favorable support from the system. Friedman had links already established with the Komsomol and this gave him a great advantage to expand his operations in the second half of 1980s. Being aware of the risks, Friedman and his colleagues “moved part of their business to Prague as an insurance policy” (Freeland, 2001: 112). Later this decision would be a teaching experience for Friedman to learn the dynamics of privatization process and pursue an active stance in 1990s after the privatization started in Russia. Friedman was a capable actor who had limited links with the Party in 1980s. He managed to build his links thanks to his personal skills and overcome most of the difficulties by the help of these links during perestroika period. For instance, after reaching to a certain threshold, Friedman transferred a former reformer to his company, Petr Aven. So that his Alfa Group gained access to government circles (Freeland, 2001: 112).

In line with Gorbachev reforms, the government started to convert ministries to concerns, holding companies, or corporations in 1989 (Hough, 2001: 32). Ministry of the Gas Industry, headed by Chernomyrdin, restructured as a state concern and renamed as Gazprom. Former bureaucrats or ministers became new directors and economic actors as a result of this reform. These reforms were undermining the legacy of the centrally planned economy and former members of nomenklatura were gaining rights to autonomously direct new companies and even engage in foreign trade. In the 1990s, directors of restructured companies preserved their positions, and gained important privileges during the privatization process. For instance,

Chernomyrdin up until his appointment as the prime minister, occupied the CEO position in Gazprom. Then, he left his protégé, Rem Vyakhirev, as the new director of the company.

Economic change in the Soviet Union gained momentum under Gorbachev, but the change was faster in Moscow. Gradually economic planning eliminated in 1980s. Figures like Khodorkovsky, Smolensky, Gusinsky, or Friedman pushed the right buttons when the Soviet regime slowly opened a maneuvering space for non-state actors. These people and a few more had already established links in political and bureaucratic circles, accumulated capital, and some of them even became owners of private banks before the collapse of the Soviet Union. Controlling institutions like banks or companies these economic actors also managed to resist to the high inflation environment after the implementation of shock therapy whereas normal citizens or petty businessmen lost their savings in rubles and could not use their money efficiently during the privatization process (Nelson & Kuzes in Lane: 124). Newly emerging entrepreneurs who owned cooperatives in the beginning and then managed to diversify their business or preserved their managerial positions in the factories became new ambitious players of the capitalist economy and managed to capture strategic state assets in 1990s. Presenting so many advantages, the center became a cradle for newly emerging economic elite. They evolved into economically and politically capable actors in 1990s because they gained access to financial means and succeeded to use them for maximizing their interests.

3.3. Restructuring the Energy Sector: Weak Elite Integration and Irreversible privatization

Reformists were the most influential group in privatization and liberalization of Russian economy. They acted both with political and economic aims in drafting the privatization scheme. The main aim was irreversibility of privatization to create a barrier before a regime setback in Russia. Moreover, establishing a competitive and efficient economic system was critical for the success of the reforms. Energy sector, with its strategic importance and potential, was on top of the agenda for different interest groups in this process.

Before discussing the restructuring of the energy sector in the 1990s, it is critical to understand the outlook of hydrocarbon sector under the Soviet rule. The reform process did not start overnight in the 1990s. Due to deteriorating dynamics in the energy sector, insiders had important inputs and views already in the late 1980s. This views had important implications on the restructuring process.

In this section, I will examine the restructuring process of the energy sector in three sections. First, I will scrutinize the sector's characteristics under the Soviet regime to show what did Yeltsin administration inherited from the past. In the second part, I will examine the voucher privatization with a broader perspective as the first phase of privatization in Russia. In the third part, I will focus on infamous Loans for Shares program and political motives behind it as the second phase of privatization that had major impacts in the ownership structure of Russian energy sector..

3.3.1. Outlook of the Hydrocarbon Sector before the August Coup

Azerbaijan was the center of oil for a long time in Tsarist and Soviet Russia. This helped accumulation of knowledge and capacity in the early 20th century. The weight of the Caucasian fields became smaller starting from the second half of the century when the Soviet administration supported new explorations in Volga-Ural and West Siberian regions respectively. The first discovery was made in Volga-Ural basin in 1929 and this continued till mid-1950s (Grace, 2005). Soviet administration started to develop these newly discovered fields during the World War II due to Nazi invasion of the North Caucasus. The German occupation negatively affected the production and transportation from the fields in Azerbaijan and the Caucasus. The development of supergiant fields like Tuymanzinkoye and Romashniko became the backbone of production in Soviet oil industry. The development upstream capacity in the Volga Ural paved the way for midstream and downstream capabilities to develop like transmission pipelines and refineries. This helped economic and industrial development in the region in 1950s and 1960s. After successful discoveries in the Volga Ural basin, the Soviet geologists headed towards the West Siberia after the World War II and they made great discoveries in 1960s. The Volga Ural region reached its peak production and the production started to decline in the late 1970s. But fields in the Western Siberia closed the gap and the production of the USSR

reached record levels in early 1980s with a production level of more than 12 million barrels per day.

Apart from the large discoveries in West Siberia, the political directives from Moscow were influential in production increase. Hydrocarbon sector became an integral part of the Soviet economy after the oil crisis in 1973 and 1979-80. In less than a decade, oil prices per barrel jumped from \$3 to more than \$36. Dramatic increases in oil prices primarily during the Arab-Israeli crisis and then with the change of regime in Iran and Iran-Iraq War made the sector the main source of hard currency for the Soviet economy.

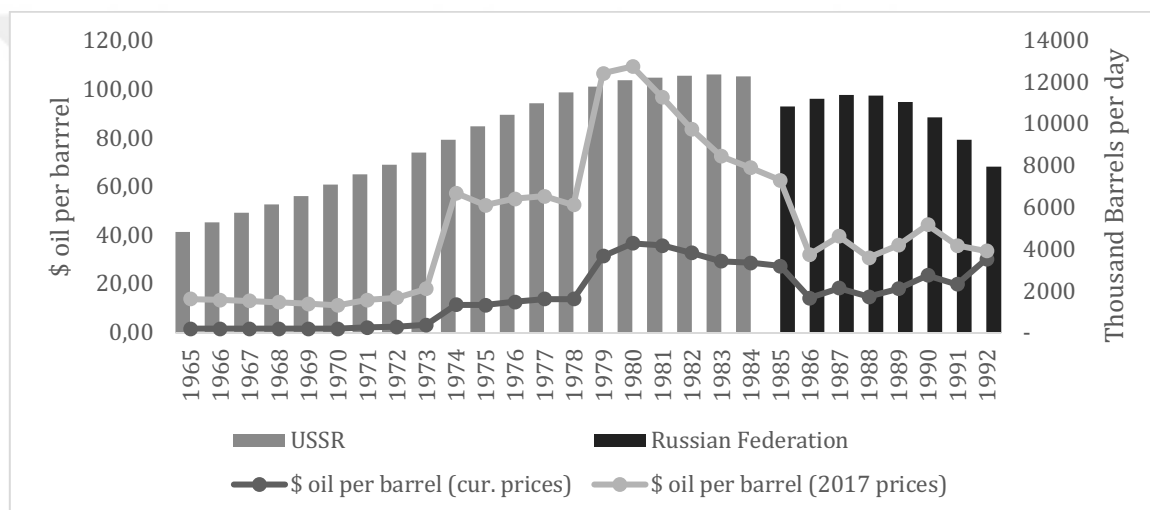


Figure 2: Oil Production in Russia (thousand barrels per day) and Crude Oil Prices (1965-1992)

Source: BP Statistical Review 2018

Growth rates of the economy started to decline in mid-1970s after three decades long high performance (Harrison, 1993). Oil revenues became an important source of compensation as the Soviet administration enjoyed the revenues flowing from exports throughout the 1970s until mid-1980s. The flow of money helped to postpone economic problems and slowed down economic decline of the command economy. The administration used oil money generally for importing necessary goods and equipment. When Moscow had to meet urgent needs like food or intermediate goods to run the industry, oil sector was used as a trump card by demanding over-production from the planned level. “Sometimes the threat of food shortages was so imminent that the Prime Minister Alexei Kosygin would call the

head of oil and gas production and tell him, ‘Things are bad with bread. Give me three million tons [of oil] over the plan’ (Yergin, 2011: 23). Thus, the system played the role of emergency valve as long as the price of oil in the global markets was high.

The affair between the oil sector and Moscow gained a symbiotic character in time. This was a functioning tactic, since the oil windfalls continued throughout the 1970s until the mid-1980s. But the system started to face problems of sustainability due to over-production. The Soviet system was not based on the principle of efficiency rather based on performance. To produce more became the main aim, but cost-profit balance was not the priority of the Soviet planners. As the revenue from oil became easy money to solve economic problems, the central planners in Moscow wanted more drillings for further discoveries and production. In return, oil generals wanted more funds from the center for further drilling. This pattern turned into a vicious circle because after the discovery of giant fields closer to the surface, further discoveries needed deeper drilling and better equipment. In the Soviet industry high quality steel was used mostly in the military industry, and the quality of the steel used in the drilling sector was not that good (Goldman, 2008: 41). As a result, engineers had to deal with broken equipment, due to low quality of the material and hard geographic conditions in Siberia as they go deeper. The solution was reaching the targets in cumulative terms by shallower drillings. This meant wasting resources that ended up with less discoveries. Issue of efficiency in production process became a secondary theme compared to the performance in drilling. As a result of barbaric exploitation of the fields and less investment in the maintenance of equipment, the production started to decline further in maturing fields.

Impacts of declining production coupled with the decline in crude oil prices in global terms negatively affected the economy. The oil exports constituted 60 percent of the hard currency earnings in the USSR and decline in oil price and production was bad news for the economy (Cockburn, June 30, 1986). This negative trend coincided with the perestroika reforms. Economic and performance problems of the sector were hardly addressed under Gorbachev’s rule. Rather the situation gained a further chaotic character due to political and economic reforms that weakened the power of the center. This had technical, financial and administrative impacts on the sector.

Azerbaijan and Ukraine were important suppliers of equipment and pipes for the system. However, the political turmoil and then the collapse of the Union caused a dramatic break down in the supply chain. It started with disruptions due to rising economic and political instability all around the USSR, and after the independence of these countries the equipment from these countries had to be imported. However, the sector did not have hard currency and necessary mediators to reach spare parts and equipment easily. This caused further technical deterioration in the production level since the broken wells or pipes could not be repaired.

Gorbachev's reforms in institutional and economic level negatively affected the flow of money and equipment to producers. The oil generals were producing oil and sending their production through the existing pipeline system to refineries or ports for exports, but this does not necessarily brought money for the producers due to controlled prices and division of roles between institutions within the system. Oil generals had control only in the upstream. Downstream procedures and marketing were under the control of refineries and the Ministry of Foreign Trade.

There were several attempts to diminish the role of central planning and liberalizing of the economy before the dissolution of the USSR. However, partial solutions and controlled liberalization triggered further problems. One of these problems was companies' problematic access to the imported technological equipment. As there was a strict control on exports and imports and absence of a well-integrated structure of the oil sector it was really hard to access necessary equipment used in extraction process. The state authorities intended to give some autonomy to enterprises and break the monopoly of the state institutions on economic activities by Law on State Enterprises in July 1987 (Iji, 2003: 9). Before ministries in Moscow were giving orders to the enterprises, but after the adoption of the law, the enterprises started to take orders from the customers (Pockney, 1990: 3). Nevertheless, removing the control, caused inflation in prices of the equipment and production phase started to face problems of covering its costs to maintain the production at peak levels since the price of oil lagged behind the production cost, and resources coming from the center started to decline as the economy faced difficulties (World Oil, August 1, 1989, Gustafson, 2012: 48). Consequently, the productivity of the fields in the West Siberia and Volga Ural basins declined dramatically. As can be seen from the Figure 6, daily

production declined from 12.5 million barrels per day to 9.2 million barrels in average in 1991. This is more than 25 percent decrease from 1983 production level. Considering the decline in the oil prices, this was bad new for the balance of finances.

At the dawn of the August coup the sector was in crisis. The number of idle wells due to lack of equipment or corruption started to increase. The export of oil was partially liberalized; people who managed to get export licenses became brokers in international market. Image of the sector was more chaotic and less promising under the current setup. Some groups have already started to take some steps to reform the sector while preserving and even maximizing their privileges. Collapse of the Soviet Union opened the window of opportunity for these people and privatization policies of Yeltsin administration further shaped the energy sector throughout the 1990s.

3.3.2. The First Phase of the Restructuring the Energy Sector under Yeltsin: Searches for Irreversible Privatization during the Transition Period (1991-1995)

The oil sector in the Russian Federation had the same symptoms of the economy in general. There were crucial problems in terms of cash flow and finding technical supplies due to shattering apart of the Soviet system. However, there were other severe obstacles in the managerial part. One of these was the non-vertically integrated character of the sector. Vagit Alekperov (2011: 345) argues that “the structure of the Russian oil and gas industry comprised nearly 2,000 uncoordinated associations, enterprises, and organizations belonging to the former Soviet industry ministry” in 1992. There was a coordination problem that made a proper management almost impossible.

Before perestroika reforms, energy sector, like other industries, was centrally planned and controlled by the state. Central planning had a pluralist structure in the ministerial level and no ministry had complete control on the sector. There were ministries of oil, gas, oil and gas facility construction, electrification, coal, and energy (Zhiznin, 2007: 479). Apart from these ministries the USSR State Planning Committee and the republican state planning committees did long-term planning.

The Communist Party played a key role in overall control while the Ministry of Trade and Finance's specialized associations Soyuznefteexport and Gazexport were controlling the foreign trade of energy commodities. There was a complicated bureaucratic mechanism for the system to function. Gorbachev administration tried to simplify this complicated structure with perestroika reforms. Ministries of energy were integrated under the Ministry of Gas and the Ministry of Oil in 1989 (World Oil, August 1, 1989).

In this section, I will explain the restructuring of the hydrocarbon sector by looking at oil and natural gas sectors separately. The former remained as a monopoly after the dissolution of the Soviet Union, whereas the oil sector was divided into pieces. I argue that in the transition period institutions lost their power and capability to shape the political sphere due to lack of elite consensus in Russia. Subsequently, actors could pursue their own agenda to maximize their interests. In this regard, members of the nomenklatura pursued different policies in the energy sector that caused atomization of the sector. The framing of the privatization program with the aim of eliminating the possibility of turning back to the Communism also presented a broad maneuvering space for many actors.

3.3.2.1. Kamikaze Privatization and Emergence of Vertically Integrated Companies in the Oil Sector

After the August coup, Yeltsin dissolved the Communist Party and before the end of 1991 the Soviet Union was totally left behind in the past. The Soviet ministries became obsolete, and they were dissolved after the Minsk Agreement between Belarus, Russia and Ukraine. Yeltsin had control over the executive body, but the economic and political situation was fragile in the country. Under these circumstances, Boris Yeltsin and his team knew that they had to bring down the legacy of the communist system before constructing a new one.

In order to get rid of the shadow of the Communist regime, Yeltsin administration designed the privatization process with minor limitations and did not hesitate to privatize large and lucrative assets in the country. The first phase of privatization started in early 1992 with small-scale assets and continued with medium and large-

scale enterprises. At the end of this process, the state's control on the economy weakened including strategic assets in different sectors.

Mostly, the members of the nomenklatura: red directors, factory managers, or the elite in the center took the advantage of the privatization. Because of this, the privatization in Russia is described as "insider privatization" (Sutela, 1994). Looking from the lens of Yeltsin administration, Thomas Gustafson says that three imperatives forced the privatization in Russia to gain such a character; these were "to build a coalition of stakeholders, to move fast before the support ends, and to keep it simple" (1999: 39-40).

All of these imperatives were directly linked with the political atmosphere in Moscow. Gorbachev and his entourage were eliminated in the aftermath of the August coup, but Yeltsin found himself with the legacy of the perestroika period. This legacy had a transitory character in the absence of a well-defined institutional framework. The elite integration among the institutions was weak, the reforms were unfinished or crippled, the economy was in a really bad shape and the political balance was fragile.

Under these circumstances, Yeltsin's main target was to start a new reform process to tumble down the system in an irreversible manner. Yeltsin explains this aim bluntly as (Interview with Boris Yeltsin, October 22-28, 2003 in Desai, 2006: 79-80):

I had a perfectly clear idea of the task to be solved. The political system had to be overturned, not just changed. In place of the Soviet political system, a democratic one had to emerge. The administrative command economy had to be replaced by a market economy, and freedom of speech had to replace censorship.

Privatization was a complimentary step of this goal. A mass privatization program would help a market economy to emerge and reaching out to the society and a group of people within the nomenklatura. This would change the political balances in favor of the reformers and Yeltsin. The logic behind this was based on the idea that giving the state property to the nomenklatura would bring the support of these people and

make them focus more on opportunities in the business sphere rather than politics (Shevtsova, 1999: 46; Sutela, 1994: 419).

The motives behind the privatization show that Yeltsin and his team had intentions of changing political balances in favor of the new administration by destroying the already shaken pillars of Russian political economy. Advisors and architects of the program had similar arguments (Boycko, Shleifer, Vishny, Fischer, & Sachs, 1993: 147-148):

Unlike price liberalization, monetary tightening, and reduction of government spending, all of which impose painful costs on some people, privatization allocates shares to the people for free or at low prices-typically a popular measure...By creating a class of supporters of reform and reducing the power of its opponents, privatization can change the political balance in the country. The need to gain support for reform is the political argument for privatizing rapidly. If privatization is slow, the benefits to the population are by definition small, and hence the political capital they buy the reformers is small as well. Fast privatization is privatization that offers large political benefits from the start – exactly what a reformist government needs.

Among others, the privatization reshaped the interests of the nomenklatura. Some actors pursuing their own interests enjoyed the blessings of the liberalization process, whereas others adopted a more conservative stance and created obstacles before Yeltsin and the reformist government particularly in the first half of 1990s. The first group became an important ally for Yeltsin in political level or moved out of his way as an opponent by gaining some economic advantages.

The reformists divided the assets into three categories as small, medium and large-scale enterprises. The central government oversaw the privatization of medium and large-scale enterprises whereas the local governments made the small-scale privatization. Moscow gave up control on hotel facilities, retailing enterprises, public caterers and housing to the states and municipalities. This was a compromise given to the local governments by the center (Boycko, Shleifer, Vishny, 1994: 101). Assets under the control of the federal government became joint stock companies in parallel with Yeltsin's Decree No. 721 (1 July 1992). Chubais and Vishnevskaya (1994: 94-95) explains this process as:

The progress in corporatizing enterprises can be described as the ‘supply side’ in the mass privatization. The ‘demand side’ is represented by privatization checks (vouchers) and check (voucher) auctions. Privatization vouchers were distributed from 1 October 1992 to 31 January 1993 under the supervision of the State Committee for Property Management (*Goskomimuschetsvo*, or GKI).

Three alternatives were given to the enterprises to follow, with different schemes of distribution of shares, while turning these enterprises into a joint stock companies before privatization.¹⁴ This way the government gave some privileges to the workers and managers, before mass privatization started, to get shares of their working place.¹⁵ Yet, in the corporatization process the privatization was the main aim and restructuring was the second target. Restructuring would cost time and energy, but Yeltsin and his team did not have time and sources for the restructuring (Gustafson, 1999: 40). So, the processes of restructuring and privatization took shape simultaneously based on the capability of actors in different tones for each sector, rather than a specific framework designed by the center and implemented thoroughly.

The privatization program became one of the main pillars of the shock therapy. It started in the late 1992 and continued until 1998. After the corporatization process, privatization of state enterprises developed so fast. Each citizen involved into the process with the distribution of vouchers. Russian government distributed 10000 (around 25 dollars) rubles worth vouchers to every man, woman and child in exchange of 25 rubles (around 5 cents) (Decree No. 914, Erlanger, October 2, 1992; Hough, 2001: 78). In this respect, the program had a populist character. Along with taking the support of “the insiders”, the reformers planned to reach out to the society by distributing vouchers to the society. At the beginning it was appealing and created supportive environment for the Yeltsin government. This support turned into a political capital in April 1993 referendum for Yeltsin (Desai, 1995: 21). Getting the support of the society, Yeltsin gained time against the legislature. As discussed

¹⁴ Some enterprises or institutions in the sectors of health, space exploration and education were kept out of privatization program.

¹⁵ Please refer to Boycko, M, Shleifer, A. & Vishny R. W. (1994). The Progress of Russian Privatization in Anders Aslund (Ed.), *Economic Transformation in Russia*, London: Pinter Publishers, pp. 101-110.

earlier, there was a tension between the Parliament and the presidency rather than a synchronization that ended up with an armed conflict.

The strategy of distributing the enterprises to the people sounded nice in the beginning. Vouchers became one of the most liquid instruments in the market in a short while. It started to be exchanged in the market for money, and even for vodka. So, people gained limited advantage from their vouchers. Some Russian and foreign investors or funds collected vouchers from the market and used these vouchers to get shares from the strategic assets. Among these there were newly emerged entrepreneurs who accumulated some capital starting from late 1980s like Khodorkovsky or foreign fund representatives like Boris Johnson from Credit Suisse First Boston (Goldman, 2003: 84). They used these vouchers to get pieces of Soviet industrial enterprises. Among these, metal and hydrocarbon industry were really attractive, because of the immediate convertibility of the products of these industries into hard currency in the international market. Thus, vouchers both served to establish good public relations between the society and the government and also helped foreign funds to be interested in Russian privatization. Later, oligarchs would have close relations with these funds to expand their investments or acquire more assets from the government.

Insiders, who were members of the nomenklatura had chance to frame the presidential decrees with their access to Yeltsin and his entourage. Ministry of Oil had the control of the sector during the Soviet period. CEO of LUKOil, Vagit Alekoperov, was then the First Deputy Minister of Ministry of Oil. He had chance to observe the vertical structuring of the Western oil companies during his visits to the West. He came up with the idea that the sector should be restructured as in the West and worked on several drafts. He proposed a bigger plan at the beginning, but faced with opposition and then decided to establish a concern in 1990. He explains the process in an interview as (We Do not Want (Мы Не Хотим), 1996):

In the now distant 1990, when the law on a state-owned enterprise was passed and ministries began to be reformed, I proposed to the then head of the USSR Ministry of Oil and Gas Industry, Filimonov [Leonid], the concept of creating a corporation based on this ministry, and he basically approved it. By that time, I had already visited a number of Western companies (Agip, British Petroleum, Chevron), looked at

their structure, got acquainted with the work, and concluded that vertical integration was necessary for the oil complex. In principle, the idea was the same as that of Chernomyrdin, who had shortly before created the Gazprom concern. However, officials from various ministries could not agree, and the national corporation did not succeed. Therefore, in the same year [1990], the idea was born to create a concern with a limited number of participants. Initially there were three of them. These are oil-producing associations in Langepas, Uray and Kogalym, the first letters of which constituted the name of the concern - "LUKOIL". A little later, they were joined by four refineries - Perm, Volgograd, Novo-Ufa and Mazheykyaysky. At the end of 1990, constituent documents were signed, and on February 1, 1991, the concern registered an interdepartmental commission at the Moscow Council. Then I was subjected to harsh criticism at various instances for "destroying the industry". But we survived, although in 1991 the concern almost did not develop, since the USSR Government's decision to start its work was prepared, but we did not have time to sign it - the August events struck. And only in October such a document was signed by Burbulis. The concern existed until the famous presidential decree No 1403, after which the company "LUKOIL" became its successor.

Alekperov summarizes two-year length process of birth of new vertically integrated oil companies in Russia. It seems that Chernomyrdin's move inspired and encouraged many in the oil ministry, but the idea of transforming gigantic industry into a big company failed in the end. Alekperov's *salami approach* of creating smaller state concerns became successful. The main idea was creating vertically integrated oil companies, but in a smaller scale. He hardly found supporters within the party in 1990, but managed to get approval initially from Moscow Council and then from Gennady Burbulis just after the August coup in 1991. Alekperov used his channels within the government and succeeded to establish a vertically structured state concern with the Regulation No. 18, Langepasuraykogalymneft (Later the company would take the initials of Langepas, Uray and Kogalym and be known as Lukoil). According to the regulation approved by First Deputy Chair Burbulis, Lukoil would be an economic concern for geological exploration, oil production, and oil refining, sales of own production and enjoys the rights of a legal entity. In other words, a wholly vertically integrated company that would have capacity of carrying out different operations as a legal entity. Before the Regulation 18, Alekperov had already well-established links and a close network with chief engineers and heads of

Langepas, Urengoi and Kogalym production associations. He organized visits to abroad with these people and showed them western style organization. Moreover, as a former oilman who worked in West-Siberia he was a well-known figure among red directors. After the establishment of Lukoil, Alekperov became the new CEO of the company. Thus, he chose to give up his political position for the new position at Lukoil. Lukoil was a milestone in the sector because it paved the way for emergence of private oil companies as the sector was going under a transformation just before the major economic reforms. Alekperov played his cards in a critical moment and wisely, just after the August coup when the party was abolished, he moved for a change in a smaller portion of the sector.

The last Soviet Minister of Oil, Lev Churilov, tried to bring together oil associations under the umbrella of Rosneftegaz in 1991, but he could not go further than creating a loose lobby association (Gustafson, 2012: 57). In fact, this was a similar attempt of Chernomyrdin's keeping the gas industry as a whole under the umbrella of Gazprom in 1989. But the political dynamics had already changed in 1991 and Churilov's attempt could not be successful. The atmosphere was not favorable for such a change. There were no strong supporters of the idea within the government and after the August coup the stakes were so high that Soviet Union was in a process of dissolution. The CPSU had already gone and taking such a macro decision was almost impossible. The idea of creation of a giant oil industry failed in the end. The restructuring in the oil sector followed Alekperov's Lukoil as a model rather than Chernomyrdin's Gazprom.

Yeltsin and his kamikaze team were decisive about privatization. But there was a problem of sharing the assets between federal and local governments. According to Supreme Soviet Decree No. 3020-1 (December 27, 1991) among other strategic assets, enterprises in extractive industry, pipeline transport, gasification, and enterprises of fuel and energy complex, electric-power generation were kept under the federal ownership. Thus, the federal unit would keep the control on energy sector. After the Minsk agreement, Soviet ministries controlling the energy industry were abolished and the Ministry of Fuel and Energy took over their duties in 1992 (Zhiznin, 2007: 480). Vladimir Lopukhin was then the Minister of Fuel and Energy. He was as a 39-year-old technocrat in the Gaidar's team. At the end of the 1991,

Lopukhin shared the plans of the new government to create eight to twelve vertically integrated oil companies similar to Lukoil in the upcoming six months period (Reuters, December 16, 1991).¹⁶ Thus, one of the main targets of the new team was to break up the monolithic structure of the oil sector by dividing it into small pieces. He was trained as an economist, and had studies on the sector back in 1980s and some acquaintances with oil generals. But he was neither an oilman nor a popular face within the sector. Unlike Alekperov, he wanted to make a big shift from the center without reaching out to the people of the industry. Yeltsin says that he was receiving complaints about Lopukhin related with his incapability of resolving problems of the sector (Yeltsin, 1994: 168). In fact, this was not all Lopukhin's fault. The coordination was almost collapsed, the state had to deal with the macro problems of the transition period. Oil sector was a critical topic, but not the first on the agenda. Plus, there was not enough financial sources and channeling funds was a problem while the government was pursuing a tight monetary policy. The sector was in dramatic condition due to controlled prices of oil and gas while the shock therapy liberated most of the prices in the economy in transition to market economy from the command economy. Yeltsin was in a dire position due to rising criticisms against the shock therapy from different spheres and the main actor was to be blamed was Gaidar. Finally, he decided to replace Lopukhin with Chernomyrdin in May 1992 and bought sometime for Gaidar and controlled the complaints. This changed the plans for the restructuring of the sector in the middle of ongoing problems.

There was no smooth way ahead of the new actors of the Russian oil sector. The price control continued, which put the sector under a great pressure along with the challenging obligation of the big companies to control subsidiaries like refineries, and oilfields in different regions. The control continued for a long time in Russia due to political reasons even after the liberalization of prices of other commodities in general with the Gaidar reforms. Oil was a strategic commodity that transportation and industrial production were directly related with its stable supply. Yet, the control

¹⁶ Lopukhin claims that he encouraged Vagit Alekperov about Lukoil. According to him Alekperov had strong links with the oil industry, but limited ideas about vertically integrated oil companies. However, he also accepts that Alekperov had a personal charisma to bring different associations under the umbrella of Lukoil. For further information please refer to Interview with Vladimir Lopukhin: "That was the Bone-Breaking Machine" in Aven, P. & Kokh, A. (2015). *Gaidar's Revolution: The Inside Account of the Economic Transformation of Russia*.

on the prices was one of the problems for the sector even at the dawn of the dissolution of the USSR. The situation became even graver with high inflation rate in the country following the shock therapy reforms. Lev Churilov stated that while leaving his post at Rosneftegaz in 1993 “the price of one ton of crude oil was worth \$5.5 inside the country; today given the exchange rate it’s worth only \$20” (Platts Oilgram News, February 15, 1993). Controlled prices were not even covering upstream operators’ costs and causing maintenance problems. Subsequently, productivity of oil wells started to decline and this also had negative consequences on state’s export revenues from oil. “Oil export revenues fell from 22 billion in 1986 to about 7 billion in 1991” (Aven, 1994: 57). One of the main reasons of the decline was loss of control on the sector. Oil managers were exporting, sometimes smuggling, domestically allocated oil to abroad through illegal networks (Sim, 2008: 19). People who had some acquaintances in Moscow was getting export licenses and mediators started to make serious profits. Considering the difference between the domestic and international prices exporting oil via mediators was so profitable. Even if the government tried to regulate the sector by controlling the licenses, illegal networks thrived around refineries and extraction units (Interview with Anonymous, June 3, 2013). The estimation of cost of illegal exports of raw materials was \$30 million per day (Leaders of Russia's Oil Industry, August 18, 1992). The picture was chaotic, but pragmatic players started to gain advantage of the transitory conditions in the country.

Under these circumstances restructuring was critical both for the sector and the economy. Before his replacement Lopukhin prepared the framework of restructuring the sector with new vertically integrated companies. He says that he introduced the idea and reached an agreement with Gaidar. Furthermore, the Ministry of Economy had been planning the structure of Yukos since August 1991 (Interview with Lopukhin in Aven & Kokh, 2015). Thus, before Chernomyrdin became the prime minister the blue prints for the sector restructuring were ready.

Lopukhin’s successor Chernomyrdin was an industrialist and a pragmatic technocrat. Gas sector was under his control and after coming to the office he managed to decrease the tension in the oil sector. He promised to channel some funds and sought the support of oil generals for division and privatization of the industry while they

would be keeping their seats (Gustafson, 2012: 76). Chernomyrdin, as an industrialist and an actor out of the reformist club, did not cancel the reform in the sector, but slowed down the process with some fine tunings.

After the approval of the Decree No. 721 in July 1, 1992 to transform state enterprises into joint stock companies another decree followed. This decree kept energy sector out of the transformation process. The government spared the energy sector and decided to follow a special path in the privatization. The Decree No. 922 (August 17, 1992) states that

The RF Ministry of Fuel and Energy, together with the RF State Committee for Management of State Properties, and the State Law Administration of the RF President shall, within one month, frame and submit draft edicts of the RF President on transformation into joint-stock companies and privatization of enterprises, associations and organizations in the coal, oil, oil-refining, oil-product supply, gas and power-generation industries, and on organization of management of these industries in a market economy.

Another presidential decree dated November 16, 1992 (Decree No. 1392) preserved federal government's hold on controlling blocks of shares in privatized enterprises in energy, communication, transportation, liquor, metal and radioactive elements extraction and processing, and weapons and ammunition production for three years. After the corporatization the government would not give up the control, rather Moscow decided for a controlled transition. A day later, the Decree No. 1403 was approved and the oil industry was divided into pieces. The pipeline system was kept under the monopoly of Transneft, three new vertically integrated joint stock companies, Lukoil, Surgutneftegaz and Yukos, were founded and production associations, enterprises or refineries which were not transferred to the control of Transneft, Lukoil, Surgutneftegaz or Yukos were kept under the umbrella of Rosneft state enterprise. Restructuring the sector, the government was aiming to modernize the industry and bring competition to the sector while new companies would be controlling "10 or 15 percent of the oil production and refining capacity" (Killen, October 18 1992).

Full ownership of the state concern Rosneft, 45 percent share of Lukoil, Surgutneftegaz and Lukoil and Yukos, and 49 percent of Transneft were assigned to

federal ownership for three years. Remaining 40 percent shares of Lukoil, Surgutneftegaz and Yukos would be sold in two years' time in investment tenders (half of the 40 percent of the shares would be privatized with vouchers) to general public, and remaining 15 percent would be sold to employees and inhabitants (they would pay in vouchers) of the oil extraction areas. Foreign investment was limited with 15 percent of the shares.

The decree No. 1403 had certain characteristics. First, the federal government kept the control on pipeline monopoly. This was a strong insurance on controlling the industry in the long run. Pipelines are not just instruments of transmitting oil from one point to another, but also an infrastructure system that helps to calculate amount of oil flows in the sector. In this regard, the control on oil flow gives advantages to the government in tax collection from the oil trade.

Second, the number of newly established companies were limited with three instead eight or twelve. This reflects the moderate and gradual approach of Chernomyrdin, in opposite of the kamikaze team's rapid policy choice. Rather than creation of 8 to 12 companies as in Lopukhin's strategy, restructuring of the sector was extended over a period of time and assets were kept under the umbrella of Rosneft. Third, Russian government appointed the presidents of newly established joint stock companies. Vagit Alekperov preserved his place as the CEO of Lukoil; former member of Lukoil team Aleksandr Putilov became Rosneft's president; head of Surgutneftegaz Vladimir Bogdanov preserved his place; director of Yuganskneftegaz, Sergei Muravlenko became the new president of Yukos, and Sergei Cherniaev preserved his position as the head of Russian pipeline system and became the head of Transneft. The new appointments show that oil generals or insiders preserved their position, which put some of these actors in an advantageous position to acquire stakes from the sector in 1990s. Fourth, Rosneft was not transformed into a joint stock company and became the object of next stage privatization. The government later divided the company into pieces and its offshoots were shared among oligarchs in the second half of 1990s with the infamous Loans for Shares program.¹⁷ Even though the

¹⁷ I will discuss this program under the title "3.3.3. Second Phase of Privatization: Loans for Shares (1995-1999)".

division was extended over a period of time, the state lost control on the sector in the second half of 1990s. However, the control passed to Russians citizens, not to foreigners.

After the restructuring of the oil industry by dividing it into pieces there were several challenges before the new managements. The main priority was consolidating the company hierarchy by controlling subsidiaries namely enterprises those were entitled to the new companies in the downstream and upstream levels according to the Decree No. 1403. This was a critical challenge because other priorities such as finding necessary finance to pay the wages of employees, covering operation costs and controlling the shares of the newly established companies in the privatization process were all linked with it. The new actors' management and adaptation capability played a crucial role in this phase. The CEOs of Lukoil and Surgutneftegaz; Vagit Alekperov and Vladimir Bogdanov showed a better performance than Yukos' Sergei Muravlenko. The newly established joint stock companies had a more maneuvering space than Rosneft in legal terms, which was kept as a state concern and left in a more amorphous form under the control of the federal government.

Alekperov and Bogdanov rapidly had already control on the subsidiaries and managed to establish funds to collect shares in the privatization process (Gustafson, 2012: 98-144). Alekperov had chance to establish Lukoil in 1991 and had full control on Ural, Kogalym and Langepas production associations. Managing to get an export license he started to receive hard currency from oil trade. He hired western advisors and partnered with a Moscow bank that helped him in providing financial services. Bogdanov pursued a more moderate strategy and rather than bringing western advisors he relied on his own sources within the company. His main advantage was his unshaken control on Surgutneftegaz and its subsidiaries after the collapse of the USSR. He used his advantages of being located in a remote state. During the auctions to privatize Surgutneftegaz by the federal government, he managed to close the city to air traffic. This way he eliminated the possibility of competition. No outsider could reach to Surgut. As the only runner, he managed to buy the shares with the help of pension fund of the company. (Treisman, 2010: 207; Gustafson, 2012: 124)

Yukos case differs from Lukoil and Surgutneftegaz. Muravlenko was the only manager who could not preserve his position like his counterparts Alekperov and Bogdanov. In the end, an outsider, Khodorkovsky gained the control of the company in the Loans for Shares. Muravlenko's character and the institutional structure of Yukos were definitive parameters in the shift of ownership. He was a good engineer and a well-respected oil general, but not necessarily had modern management skills. Bogdanov and Alekperov were really innovative and active in financial management like establishing funds to be used in the privatization auctions or cooperating with banks for exports or finding credits. Muravlenko was a well-equipped engineer, but hardly interested in these issues. Furthermore, the relations between Yukos and its subsidiaries had a loose character. Before the establishment of Yukos, as the head of Yuganskneftegaz, Muravlenko had incentives to cooperate with the head of head of Kuybyshev refinery and follow Alekperov's steps to create a vertically integrated oil company. In this regard, there was the necessary incentive, but subsidiaries of Yuganskneftegaz had already started to act autonomously before the corporatization of Yukos in 1992 (Sim, 2008: 48-49). The subsidiaries were not enthusiastic to share the power and financial interests with the headquarters. Establishing control was not easy in a chaotic environment that illegal groups like mafia carrying out illegal trade. Not long after the establishment of Yukos, Vice president Vladimir Zenkin was murdered in October 1993 while trying to control money flow of Kuybyshev refinery by illegal networks who perceived the attempt as a threat to their interests (Russian oil company chief murdered, October 1, 1993, Aven & Kokh: 2015)¹⁸. Between 1992-1995 problems in sustaining cash flow and consolidating holding's power on subsidiaries caused declining production and rising debts for Yukos. Thus, he could not prevent outsider control on shares in the privatization process.¹⁹

Rosneft's destination was not different than Yukos. Unlike others, Rosneft was not transformed into a joint-stock company. Rather it was seen as an umbrella

¹⁸ Kokh claims that Zenkin was against Muravlenko's close relationship with Khodorkovsky and there are some blurred parts about his murder.

¹⁹ I will continue to discuss change of ownership in Yukos in "Second Phase of Privatization: Loans for Shares (1995-1999)".

organization for production associations. The government sliced company into pieces and its offshoots became objects of competition in the second half of 1990s.

Thus, in the first phase of privatization the government acted rapidly to liberalize the economy. First, there were political incentives behind this strategy such as making the reform process irreversible and preventing old regime to resurrect. Second, new elite around Yeltsin planned to gain public support with voucher privatization and form a base of elites that they would rely upon in the transition process. Oil industry was not kept out of this process, but a different strategy was pursued. Technocrats in Moscow like Chernomyrdin, Alekperov and Lopukhin were influential in framing and implementing policies of restructuring in the first half of 1990s. Parallel to the inputs of these actors, the state oversaw the privatization process and kept a certain share in the sector due to its strategic importance. Furthermore, the first phase of the privatization turned out to be an insider privatization and oil generals became new CEOs of the newly founded vertically integrated companies. The sector was not totally handed over to these actors, but these generals were active to control a piece of the sector. Yet, their capability of adapt to the new rules of market economy was definitive in their future roles.

3.3.2.2. Keeping the Gas Industry as One Piece: The Case of Gazprom

Restructuring of the gas sector had already started in the perestroika period. State concern Gazprom had already transformed into vertically integrated gas monopoly before the dissolution of the USSR. Viktor Chernomyrdin, who was then the Minister of Gas, is the architect behind the strategy of transforming the Ministry of Gas in to a state-corporate enterprise (100% owned by the state). After the foundation of the state concern, he was elected as the chairman of the company and kept his position till his appointment as the prime minister in December 1992. When Yeltsin approved the Presidential Decree No. 1333 in November 5, 1992 to turn the state concern into a joint stock company, Chernomyrdin was the deputy prime minister in charge of fuel and energy. Following this decree, Chernomyrdin approved the corporatization of Gazprom as the prime minister with the Governmental Regulation No. 138 in February 17, 1993.

These legal documents preserved monopolistic structure of Gazprom and regulated federal ownership. According to these documents, the government would keep 40 percent of the shares. In the privatization process, the employees were entitled to get 15 percent and Russians citizens at least 20 percent, and foreign investment was limited with 9 percent of the shares.

As a monopoly Gazprom had some other advantages that other oil companies did not have. Gazprom was designed as a fully vertically integrated company, which would be controlling gas sector in Russia. It was authorized to negotiate and export gas to third countries, and had the full control on the gas pipeline infrastructure. This would put the company in a unique position that other oil companies would be dependent on Gazprom in gas transmission.

In this peculiar design, Chernomyrdin and Gaidar were influential actors.²⁰

Chernomyrdin as the founding father of the company did not let the company to be divided into pieces whereas Gaidar also thought it was in the best interest of Russia to keep the company as one piece since gas was different than oil. People needed stable gas flow for heating purposes and electricity supply (Gustafson 2012: 71). Transition process was so fragile and it was not right to embark on an adventure that would risk the future of the reform process. Instead, leaving Gazprom intact would help to control opposition against the shock therapy reforms.

Chernomyrdin was an influential figure and his role in the government strengthened his position further. He used his political power to keep Gazprom intact. Kokh (Aven & Kokh: 2015) says that Chernomyrdin “would not have allowed it [Gazprom] to be restructured”, he was “a minister and the vice premier for fuel and energy...he was a big player and the only one with a huge amount of cash”.

Chernomyrdin was a red director and a Soviet minister. He had already established control on the associations before the privatization debate gained momentum. Thus, the dynamics in the gas industry was more favorable than the oil industry in general. After becoming the prime minister, Chernomyrdin kept his control on Gazprom

²⁰ Lopukhin also argues that he also supported the idea of not dividing Gazprom into pieces.

through his protégé Rem Vyakhirev. Vyakhirev was in an advantageous position, because he had the support of the premier and had capacity of taking strategic decisions, because he had both control on government's and company's shares.

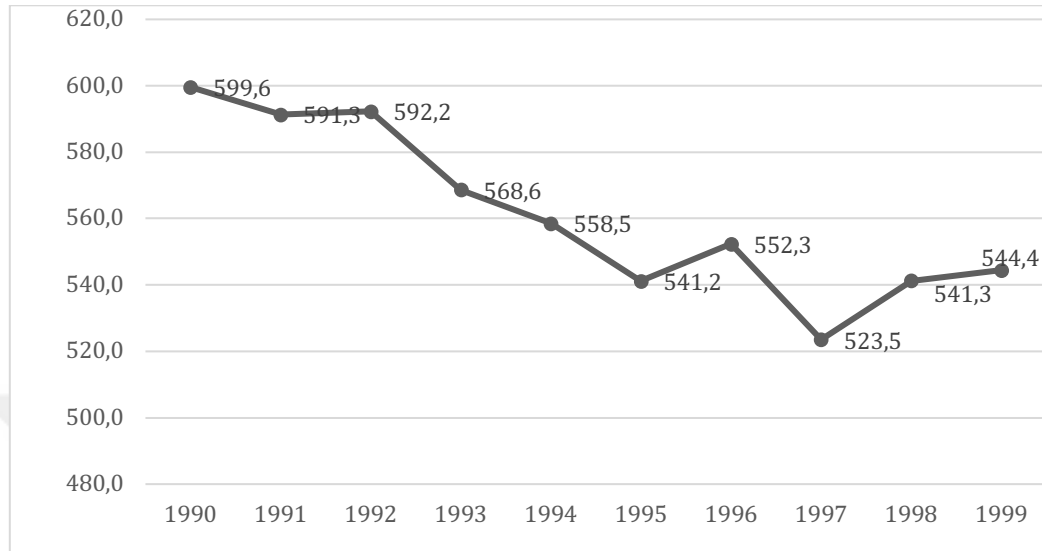


Figure 3: Natural Gas Production in Russian Federation (bcm) (1990-1999)

Source: BP Statistical Review of World Energy 1965-2017

The government's control on the shares prevailed, but the administration had incentive to take decisions in place of the government. At the end of 1995 the federal state had 40 percent of the company²¹, 33 percent was sold in voucher privatization to the citizens and 15 percent was owned by the workers, and the company held 10 percent of the shares (reserved to be sold to foreigners) (Hoffman, December 3, 1995). 747000 people were holding 33 percent of shares of Gazprom (Goldman, 2008: 60). Thus, Vyakhirev had control on the majority of the shares.

The company had a certain autonomy, there was a close relation between the government and Gazprom. Yet, the performance of the gas sector was not that bright. As can be seen from the Figure 3 natural gas production gradually declined from 600 bcm to less than 550 bcm between 1990 and 1999. Main problems were great tax burden and bad management of the company. Moreover, the economic dynamics negatively affecting balance sheet due to high inflation rate and depreciation of

²¹ This number slightly decreased below 40 percent in the following years. For instance the share of the state was 38.7 percent whereas foreigners were holding 4.48 percent and the corporate entities 36.2 percent of the company. For further information please refer to Gazprom 1998 Losses Top 42.5 BLN Rubles. (June 29, 1999). *Interfax*.

ruble. For instance, after the 1998 crisis the company had to deal with high tax burden and loss on operating income. Sales revenue in 1998 was 171 billion rubles, whereas after the tax, losses amounted to 42.5 billion rubles – a quarter of the company's revenues (Gazprom 1998 losses top 42.5 BLN rubles, June 29, 1999). As in the case of oil industry, Gazprom was facing with financial constraints even for the maintenance of infrastructure and sustaining production capacity. This led decline in the production throughout 1990s.

Paying taxes, supplying subsidized gas to Russians and post-Soviet countries were the main roles of the company. Almost 70 percent of the produced gas was consumed domestically. Gazprom exported gas to post-Soviet countries in discounted prices. These were strategic tasks in political terms, but in the expense of the company's profitability. Along with the problems of production performance and lack of competition in the sector, the company had some transparency problems in financial terms. Its non-energy related activities such as in real-estate business or relations with mediators in exporting produced gas to third parties were problematic and became an issue for reformists in the government (Russian government prepares to oust, July 18, 1999). Gazprom was using mediators like Itera based in Jacksonville, Florida. Through these mediators the profits of the company were siphoned, which caused further decreases in the profitability. Thus, there was tax evasion and hardly payment of dividends to its owners, rather a small circle of people was enjoying financial privileges. These were Vyakhirev, "Chernomyrdin, and other senior management associates, and their various children, wives, and mistresses" (Goldman, 2007: 362).

The economy was in bad shape. IMF conditioned restructuring of energy monopolies and asked for reregulating price policy for domestic consumption to a more rational level for providing loans to Russia (Russia meets key IMF demands on Gazprom, utilities, January 28, 1997). In the second half of the 1990s, the option of division of the company was started to be speculated (York, March 24, 1997). These debates could not be realized and the company's monopoly status did not change. Under Putin's rule the administrative team reshuffled and the company's autonomy weakened.

To sum, Chernomyrdin and Vyakhirev kept outsiders away from Gazprom in the 1990s. The government had limited access to the company's decision-making mechanism, because the insiders were dominant and cooperated closely. This factor limited the efforts of restructuring of the company while a mass privatization was going on in Russia. Chernomyrdin transformed the Ministry of Gas into a gas conglomerate and no dramatic steps were taken for restructuring during the Yeltsin period. Company's strategic role in social, political and economic terms were crucial in keeping it intact. Besides, natural gas compared to oil has some peculiarities that helped the sector to have a lower than metal and oil sector. It is not easy to store natural gas, and in 1990s it was not easy to market the commodity in the retail and international market like oil or metal products. Rem Vyakhirev enjoyed these dynamics and preserved his position until Putin's reshuffling in Gazprom. The Kremlin consolidated its ownership and control on the company. This close grip made Gazprom to play a more critical role in Russian economy and foreign policy under Putin's rule.

3.3.3. Second Phase of Privatization: Loans for Shares (1995-1999)

Russian reformers founded new, vertically integrated oil companies from a horizontally structured energy sector in the first half of 1990s. After the first phase privatization, horizontal structure and the ownership model changed in Russia. New vertically integrated joint stock companies emerged and the state was no longer the only owner in the sector. The management had already started to change in the expense of the state's control before the second phase of privatization started. The access of foreign actors was limited, and the crown jewels of the USSR industry was distributed to Russian citizens in the first phase. The oil industry was categorized among strategic sectors and its corporatization pursued a *sui generis* path. The new managers of these companies were canonical names of the sector, known as red directors. These people played active roles in the restructuring phase and afterwards.

In general, red directors faced with difficulties to adopt new methods to modernize Russian industry and create new funds. The economy was in rapid transition, but the pace of restructuring of economic infrastructure was slower and oil sector was not an

exception. Apart from few innovative figures, the sector was suffering from declining production and ongoing corruption.

The government cascaded the privatization into phases. The first phase was the voucher privatization and was not designed to bring funds. The main idea was bringing every actor on board and destroying the Soviet legacy to make the reform process irreversible. However, the government also needed funds for keeping the economy functioning. Privatization revenues for the first eight months of 1995 was only \$36 million, well below \$2 billion budgetary target (Rosett & Liesman, October 2, 1995). The opposition of the Parliament could not be broken. The government was planning to sell lucrative assets, but facing blockades from the Parliament. In line with this policy, Duma banned energy sector's privatization (Treisman, 2010: 216). The fragmented nature of the political elite was still there. The government's coalitionary characteristics was also impeding the pace of reforms. There was a balance, but this balance was not in line with synchronization of positions, rather in a fashion that each group was seeking to maximize their interests by lobbying through different channels and reaching out to Yeltsin. Yeltsin's health was deteriorating as his political popularity. He was keen on keeping Russia on transition track, but well-qualified and decisive reformist elite around Yeltsin was losing ground. Conservative groups were politically on the rise. In return, another group, the new economic elite that emerged in the last decade, was perceiving this rise as a threat to their very existence.

Reformist premier Gaidar was sacked by Yeltsin at the end of 1992, but the architect of the privatization program Chubais was a deputy minister and reformers were still in the government leading the privatization process. The reformers were decisive about continuing the privatization. They were not merely decisive technocrats with bureaucratic and political interests, but also had close links with the new economic elite. The new economic elite emerged in the perestroika period and made a fortune from financial sector. As discussed earlier, the financial sector developed from a very primitive stage to a chaotic form of state in the early 1990s. The newly emerging banks became a new area of interest for the oligarchs who perceive establishing banks both as the best way to keep their money safe and an instrument that can be used to maximize interests from a lively financial sector thriving in the transition

process. The government was borrowing money from the banking sector in the form of short-term credits with high interest rates. There was a great opportunity of foreign exchange speculation due to uncontrolled market liberalization. In this setup, Russian politics witnessed an interesting relationship between politicians, technocrats and oligarchs. Oil sector became the object of this relationship, because it was both instrumental and attractive. The framework of this relationship was *Loans for Shares* designed for distribution of the oil industry among newly emerged Russian elite in return of political and economic gains.

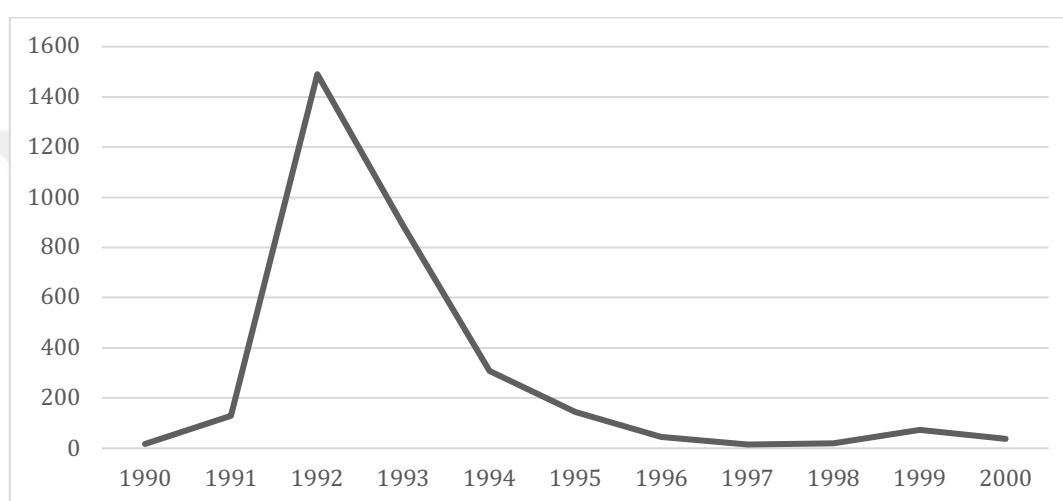


Figure 4: Inflation, GDP Deflator in Russia (annual %)
Source: World Bank

Loans for Shares framed by Vladimir Potanin in 1995. Vladimir Potanin was then the owner of the Oneximbank and he had close relations with Chubais and Alfred Kokh. The former became deputy PM in November 1994 and the latter was the acting director of the GKI. Chubais was overseeing the privatization and Kokh was orchestrating the process. The idea was finding new funds for the economy, consolidation of the irreversibility of reforms, and bypassing the parliament's ban on energy sector's privatization (Treisman, 2010). The funds were necessary to bring stability to the economy. After the liberalization reforms, inflation rate skyrocketed from 15 percent in 1990 to 1490 in 1992. As can be seen from the Figure 4, three-digit inflation rate became the new normal of Russian economy. Even though the inflation decreased gradually in the following years it was still hard to talk about a price stability. Under these circumstances, the wealth and income of the Russian citizens melted dramatically. The state was facing difficulties even in paying wages

(Richter, 2006). Prior to presidential elections in 1996, the approval rates of Yeltsin were falling due to unfavorable dynamics in the economy. Thus, for some members the idea of Loans for Share was more political than economic. Chubais says that (Interview with Chubais, in Kokh & Aven, 2015):

[M]y position was completely noneconomic. I still think that the loans-for-shares auctions laid down a political foundation for the irreversible defeat of the communists in the election of 1996. Those were the real “commanding heights,” the largest enterprises of the country led by “red directors.”

As discussed in the previous section, in the first phase of the privatization, corporatization and voucher privatization weakened state ownership and control in the economy in general. However, red directors preserved their positions in the strategic sectors. Only some of these people had innovative approach to reform the production methods, the rest continued to pursue economically inefficient Soviet style management models. The corruption was a countrywide problem and the government had some problems of collecting taxes and paying its debts.

Potanin had the idea of the Loans for Shares and Boris Jordan put the idea into paper. In return of giving debts to the government the oligarchs would get the control of large assets, which had economic potential. Afterwards the idea was supported by Chubais. Jordan (Commanding Heights, March 10, 2000) says that there are some hypotheses about the reason behind the implementation of the program:

One [hypothesis] is that Anatoly Chubais was creating a group of supporters for Yeltsin politically, because even after the elections of '93, he was under massive attack by the still-Communist-led Duma. He was looking for a way to solidify Yeltsin's position so that the Communists could not come back in '96 and reverse the process that might still have been possible.

He needed to create a support group...and he said, “I need to transfer certain industries into Russian hands so that Russians, those that will have an interest in Russia's economic future as a market economy, will support me and the president in what we're doing.” And so he created this group of people who also amassed tremendous wealth overnight in order to be able to support himself and Yeltsin. There's that hypothesis.

Then there's the hypothesis that Chubais was under tremendous political pressure for selling too much to

foreigners under voucher privatization by the prime minister [Chernomyrdin]. Then he had to sell something to Russians, and he picked a group of Russians and sold the assets to them.

Privatizing Russian industry was a mean, not an end for Yeltsin and reformers.

Yeltsin and his entourage were politically in an advantageous position as they had the executive power, but standing in a slippery state. They needed allies to support them politically while they were losing support in public level.

Consolidation/formation of a strong economic elite would be in favor of them by giving away these assets to Russians in return of political support (Interview with Anonymous on May 18, 2013; May 30, 2013; January 10, 2015). The legacy of the Soviet Union was standing there with anti-reformists who were dreaming of bringing back the old rule.

Under these circumstances, Yeltsin approved the Presidential Decree No. 889 (Rules for the Pledging of Shares Held in Federal Ownership) that draws the frame of the program in August 31, 1995. Two-phased program would bring new funds and change the ownership structure of the oil sector. In the first phase, the government would borrow a certain amount of money in an auction from the creditors by showing its shares in holding companies as security deposits. If the government fails to pay back its debt until September 1, 1996 to the creditor, the banks had right to sell the share they hold (Russia's Potanin-2: Loans-for-Shares, October 3, 1996). They could keep the 30 percent of the profit as a commission for themselves. After the selling of the shares, the government would not have any obligation against the creditor. The auctions had to be done not later than three years' time from the date of the conclusion of the contract, unless the GKI would sell the shares.

The economic dynamics in the country was so problematic that it was almost impossible for the Russian government to balance the budget of the next year and payback its debts by collecting taxes. In the end, winners of the auctions sold the companies to themselves in a non-competitive environment. As a result, new economic elite who were outsiders of the energy industry became the new actors of both the global and Russian oil industry.

The auctioned companies were offshoots of Rosneft. Rosneft was not transformed into a joint stock company, rather designed as a state concern in 1992 with the Decree 1403. Later it gave birth to new vertically integrated companies between 1994 and 1995. These were Sidanko, Onako, Slavneft, VNK (Eastern Oil Company), VSNK (East Siberian Oil & Gas Company), TNK (Tyumen Oil Company), and Sibneft. Rosneft also transformed into a joint stock company (Presidential Decree No. 327 in April 1, 1995). Thus, in line with Lopukhin's plan seven more companies, plus Rosneft, joined to the club of vertically integrated oil companies. Then the Minister of Energy Yuriy Shafranik (Sim, 2008: 25) says that "51 percent [of the shares of newly established vertically integrated companies] was left for the state but we intended to leave more...it was a compromise with Gaidar's group". Shafranik was the former governor of the Tyumen Oblast, a close friend of Bogdanov and served for three years as the minister of energy. As a member of nomenklatura he wanted to maximize the control of his ministry on the industry, but actually newly established companies became trophies for the oligarchs close to Yeltsin and political safety net for Yeltsin.

Loans for Shares was not a risk-free program. Yeltsin decided to run once again for the presidential elections, but his popularity was not as high as in the beginning of 1990s due to economic dynamics. On the one hand Yeltsin's rating was "hovering in the 4 to 8 percent range" (Hockstader & Hoffman, July 7, 1996). On the other hand, Gennady Zyuganov's Communist Party became the first runner in December 1995 parliamentary elections. His party got 157 seats out of the 450 seated government and the second runner was another opposition party leader Vladimir Zhirinovskiy. Election results was a shock for Yeltsin and his entourage. The stakes were so high. Zyuganov was threatening to cancel the entire privatization program and take back what was given under Yeltsin's rule. The second phase of the program would start after the elections in September 1996. They were holding the shares, but they were not the owners of the companies. Considering the fact that Yeltsin's popularity was so low at the beginning of 1996, the oligarchs were taking a great risk by investing in these assets.

Yeltsin says that Boris Berezovsky, Vladimir Gusinsky, Mikhail Khodorkovsky, Vladimir Potanin and Mikhail Fridman perceiving the risk of the Communists

coming to power demanded a meeting from him. In this meeting they said that (Yeltsin, 2000:21):

Boris Nikolayevich...What's going on in your campaign headquarters and in your entourage means almost certain failure. This situation is forcing some businessmen to make a deal with the Communists or pack their bags. We don't have anyone to make a deal with. The Communists will hang us from the lampposts. If we don't turn this situation around drastically, in a month it will be too late.

Oligarchs were concerned about losing all they possessed and proposed to support Yeltsin in the presidential elections. As designed, privatization process created an interest group who were afraid of losing what they owned. They were aware of the fact that they were on the same boat with Yeltsin. There were media tycoons and strong bankers among these people and they provided Yeltsin funding, and media and professional support for the campaign. Liberalization process in the country created a new economic class with conflicting interests with the conservatives and these people saw Yeltsin as a natural ally. Loans for share was the next step of consolidating reform process and new economic class emerged in 1990s. Chubais (Aven and Kokh, 2015) says that:

It is a question of who bought whom! It is not clear if we bought their support or caught them on our fishhook! After all, the pawned shares could be bought only after the election, and privatization was out of the question if Zyuganov had won the election. That would have meant their money was wasted. And you have to agree that the election results were achieved mostly thanks to the loans-for-shares auctions.

Chubais' statement also supports the idea that the dual level character of the program was also designed to guarantee the support of tycoons for Yeltsin. It was not designed as one-time shopping. The oligarchs had to fight to save their wealth in the upcoming elections. In this regard, a new coalition was established between the Yeltsin elite and the new economic elite. This was based on mutual interests and against the old conservative political elite.

From 4 to 8 percent approval rates, Yeltsin received 35 percent of the votes (Zyuganov received 32 percent) and became the first runner in the first-round presidential elections. In the second round Zyuganov received 40 percent whereas

Yeltsin got 54 percent of the votes (Killen, June 18, 1996; Landrey, July 5, 1996). Considering the fact that Yeltsin suffered from a serious hard attack and had a bad approval rating, the campaign was so successful. The media was on Yeltsin's side and as he stated oligarchs provided necessary funds and human capital for the campaign.

Table 6: Acquisition of Oil Companies in Loans for Shares Auctions

Oligarch's Name	Acquired/Consolidated Company Shares in LFS²²	Loans given to the government (million dollar)
Boris Berezovsky	Sibneft (51 %)	\$100.3 million
Vladimir Potanin	Sidanco (51 %)	\$130 million for Sidanco
Mikhail Khodorkovsky	Yukos (45 % LFS) + Yukos (33% investment tender)	\$159 million (LFS) + \$150.125 million (investment tender)
Vagit Alekperov	Lukoil (5 %)	\$35 million
Vladimir Bogdanov	Surgutneftegaz (40.12 %)	\$88.9 million
	Total:	\$662.5

After the elections the state failed to pay back its debts and oligarchs became the new owners of the companies they were holding after the Loans for Shares auctions. In 1995 only 12 out of 30 auctions could be made (Russian Loans for Shares Brings, January 12 1996). Yeltsin took 8 companies out of the list, the commission struck out four and two companies were taken out by arbitration court. Four companies did not receive any bids. The turnout of the loans for shares was \$1.1 billion and more than two third of this amount was raised from oil industry biddings.

²² Loans for shares

Table 7: Vertically Integrated Oil Companies in Russia (1990s)

Vertically Integrated Oil Companies in 1990s	Created by Presidential Decree (D) # / Resolution (R)	Date Created	Share (%) of the State as of 1994 ²³	Share (%) of the State as of 1999 ²⁴
1) Rosneft	1403 (D) (State Concern) 327 (D) (Joint Stock Company)	17 November 1992 1 April 1995	100	100
2) Lukoil	1403 (D)	17 November 1992	54.9	16.9
3) Yukos	1403 (D)	17 November 1992	80	0.1
4) Surgutneftegaz	1403 (D)	17 November 1992	40.1	0.8
5) Onako (Orenburg Oil Company)	452 (R)	19 June 1994	85	85
6) Sidanco (Siberian and Far East Oil Company)	452 (R)	5 May 1994	85	0
7) Slavneft	305 (R)	8 April 1994	83	75
8) VNK (Eastern Oil Company)	499 (R)	20 May 1994	85	36.8
9) VSNK (East Siberian Oil & Gas Company)	306 (R)	8 April 1994	85	1
10) TNK (Tyumen Oil Company)	327 (D)	1 April 1995	100	49.8
11) Sibneft	872 (D)	24 August 1995	100	0

The design, and bidding process were not transparent. For instance, Potanin's Onexsimbank got 38 percent of one of the biggest metal producers of the country for \$170 billion. Another competitor, Bank Rossisky Kredit's \$355 billion bid was excluded on the grounds that the bank does not have sufficient funds (Russia Loans/Shares-3: Sales Have A Future, December 28, 1995). One of the bankers and media tycoon, Boris Berezovsky, also lobbied for an oil company and proposed combination of one of the most valuable oil field, Noyabrneftegas and the most modern refinery of the country, Omsk refinery, under the brand of Sibneft (Grace, 2005: 131). The company was created a week before the approval of the Loans for Shares program in 24 August 1995 with Yeltsin's decree. Sibneft's auction was the latest item in the program and the bidding was made in December 28, 1995.

²³ Russia Energy Survey 2002. (2002). IEA. p. 68.

²⁴ Russia Energy Survey 2002. (2002). IEA. p. 68.

Alekperov and Bogdanov managed to turn Loans for Shares into an opportunity to consolidate their control on Lukoil and Surgutneftegas. Alekperov's Lukoil got 5 percent of the company for \$35 million, whereas Bogdanov's Surgutneftegaz got 40.12 percent of the company for \$88.9 million (Lynn, May 20, 1997; Russian Loans for Shares Brings, January 12 1996). Following the Loans for Shares, the privatization of the oil sector continued until the early 2000s. Presidential Decree No 505 dated May 19, 1997 also put state companies VSNK, TNK, and Rosneft on the list of privatizations (Puchkov, July 7, 1997).

As of 1999 the private national players were controlling more than 50 percent share of the oil sector. Eleven large vertically integrated companies were producing 88 percent of the crude oil. Gazprom was producing 3 percent of the production whereas over 100 small producers had the same share with Gazprom. The remaining 6 percent accounted for joint ventures and product sharing agreements (Russia Energy Survey 2002: 65). The production of crude oil by Rosneft was a little more than one fourth of Lukoil in 1999 (Figure 5).

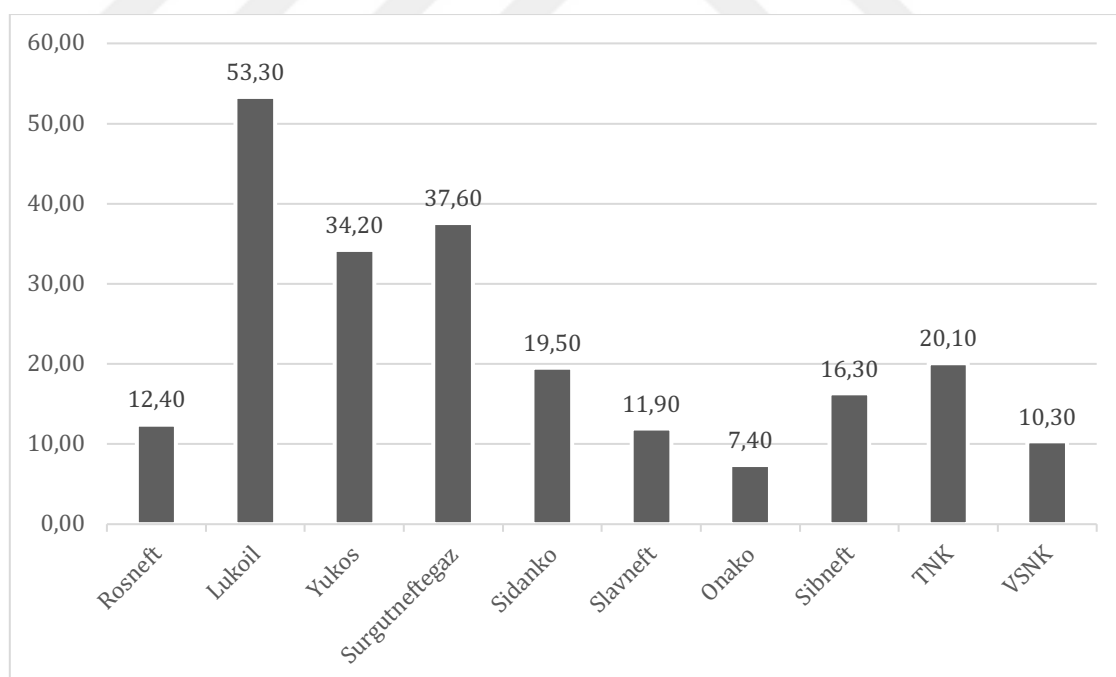


Figure 5: Russian Crude Oil Production by Company in 1999 (million tons)
Source: Russian Energy Survey 2002, IEA.

As can be seen from the Figure 6 crude oil production hit the lowest level in 1996 with 6.06 million barrels per day and hardly recovered until 2000s. After racing to

the bottom to as low as \$12 per barrel in average in 1998, recovering oil prices in the international markets brought extra funds for the oligarchs. The increase in prices made investment into the energy companies more attractive for the new owners, as the marginal return for each dollar started to increase geometrically particularly in the 2000s. They started to develop companies' efficiency in upstream operations, by adopting new approaches with new technology from the West.

The new economic elite had already got an access to the power before the 1996 elections, but in limited terms. Yeltsin's health condition and his trails of new premiers created a maneuvering space for the economic elite and their leverage on the media and economic resources contributed further to their position. Players like Berezovsky or Potanin became influential actors in Yeltsin's entourage. It was even claimed that Berezovsky's office in Sibneft became the main address to arrange ministerial appointments between 1997 and 1998 (Jack, 2006).

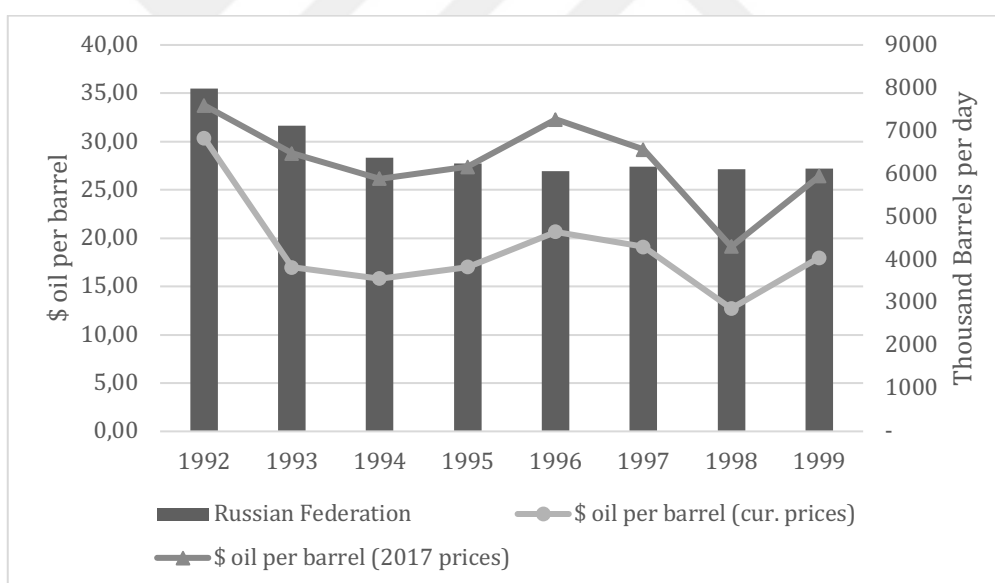


Figure 6: Oil Production in Russia (thousand barrels per day) and Crude Oil Prices per Barrel (1992-1999)

Source: BP Statistical Review 2018

To sum, in the second phase of the privatization the economic elite (the oligarchs) acquired newly created vertically integrated oil companies through the Loans for Shares auctions. Political dynamics along with the deteriorated economic conditions played a crucial role in this. Actors like Yeltsin and Chubais decided to invest more in irreversibility of the reform process. Oil industry was seen as a trump card to bring

in new stakeholders around the table as new allies against the rising threat of communists. The design served into the interests of both the political elite and the economic elite. On the one hand, Yeltsin won the presidential elections in 1996 with the support of oligarchs and his government gained extra time for the reforms and prevented the rise of the Communist Party leader Zyuganov. On the other hand, the economic elite who were mainly acting in the economic sphere became new actors in the politics. Oligarchs got access to the Kremlin and actors like Potanin, Khodorkovsky and Berezovsky captured the lucrative assets of the oil industry in a real bargain. Red directors who could not adapt to the modern economy lost their control on the holding companies, whereas actors like Bogdanov and Alekperov as in the first phase of the privatization managed to maximize their interests by consolidating their ownership and control on Surgutneftegaz and Lukoil. The reformers decided to bring in the new economic elite in Russia as the stake holders rather than foreign actors. Their choice of partners not only shaped politics, but also the ownership structure of the oil industry that makes Russia a unique case in the post-Soviet state. This set up would continue to affect political dynamics in 2000s.

4. Strong Elite Integration and Reinforcing State Ownership in the Energy Sector: 1999 onwards

The energy sector has transformed into a new structure after a decade long reform process in Russian politics. Having a horizontal design and full state ownership, energy industry was divided into pieces. The state kept its control on the gas industry, but its share in the ownership diminished to less than 40 percent. The oil sector, once under the control of state ministries gave birth to new vertically integrated companies and the new economic elite with former red directors took the control in the sector in the expense of the state.

Corporatization of the companies brought dynamism to the energy sector. New management approaches introduced in the oil sector. Starting from 2000s the production started to increase. Russia once again became the one of the top producers in the world. Recovering oil prices in the international market contributed to this trend. The increasing oil rents created extra funds for modernization of production and operation infrastructures. In the 2000s, the state came back as a major

player and some oligarchs lost their control on their companies. This brought a new balance to the sector. The state once again became the dominant actor, but private national companies remained in the sector. The state pursued a selective policy in restatization of private oil companies. The gas monopoly, Gazprom, was not immune from the power shift and change of balances in the international market. The state increased its control on the company with Putin's decision to make a big shift in the management of Gazprom.

The energy industry gained more of an instrumental character in Putin period. In this regard, control of energy assets was a pragmatic political decision. Unlike in Yeltsin period, the state did not used these assets as bargaining chips rather took an active stance in controlling. The change in elite structure and understanding were critical in this shift. In this part, I will scrutinize the changing dynamics in the elite structure and energy sector under Putin. In this framework, this part is composed of two sections. In the first section I will look at political elite integration in Russia and how it played a role in construction of the Putin regime. In the following section, I will analyze the dynamics of restructuring of Russian energy sector.

4.1. Towards a Stronger Political Elite Integration: Construction of the Putin Regime

Vladimir Putin became the new President of Russia on December 31, 1999. The first president of Russian Federation, Boris Nikolayevich, after changing five premiers in one and a half years' time decided to leave his position to a former KGB agent. In his private meeting with Putin Yeltsin told him (Yeltsin, 2000: 6), "I want step down this year, Vladimir Vladimirovich...This year. That's very important. The new century must begin with a new political era, the era of Putin". Yeltsin had just appointed Putin as the prime minister in August and left his office to him in the eve of presidential elections. Putin was not a well-known figure in Moscow politics. Thus, Yeltsin's move gave Putin an advantage before the elections. He would be in the race as the first person of Russian politics with the advantage of the Kremlin in his back. Even though Yeltsin claims that he decided to leave his office to Putin before appointing Stepashin as his predecessor, actors like Yumashev and Berezovsky were claimed to lobbied for Putin's succession (Jack, 2006; Glasser and Baker, 2007).

After coming to power, the elite structure in Moscow and Russia changed rapidly. Unlike Yeltsin, Putin was a man of networks. Yeltsin came to Moscow upon invitation in the perestroika period as a member of the Communist Party from Sverdlovsk and found himself at the top of the system when the USSR dissolved. In a sense, he had to find members of his team throughout the process. Putin's career path in politics were totally different than Yeltsin's and so the elite structure under his regime. Even though presence of different groups of interests prevailed under Putin's rule, the new president had well-knitted relations with them. Some of these clans also had strong elite integration within their own network. Furthermore, elite groups or figures that competed with Kremlin were co-opted, marginalized, or even eliminated.

In this part, I will focus on the political elite integration under Putin's rule in three sections. In the first section I will scrutinize the institutional context. Then I will look at structural integration and value consensus among Putin elite. I argue that the level of political elite integration shaped Russian politics dramatically throughout 2000s and onwards in different dimensions.

4.1.1. Institutional Context of Russian Elite Integration

The power dispersion was one of the main challenges of the Yeltsin era. Kremlin was the winner of the conflict between legislative and executive power after the 1993 constitution. It was not an absolute superiority. The base of the president was so weak in State Duma since the opposition parties were on the rise during 1990s against the parties supported by Kremlin. Political figures like Zyuganov, Primakov, Luzhkov were seen as potential candidates for the next presidential elections in 2000. Thus, the parliamentary elections in December 1999 was critical for Russian politics beyond the balances in the legislative level. Furthermore, Moscow's control on 89 federal subjects of the federation weakened. There were even demands for independence in republics like Tatarstan and Chechnya, which turned into an armed conflict in the Caucasus in 1990s. Even though these demands seemed to be taken under control, the central power could not be consolidated.

The central power was weak, oligarchs became political actors, and a deep financial crisis was left behind in 1998 when Putin became the prime minister in August 1999. The “family” had already decided about Putin’s succession, but parliamentary elections could become a game changer for domestic balances. Putin was a new face, and charismatic leaders were working on new strategies for the upcoming presidential elections. Former Prime Minister Yevgeny Primakov aligned with Moscow mayor Yury Luzhkov under Fatherland-All Russia bloc and they were seen as potential runners for the presidential elections (Graham, 1999: 337). Gennady Zyuganov’s Communist Party, Chubais-Khakamada-Nemtsov led Union of Right Forces, and Grigory Yavlinsky’s Yabloko would be running for Duma elections. These people had also political ambitions and parliamentary elections would be the main test for each contender as it was certain that Yeltsin would not be running for the 2000 elections. The newly established alliance around Yeltsin (the Kremlin elite and the new economic elite) decided to support Putin, but he was an unknown figure with a KGB-label. Legislative elections not only a challenge, but also chance to promote Putin in the public sphere.

The elections scheduled for December 19. Yeltsin says that “regardless of the elections, the future president would need some real support in the Duma. How would he build a normal economic policy and normal laws if he was constantly fighting and unbridled, embittered parliament?” (Yeltsin, 2000: 351). The family decided to pursue a similar public relations strategy as in 1996 presidential elections. “A few days after Putin’s appointment, Kremlin leaders held a strategy session at the dacha of Yeltsin chief of staff Aleksandr Voloshin. Among those present were Valentin Yumashev, Tatyana Dyachenko, Boris Berezovsky, his partner Roman Abramovich, and Vladislav Surkov” (Baker & Glassner, 2007: 56). In this meeting the family decided to establish a new party and support it with media outlets as in 1996 elections while targeting the others. Once again Berezovsky’s media outlet would play a critical role, but Gusinsky chose to support Primakov-Luzhkov tandem with his NTV since one of these figures were seen the next president of Russia in 2000.

The new party was named as the Unity (Edinstvo). Gaidar’s and Chernomyrdin’s political parties had failed to reach out to the people in previous elections. The Unity

would not be the premier's own party, but support the premier and the government (Russian Analyst Considers Reasons, December 12, 1999). The Unity was positioned in the center and the minister of emergency, Sergei Shoigu, led the party in the elections. Putin implicitly supported the party. Rather than campaigning in the rallies he chose to make few statements supporting the party. In one of these statements he said "[a]s a citizen I will vote for unity" (Putin declares that He will Vote on the Parliamentary Elections for "Unity" (Путин Заявляет, Что Будет Голосовать На Парламентских На Парламентских Выборах За "Единство"), November 25, 1999).

The election atmosphere was shaped in an atmosphere of rising nationalism and harsh media wars. The restarted operations against Chechen separatists positively contributed to Putin's popularity. Political parties like the Union of Right Forces also supported the operations and Putin, considering the fact that his popularity would contribute to their popularity in December. They positioned themselves as supporters rather than as opponents against the Kremlin. Interestingly, it was not only liberals, but also some figures like Gennady Seleznyov from the ranks of the Communists cut deals with Putin's team. (Baker & Glassner, 2007: 58). Berezovsky's ORT channel targeted the Fatherland and its leaders Primakov and Luzhkov (McFaul & Petrov, 2004: 47). This rapidly decreased their popularity and chance to run as presidential candidate in March 2000.

The Unity became the second runner in the December elections. It received 23 percent of the votes, 1 percent below the Communist Party (Unity Party Pledges to Support, December 28, 1999). In less than four months after its establishment, the Unity managed to get 72 seats from 450 seated Duma. After the elections the Unity's delegates passed a resolution iterating their top priority as supporting Putin's presidential bid (Isachenkov, December 28, 1999). Not surprisingly Putin won the next elections in March 2000 in the first round.

In legislative level, the outlook of the Parliament was in favor of Putin. Shortly after the elections the Unity coalesced with the Communists. Later in December 2001, the third strongest movement, the Fatherland-All Russia and the Unity decided to join forces. These two united under the flag of the All-Russian Unity and Fatherland

Party, later to be known as United Russia (*Единая Россия*) (Bellaby, December 2, 2001). Among the party's founders there were charismatic figures like Sergei Shoigu, Moscow mayor Yuri Luzhkov and Tatarstan's President Mintimer Shaymiyev.

Being positioned in the center and enjoying Kremlin's support, United Russia became the leading party of Russian politics. In 2003 elections the party received 37.57 percent of the votes and got the majority in the Parliament (Guttermann, December 19, 2003). The other parties that could pass the 5 percent threshold were Zyuganov's Communist Party, Zhirinovskiy's LDP, and Dmitry Rogozin and Sergey Glazyev's Motherland (*Родина-Rodina*). Rodina was supported by Kremlin during the campaign period via media with intentions of attracting electorates from Communist Party's constituency (Baker & Glassner, 2007: 298). It received 9 percent of the votes, but Liberal Yabloko and the Union of Right Forces could not pass the threshold. Looking at the parties in the Parliament the common denominator was nationalism after 2003 elections.

Putin had the constitutional advantage, which gave him a superiority over the legislative power. The outlook of the Parliament was in his favor. He could pass necessary reforms from the Parliament with the majority support. Still he opted for consolidating his power further in the Parliament. Remington argues that the "Kremlin decided to subordinate the Duma completely to its control" (2006: 25). The Kremlin brought new rules to the political system by changing the election system, increasing threshold from 5 percent to seven percent, and new barriers for establishing new parties (Gel'man, 2008: 919). The new changes eliminated small parties and limited the number of parties in Russian politics. The impacts of the new reforms were obvious in 2007 elections. The United Russia won 64.3 percent of the votes and more than two thirds of the seats in Duma (Putin's party wins 64.3, December 6, 2007). The Kremlin continued to control United Russia and new changes in the system strengthen party discipline and loyalty to Putin. As expected, party lists prepared in the Kremlin. Unlike in Yeltsin period, the Parliament turned into an important supporter of Kremlin policies.

Another challenge under Yeltsin's rule was increased autonomy of the federal subjects and weakened central power. In a few years period, Putin strengthened the central power by curbing regional governments powers. After his election as the president, without a delay he introduced his recentralization efforts. He divided Russia into seven districts and appointed presidential envoys to each district. The new reform formed a hierarchical structure that would put federal subjects under the control of Moscow. He also appointed strong figures with security bureaucracy background. Five of these seven envoys were former army generals or KGB generals known as *siloviki* (Rivera & Rivera, 2018: 223). The next step was abolishing elections for regional governors. As of 2005, the president has right to appoint and dismiss regional governors. Regional assemblies only approve or declines the president's nominee, but the president also has power to disband a regional assembly in case of decline of his deputy twice and appoint an acting governor (Ross, 2011: 645). Regional governors adapted to the new balances shortly. They joined to United Russia. The party enjoyed the local support that increased its presence in regional assemblies (Tsygankov, 2014: 110). This was actually a normal reaction since, the federal subjects faced not only political, but also financial constraints. The center decided to divide tax revenues in a 70 to 30 percent equation in 2003, which pushed them closer to Kremlin for further funds (Konitzer & Wegren, 2006). The new regulations gave Putin a leverage to control local elites. Being closer to Kremlin means preserving political power in local level and guaranteeing the next term. In this regard, the center gained power to design and control local politics through the United Russia and local elites in the 2000s.

After a decade long of absence in party-president coordination, a new equation emerged in the 2000s under Putin's regime. Acting as Putin's party, United Russia became the dominant party. Putin enjoyed the constitutional majority after the 2003 elections, which further strengthened the Kremlin. Thus, the period between 1999 and 2003 was transitional for Putin to consolidate power. The ongoing conflict in Chechnya and the state's decisive intervention further contributed Putin's popularity and legitimacy among the public and security bureaucracy in this period (Interview with Anonymous on 10 January 2015). It preserved its majority in State Duma in 2011 and 2016 elections. Even though the threshold decreased to 5 percent in 2016 elections the number of parties passed the threshold was limited with four, as in the

previous elections. These were the Communist Party, the LDP, and A Just Russia. In this setup, the Kremlin has a strong control on party politics and the legislative power is not an opponent, but a supporter of Kremlin's policies. There is a similar picture in the regional level. United Russia is the main political party and the governors are members of the party. "When Putin's second term in office started, all the autonomous power centers existing under Yeltsin (presidential administration, governors, business, State Duma and Federation Council) were abolished (Gaman-Golutvina, 2008: 1039). The center re-established its power on federal subjects and local elites. In institutional context, there is a strong coordination between Putin and the political elites in federal and local level. In bureaucratic level the Kremlin also has a leverage on institutions and their elite structures within. This is also related with Putin's career path and elite network around him, which I will scrutinize in the next section.

4.1.2. Structural Integration among Political Elite under Putin

Before becoming the president, there are four main stages in Putin's life: his adulthood, KGB, St. Petersburg municipality, and Kremlin. He was 48 years old when he became the president and had already built up a network of friends and partners with different backgrounds. There are different groups within Putin's entourage: *siloviki*, *pitersky*²⁵, and former Yeltsin members. There are no clear-cut boundaries between these groups, even there are intra-group factions. People with a background of law enforcement bureaucracy, such as military, or KGB are defined as *siloviki*. *Pitersky* as a concept is used for people coming from St. Petersburg and these people are mainly former colleagues of Putin from St. Petersburg municipality. There are not so many former Yeltsin elite, but as a bureaucrat in Kremlin, after becoming the president he continued to work with certain figures from presidential administration. Gaman-Golutina (2008, 1039) says that groupings in Russia do not necessarily have relative and ethnic ties, but they have the same typical features like "narrow egoistic orientation" of clan relations. The commonality of members of elite groups around Putin is that they have common interests with Putin and share a common background with the president. The relationship is not only based on mutual

²⁵ I used this term to refer to people coming from St. Petersburg.

interest, but also loyalty. These people do not only see each other professionally, but also spend time together in vacations, holidays or social events.

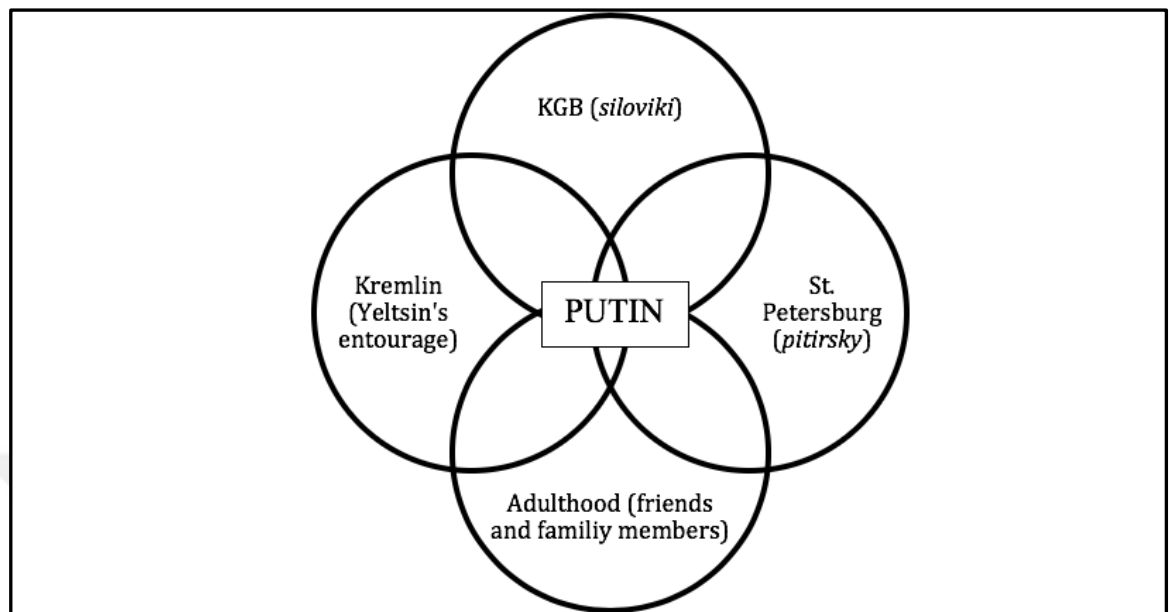


Figure 7: Structural Background of Putin's Elite Network

Putin's bureaucratic career is more determinant than his political career in shaping his elite network. He had already established a close network before becoming prime minister in 1999. Putin who grew up in St. Petersburg (Leningrad, during the USSR) went to Leningrad University and graduated from the faculty of law. After the graduation he joined to the ranks of KGB in 1975 and worked in East Germany, Dresden, for five years. He turned back to his hometown after the unification of the East and West Germany in 1990. For a short while he worked in Leningrad University as the assistant to the rector. He left this position when he received a job offer from St. Petersburg mayor, Anatoly Sobchak, who was a former professor at the same university. In 1990 Putin started to work as Sobchak's deputy responsible of foreign liaison. Having an experience abroad, he managed to play a crucial role in St. Petersburg's economic transition, and cooperated with BMW, Procter & Gamble or Coca Cola when these corporations were looking for opportunities of investment in the city. Anatoly Sobchak lost the elections in 1996, which left Putin unemployed. The same year he received a proposal to work in Kremlin and started in Moscow as deputy head of Presidential Property Management Department under Pavel Borodin. The department was responsible of managing real estate of the Russian Federation all

around the world that worth billions of dollars. The Kremlin was an interesting stop in his career, he rapidly climbed the stairs of his career before becoming the acting president on December 31, 1999. He was not the only the St. Petersburg, there were former friends from Sobchak's office like Aleksey Kudrin in Kremlin. There was an alignment between Petersburgers. Apart from his first boss Pavel Borodin, two pitersky, Aleksey Kudrin and then the deputy prime minister Aleksey Bolshakov, helped Putin's recruitment in the Kremlin (Putin, Gevorkyan, Timakova & Kolesnikov, 2000). After coming to Moscow, Putin pro-actively assisted his friends' employment in presidential administration.

In 1998, Putin became the deputy head of presidential staff and shortly after he was appointed as the head of FSB by Yeltsin. In the former position, he was responsible of governors and he was in contact with these people all the time. After his St. Petersburg experience, he had chance to develop a deeper insight about the federal system in Russia and its problems. Putin argues that he had chance to see the problems of the system from the first hand and the necessity of strengthening the center when he was in this post (Putin et.al. 2000).

His appointment as the head of the FSB (*Federalnaya Sluzhba Bezopasnosti* – Federal Security Service) was a critical job. As the successor of the well-known KGB under the Soviet period, the FSB is one of the strongest and well-rooted institutions of the Russian Federation. Putin was a colonel as a reserve agent, but rejected Yeltsin's proposal to be promoted to the rank of general in his new post. He did not want to turn back to the FSB as an agent and became the first civilian director. After coming to the office, he made some changes in the institutional structure. He established new departments and abolished some others. This institutional change helped him to bring his friend's to the administrative posts of the FSB. He brought six former colleagues from St. Petersburg with KGB background. These were Viktor Cherkesov, Aleksandr Grigoriev, Sergey Ivanov, Nikolay Patrushav, and Igor Sechin (Dawisha, 2014: 193).

He continued to develop his relations with Yeltsin and the family when he was in the FSB. His loyalty to his supervisors caught attention of this group who were looking

for a safe exit after Yeltsin's end of term in the presidency.²⁶ Prime Minister Primakov's popularity was on the rise. He had already started giving signals about the new term after the presidential elections in 2000s. He was talking about conducting necessary investigations and freeing prisoners to open capacity for the ones who were corrupted (McKay, February 8, 1999). Under these circumstances the chief of presidential administration, Yumashev, started lobbying for Putin considering that Putin can be a safe option for post-Yeltsin era. Berezovsky also had close relations with Putin and thinking about supporting him in the presidential elections. Thus, Putin became the prime minister, then the acting president with the support of Yeltsin's inner circle.

After becoming the president, he approved a decree that gives legal immunity to Yeltsin. Also, he did not make big shifts in the cabinet. The decree later approved in the Duma (Popeski, November 29, 2000). He left Patrushav in the FSB as his successor and brought Dmitri Medvedev, Igor Sechin and Sergey Ivanov to the Kremlin. In his autobiography, when he talks (Putin et.al. 2000) about Sechin, Ivanov, Patrushav, Medvedev and Kudrin he gives uses concepts like comradeship and trust.

Putin made gradual shifts in the elite structure. He did not hesitate to appoint his friends to the presidential administration and to some ministries as deputies or ministers. But he also kept some of Yeltsin's entourage in his team as long as he thought they were useful. For instance, he appointed Mikhail Kasyanov as the premier, who was the former first deputy prime minister under Yeltsin administration. He did not change Voloshin as the chief of presidential administration, and also kept figures like Vladislav Surkov. Looking at his second term the number of people worked in Yeltsin's team decreased immensely and people from St. Petersburg and KGB started to be seen in high level cadres.

²⁶ After coming to Moscow, he helped Anatoly Sobchak about an investigation, and then his former supervisor in the Kremlin, Pavel Borodin, when he was the head of the FSB. The Procurator's Office started investigation about these people, but Putin helped these people in his own capacity and prevented the investigations to turn into arrests. For more information please refer to Jack A. (2004). *Inside Putin's Russia: Can There Be Reform Without Democracy?*. New York: Oxford University Press.

He appointed people from his inner circle to critical positions as early as 2000. For instance, Sergey Ivanov became the secretary of the State Security Council and then the minister of defense. Dimitri Medvedev became his campaign manager and then the deputy head of presidential administration with Viktor Ivanov and Igor Sechin. He appointed a former businessman Leonid Reyman as the new minister of communication and Kudrin the minister of Finance.

Putin has been governing the country since 1999. In the last two decades his inner circle took shape. Even though there can be slight changes in his inner circle, these people play a central role in shaping the political decision. At the end of the first decade Monaghan (2012:7) says that the members of this group include “Putin, Medvedev, Sechin, Naryshkin, Surkov, Sobyenin and Kudrin...and the businessmen Yuri Kovalchuk, Gennadi Timchenko, Roman Abramovich and Alisher Usmanov”. Putin chose to work with a loyal cohort after becoming the president and rather than making frequent changes in his entourage. He inclined to protect the network while providing some incentives for its members. “[T]he ‘St. Petersburg’ have an enviable advantage over the other applicants for high government ranks. And not even Petersburgers, fellow students and personal friends-acquaintances of the president [Medvedev] and the prime minister [Putin] occupy all key posts in Russia. The practice of the clan approach goes beyond all boundaries; in the government, families are already heading ministries” (Ptashkin, 2010). Due to the long period of Putin’s rule and his choice of keeping close friends in the game, family links started to play a crucial role in the system. Recently, children of his entourage reaching to their 30s started to be seen in high level positions in state institutions or executive boards of state enterprises.

Looking at the bureaucratic level siloviki had an obvious advantage of reaching a wider pool of human resources. Putin tends to work with people from KGB and these people after coming to power also hire people with security bureaucracy background. Olga Kryzhanovskaya (in Baker and Glasser, 2007: 253) states “There is a snowball effect caused by the clan structure of power in Russia. Putin, for example brings ten FSB agents with him to power, and each of them brings ten more, and so on and so on”. In a wider picture there is a militarization of the system, which creates a hierarchical state structure based on loyalty (Kryzhanovskaya & White, 2003;

Rivera & Rivera, 2018). In Ted Koppel's Nightline at ABC Putin explains the reason behind his choice to work with ex-KGB officers as "I've brought some of them to the Kremlin in staff positions -people who I've known for many years- and people whom I trust. So that is the reason why I've brought them in. Not because they worked in the KGB and follow some specific ideology. It has nothing to do with ideology -it has to do with their professional qualities and personal relationships." (Dawisha, 2014: 38). After serving within political or bureaucratic cadres, people from Putin's network become high level executives of big Russian enterprises. These posts bring them many benefits along with big fat paychecks. In return, they provide these companies acting in synchronization with Kremlin policies. Among these we can refer to Igor Sechin and Aleksey Miller who are directors of Rosneft and Gazprom respectively.

Putin took a position in recruiting people to bureaucratic and political positions just like his policy of centralization even before his election as the president. His background turned into a favorable asset in bringing new people to the institutions in Moscow. He had chance to reach out to professionals from different backgrounds thanks to his KGB career and position as the deputy mayor St. Petersburg. He had served with these people for years and managed to develop a code of conduct based on trust. There is already a well-established relationship between these people and Putin even years before. He valued loyalty more than professional features to keep people in his inner circle. It is hard to talk about a homogenous structure of elite network around Putin. There are different groups with different interests, Putin acts as an arbiter among these. Some people even from Yeltsin's team managed to find a place in Putin's entourage like Vladislav Surkov or Sergey Shoigu. Even though there are hot debates within the group it is Putin to have the final saying. As long as the group members abide by this rule, which is based on loyalty and power vertical they can remain within the group. Otherwise, they lose their positions and are marginalized from the system.

4.1.3. Value Consensus 'Stability' after Regime Breakdown Trauma

Spiral of instability was the main theme of 1990s. Problems between the center and regional subjects was of the main challenges for the Kremlin. In the Caucasus, these

problems evolved into armed conflict, and the conflict was carried to Moscow with bombings and hostage crisis. Grave economic crises fed the atmosphere of instability further. Russia lost its super power status in the world politics, there was a rising rate of crime and poverty in the social sphere and the leadership had an image of incapability of addressing the problems. This environment reshaped the expectations in the society and approaches to the western concepts like democracy, free markets, or liberalism.

At the end of 1990s, the image of transition to democracy was equal to weakening state power and poverty in Russia. Ratings of the reformist elite and liberal values plunged. But they were still present in the ranks of power elite with figures like Chubais. Moreover, oligarchs who supported further liberalization had access to Kremlin. Among these there were Berezovsky, Khodorkovsky and others.

The weight of conservatives in the Parliament increased along with the statist in the government not later than the second half of the 1990s. The balance of power changed more in favor of statist and conservatives when Putin brought new actors to Kremlin. These figures were mainly his friends from St. Petersburg and security services. There was a strong structural integration among these people, but looking closer to these people there was hardly a homogenous world perspective. Gaman-Golutivna (2008: 1039) says that “because of the considerable differences in ideological loyalties, political mentalities, and career types of Putin’s Petersburg proteges, one cannot talk of his ‘team’ as a united body”. Even though there are some subgroupings within the siloviki, looking at their worldview one may say that they are more conservative about “what is to be done” and “how it to be done” in the economy, whereas civilian actors like Kudrin, Medvedev embrace modernist, and up to a certain extent ‘liberal’ idea. Still these differences are not as deep as the differences between the reformists and the State Duma as in Yeltsin era. There are also some common denominators that make these groups to agree upon.

Kyrshstanovskaya and White (2005: 1073) say that

Siloviki and liberals have few differences about the concentration of power: they are both agreed that Russia needs a ‘single vertical’ of executive authority. They are much divided in their views about the economy. The ‘liberals’ do not object to the partial renationalization of natural resources, but

believe any changes in this kind should be carried out in accordance with law and over a relatively extended period...The siloviki, on the other hand, are convinced that privatization has inflicted great damage on Russian national interests and take the view that 'strategic' enterprises, especially in the energy sector returned to state control.

Putin manages to keep different groups and ideas on board in a balanced way.

Looking at Russian politics in the last two decades, from time to time policies in line with siloviki's worldview gain advantage against pitersky liberals and vice versa. For instance, a debate of privatization gained momentum under Medvedev's presidency in 2009. This was supported by Kudrin. The debate of including strategic assets like Transneft and Rosneft into the privatization programme continued for more than three years, but opposed by Igor Sechin. Putin took Sechin's side in this debate. Observers claim that Putin used Sechin as his proxy in this debate to prevent the privatization package to be approved by the government and he also took a firm stance against the privatization in 2013 when he became the president again (Gaaze, October 3, 2016). On the other hand, Putin chose a non-siloviki, Medvedev, as his protégé in 2008 elections when his second term came to an end in the presidency. Since 2012, Medvedev also has been the prime minister of the government. Thus, rather than a siloviki, Putin pointed a civilian from his entourage as his candidate in 2008 elections.

Putin chooses to work with people he knows from his past, but does not necessarily promotes a certain ideology or a value set. There are certain priorities in his policy making like strong state, Russian nationalism, stability and economic development. Alexander Dugin (2014: 44) describes this formula as "nationalism (patriotism) plus liberalism (economic reform)". As stated above by Khyrshtanovskaya and White Putin elites have an agreement about the first part. The main divergence is about the implementation of economic reforms. There is a common understanding about the virtues of capitalist economic system, but there are some differences in terms of methods.

Democracy is not an end for Putin elite, but rather a mean that needs to be controlled and manipulated by the state. "The belief in the importance of a strong state is likely to be behind the view that Russia needs its own unique type of democracy

established on the basis of national traditions, which is different from European -or Soviet- style democracy” (Tsygankov, 2014: 131). A unique type of democracy does not rule out elections, but the Kremlin redesigned the rules of the game in the post-2000 period as I summarized in the section entitled “Institutional context of elite integration”. Apart from changes in election law and curbing the autonomy of federal subjects, the Kremlin took the control of the media by taking over media outlets from oligarchs as early as summer 2000.²⁷ The Kremlin used the legal mechanisms and security services in these takeovers. Putin and his elite were aware of the power of media, particularly television from consecutive elections in the post-1995 period. Taking these steps, he ruled out the possibility of use of media outlets against him in a future election campaign.

Bringing further barriers on fair elections, the Kremlin gained an upper hand in shaping the results of elections. The rationale and practice behind this manipulation was framed by actors in Kremlin like Vladislav Surkov and Aleksandr Voloshin. A new concept, ‘sovereign democracy’, was developed to define Kremlin’s understanding of democracy. Surkov (2009: 15) says that “[s]overeign democracy is distinguished from other kinds of democracy by its intellectual leadership, its united elite, its nationally oriented open economy, and its ability to defend itself”. Thus, sovereign democracy is a mean to defend Russia from threats coming from outside. In fact, these efforts are reflections of a search for a strong state.

After the traumas of 1990s, search for a stronger state was a common denominator of the political and bureaucratic elite in Russia. As a former KGB-agent Putin was also a believer of a strong state. In his annual address to the Federal Assembly of the Russian Federation he said that (July8, 2000):

For a long time we have been trying to make the choice: to rely on others’ advice, aid and loans, or to develop relying on our own distinctive character, and own efforts...If Russia remains weak, we really will have to make the former choice. And it will be the choice of a weak state. It will be the choice of the weak. The only real choice for Russia is the choice of a strong country. A country that is strong and confident

²⁷ Kremlin forced Boris Berezovsky and Vladimir Gusinsky to sell their shares in ORT and NTV. For detailed information please refer to Jack, A. (2004). *Inside Putin’s Russia: Can There be Reform Without Democracy?*. New York: Oxford University Press.

of itself. Strong not in defiance of the international community, not against other strong nations, but together with them.

We have convinced ourselves: the authorities' indecision and the weakness of the state will bring economic and other reforms to nothing... We have created separate "islands" of power, but have not built reliable bridges between them. We have yet to build effective cooperation between different levels of power. We have talked a great deal about this. The center and the territories, regional and local authorities are still competing among each other, competing for power. And their often mutually destructive fight is observed by those for whom disorder and corruption is advantageous, who make use of the lack of an effective state for their own goals. And some would like to keep this situation in the future.

One can easily see the next steps that the new Putin administration would take from between the lines of his speech as early as July 2000: strengthening the central power, bringing order by putting limits to manipulators "who make use of the lack of an effective state for their own goals" and a more emphasis on national values. These were also signaling change in political and economic structure of Russia. Oligarchs, who gained access to Kremlin after 1996 elections, with liberal thoughts were tamed or eliminated from the political and economic scene. The coalitionary image of the elite group in Kremlin faded away rapidly before his first term comes to an end in 2004. Thus, liberal values in the elite network was limited with economic issues and people who came from St. Petersburg.

In his search for a strong state, Putin acts pragmatically rather than ideologically. He leans on the siloviki, and loyalty is one of the main virtues for this group. He also chooses to work with technocrats. He gives a certain space to liberal economic thought, but he is also a strong believer of state and its role as a regulator and dominant actor in the economy. From time to time, most of the debates regarding different views within Putin's elite can reflect to the media, but these debates hardly target Putin. In this regard, the policy and debates regarding restructuring of the energy sector under Putin is an interesting case study to understand how Putin's elite work and why energy sector is still an important topic in Russian politics.

4.2. Distancing from the Center and Weakening Elite Confrontation: Centralization of power and Stronger Elite Integration in Putin's network

After a decade-long instability in economic and political terms, Russia's position as the center in a closed system weakened. It became more prone to political and economic impacts from abroad. The country faced with brain-drain in 1990s due to unfavorable conditions and money concentrated in the hands of a few. These people became politically stronger, but chose to channel their wealth abroad. This hardly prepared a basis for economic development, with the impetus of private sector as expected with the shock therapy. The state's position was stronger than 1991, with the new constitution, but this also gave certain advantages to the Kremlin to maximize power. Still, the country became more integrated to the international system, a better banking system emerged and most of the obstacles had been put by the Communist regime were eliminated. The system had moved away from the center, but it was not easy to define Russia as a peripheral state at the beginning of 2000s. The characteristics of the center still were stronger in Moscow, in terms of presence of sophisticated institutions, elite diversity, and high elite capacity.

Vladimir Putin came to power under these circumstances. He enjoyed the support of a network of people around Yeltsin. Among these people there were oligarchs like Boris Berezovsky, who was acting as the kingmaker after the presidential elections of 1996. In fact, this was not exclusive to Berezovsky. Oligarchs, who became super rich in the last decade had control over the financial system, media and thanks to the loans for shares programme an important share of the extractive industry that gave them not only economic, but also political power. Coming from the security bureaucracy, Putin was not comfortable with the existing scheme and gave signals of his inclination of strengthening central power. Apart from curbing autonomy of regional elite through new reforms, he also took steps against the oligarchs in Moscow. He had both the advantage of the new constitution and a stronger political elite integration.

Initially, he took the control of the media. He was aware of the fact that media is the key for political power in Russia. Gusinsky's Media Most, with its television channel NTV, was one of the most influential media corporations in Russia. It was among the

most popular stations along with ORT and RTR. After the elections in 1996, Gusinsky had financial support of Yeltsin's and Gazprom became the shareholder of his media corporation. NTV had a critical stance against Putin's policies in Chechnya and vocally criticizing the president in spite of Kremlin's demands of lowering its tone against Putin. Its shareholder Gazprom headed by Vyakhirev was silent about NTV's stance, since the government also pushing for further rents from Gazprom revenues through new tax regulations. Putin vividly showed that this kind of an attitude in the new era would not be tolerated anymore, when a legal process started against Gusinsky.²⁸ The media tycoon arrested and put into prison in June 2000. After signing a protocol, in which he accepts to sell NTV, he was released from the prison. He left Russia for Spain and soon after, Gazprom got the full control of his media conglomerate. This was a shock for the oligarchs, who took Putin as a liberal figure.

Putin invited 21 oligarchs to Kremlin in July 2000. The main aim of the meeting was to give message to the oligarchs the era of intermingling between politics and oligarchs was over. As long as oligarchs focus on their business and avoid from manipulating the politics, they would be intact and could preserve their shadily owned properties during the Yeltsin period. This meeting can be described as an agreement of "peaceful coexistence" (Interview with Anonymous on June 27, 2013).

Putin in the opening of the meeting said that "I want to draw your attention to the fact that you built this state yourself, to a great degree through political or semi-political structures under your control. So, there is no point in blaming the reflection in the mirror. So let us get down to the point be open and do what is necessary to do our relationship in this field civilized and transparent" (Tavernise, July 29, 2000). A politician from the liberal wing of Yeltsin's entourage, Boris Nemtsov, who played a mediator role in organization of the meeting stated that "This is the end of the oligarchs in Russia. All the businessmen present agreed to live under equal

²⁸ Andrew Jack (2006: 135) says that before the presidential elections Gusinsky met with Putin and asked for \$100 million in return for supporting his candidacy in the upcoming presidential elections, in which according to him Putin had a slim chance to win. In this meeting he also adopted a critical tone about the ongoing operations in Chechnya and politics in Russia. Even though Gusinsky denies such a conversation a Kremlin bureaucrat claims this was the main tone in the meeting.

conditions and that there would be no more special conditions for anyone” (Aris, July 29, 2000).

Boris Berezovsky who was absent in the meeting continued to meddle with the politics. He was uncomfortable with Putin’s inclination of centralization of power. After the presidential elections he threatened Putin with establishing a new political party an opposition actor against him. Moreover, hearing the Kremlin was paying members of Duma \$5000, offered to pay \$7000 for voting against Putin’s legislation proposals (Baker & Glasser, 2007: 85). His biggest mistake happened in the Kursk submarine tragedy in August 2000. Kursk nuclear submarine sunk with 100 sailors when Putin was on his holidays in Sochi. Having insufficient technological capabilities, the military failed to rescue his men and the government refused to take assistance from the international community. Instead of cutting his holiday short and turning back to Moscow, Putin kept his silence for a while and delayed in intervention (Cockburn, August 22, 2000). Throughout this process Berezovsky encouraged ORT to make a critical coverage of Putin’s incapability of handling the disaster and promised to raise funds for the investigation of the incident (Williams, August 24, 2000). After the incident Putin and Voloshin had a meeting with Berezovsky and the president told him to give up his shares in the ORT (Gardham, November 14, 2000). This was an open threat for Berezovsky and shortly after a lawsuit was opened against him related with the fraud in Aeroflot, but the oligarch had already left the country (Sarazdyan, November 15, 2000). Berezovsky sold his 49 percent share in the ORT to Abramovich in January 2001. The board of directors of the channel redesigned and two new names joined to the board, Press Minister Mikhail Lesin and Putin’s press secretary Alexei Gromov (Editorial – Lesin’s Right, March 1, 2001).

In both of the Gusinsky and Berezovsky cases coercive mechanisms were used against the oligarchs who took a firm stance against the Kremlin. Formerly influential figures with political and economic capabilities, these actors failed to resist to the state power and fled the country. Following these cases, Putin took the control of two influential television channels in Russia and eliminated two prominent figures from the club of oligarchs. Moreover, he warned the oligarchs to keep away from the politics and abide by the new rules of the game. These steps were

threatening for the oligarchs who had concerns about the security of their property. Thus, after gaining control on the Parliament and taking steps towards the centralization of power gave a strong warning to the economic elite that the times of meddling with politics were left behind. The coercive institutions like the legal mechanisms, the Minister of Interior, the KGB played crucial roles in this warning as they played a prominent role in opening law suits and making raids to the offices with masked forces. Putin and the siloviki were in the same page in terms of taming the politics and oligarchs. The economic elite were used to the absence of the rules of the previous regime and had difficulties of adapting to the new dynamics. This was also obvious for the energy sector and its actors. Putin gave the message that he would not take back what was privatized in 1990s, but there were some conditions. In the next part, I will discuss these conditions and the efforts of restructuring energy sector under Putin's administration.

4.3. Restructuring the Energy Sector under Putin: Stronger Elite Integration and Reinforcing State Ownership

The state lost the control on the energy sector during the Yeltsin era. Once having 100 percent ownership on the sector, the state's share shrank to a small portion of the production and ownership of the reserves particularly in the oil industry. Privately-owned national energy oil companies became the locomotive of increasing crude oil production in Russia, which started to recover after hitting bottom in 1996. The only state-owned company was Rosneft and there was still a competition for new licenses or control of production associations among private companies to expand their operations in Russia. As can be seen from Figure 8, the oil production reached to 8.6 million barrels per day in 2003 and the crude oil prices started to pursue a stable upward trend throughout the 2000s. The state had the control on the natural gas industry, but the synchronization between the Kremlin and the management of the company was limited due to autonomy of the bureaucratic mechanism in Gazprom. The ownership of the state shrank below 50 percent, but the company was still an important asset for the government in financial and political terms. Moreover, globally the demand for natural gas started to increase with developing technologies like LNG along with the pressure of lowering carbon emissions in line with policy framing in fighting against climate change with Kyoto protocol. Oligarchs were the

primary winners of the upward trend, but the new administration also was interested in increasing its grab on the energy sector.

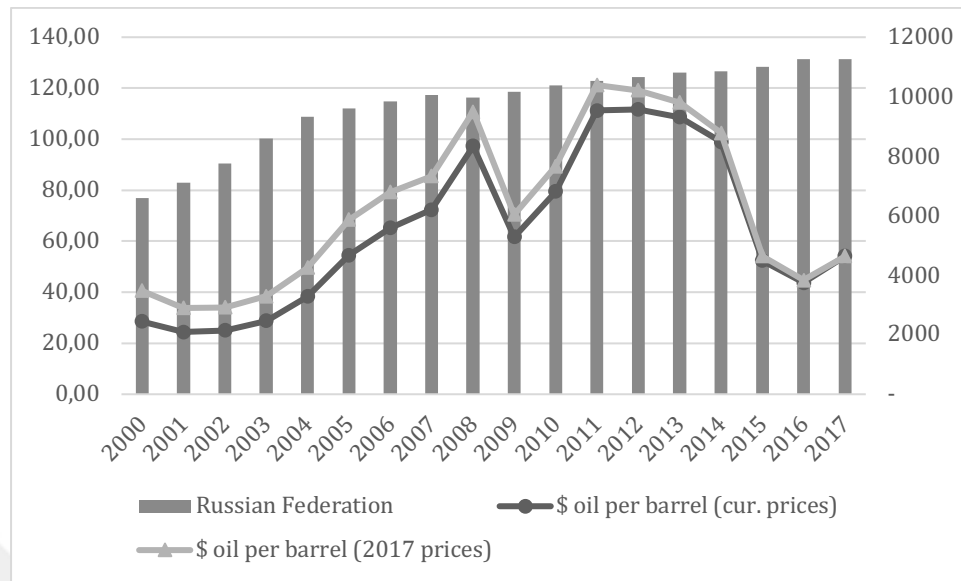


Figure 8: Oil Production in Russia (thousand barrels per day) & Average Crude Oil Prices per Barrel (2000-2017)

Source: BP Statistical Review 2018

The energy sector was not a remote area for Putin. On the contrary, he had developed an academic interest about the issue in the second half of 1990s. He wrote a dissertation entitled “Strategic Planning of the Renewal of the Mineral Raw Materials of the Region in Conditions of the Formation of the Market Economy” and submitted it to the St. Petersburg Mining Institute in 1997. The dissertation’s main focus was strategic planning, but the content was hardly about mineral resources due to lack of resources in the St. Petersburg area (Balzer, 2005: 214; Hill & Gaddy, 2015: 203). Two years later Putin published an article entitled “Mineral Raw Material Resources in the Growth Strategy of Russian Economy” in the “Zapiski (Notes)” journal of the same institute. The article had a broader perspective. In the article, Putin emphasized the importance of extractable resources in the restructuring of the national economy. Moreover, he advocated establishment of large financial industrial corporations and a dominant role of the state in the regulation. Putin (1999) had the following analysis:

[P]rocess of the re-structuring of the national economy must have the goal of formation of the most effective and competitive companies both on the internal and on the world markets. Considering the huge mineral and raw materials potential of Russia, the restoration of the domestic raw materials processing industry must take place based upon its

comprehensive integration with the extraction industries. The most promising form for such integration should be the creation, with the comprehensive support of the state, of large financial-industrial groups - corporations with a cross-industry profile, which can compete with the transnational corporations of the West.

Regardless of who the natural, and in particular mineral resources belong to, the state has the right to regulate the process of their development and use, acting in the interests of society as a whole and individual owner whose interests conflict with each other, and who need the assistance of state authorities to reach a compromise.

Looking at his arguments Putin attributes a dominant role to the state and is aware of the fact that the economy should be restructured and supported with competitive corporations. Bringing back the state was not an easy task in the early 2000s, since the private sector was used to pursue its interests in the absence of a strong authority throughout the 1990s. The picture was even more complicated in the energy sector, where the state evolved into a small and passive actor. In this section, I will scrutinize how Putin and his network reestablished the control on the energy sector.

4.3.1. Reinforcing the State Back in the Hydrocarbon Sector

Legacy of the Yeltsin era for the energy sector was new vertically integrated energy companies both in the natural gas and oil sector. Natural gas monopoly, Gazprom, had a unique position with its control on natural gas pipeline system. The oil sector was dependent on Transneft for transmission of its products and their exports were under the state control. In this setup, oil companies had to coordinate with Gazprom and Transneft their strategies especially for the development of new reserves in Russia. Since they depended on state conglomerates for transmission of extracted crude oil and natural gas. In the absence of an existing infrastructure developing new fields were meaningless. Thus, private companies chose to develop brownfields rather than green fields. This created a competition for control on oil producing subsidiaries 1997 onwards. State owned Rosneft had a disadvantageous position as its assets were seen potential trophies by others. Even though several attempts of privatization of Rosneft and its subsidiaries came to the fore until 2000, the financial

crisis and change of governments hindered the process (White, September 26, 1997; Rosneft is One of the Top Ten Oil Companies, 2000, February 28).

After the privatization process of the 1990s, the state had full control of one oil company, Rosneft. It was left with few productive fields. In the natural gas sector, Gazprom became the state within the state. The administration was not keen on increasing the amount of tax it pays to the state and through mediators the profit of the company was going to the pockets of family members of the administration. The private companies were pursuing a strategy of tax optimization. Rather than paying taxes to the state, they were registering their companies in tax havens within the Russian Federation, like Mordovia and Evenk Autonomous Okrug. These were federal subjects which had status of Restricted Access Jurisdictions governed by federal law. In these regions, local governments were offering some competitive taxing terms for companies which were registered within their borders. This setting was legal, but there was a thin line between tax evasion and tax optimization (Gololobov, 2008: 175).

The economy was not in a good condition and the state was running on budget deficits with piled up financial debts. Moscow had to declare moratorium after the financial crisis in 1998. As suggested in Putin's article the fastest possible exit strategy from this deadlock was stricter control on the energy rents. Increasing oil prices in the global market also was another incentive for the government to focus on this sector.

This was a tendency of a rentier state that seeks to control oil rents rather than searching for diversifying the economic resources through fiscal and innovative economic policies. A former advisor to the Kremlin Gleb Pavlovsky says that "Everyone knew that making Russia's economy more reliant on rising energy prices was risky and would probably lead to a dead end in a decade or two, but no one was worried too much about the future" (2016: 14). Putin administration pursued couple of tactics to consolidate state's control on the energy sector. These were redesign of Gazprom, a new tax policy and taming privately-owned national energy companies. These policies were also directly linked with consolidation of the central power. The Kremlin was redesigning the relations between the state and the economic elite,

which gained manipulative power on politics particularly during the second term of Yeltsin period.

4.3.2. Redesign of Gazprom

The state had the biggest share in Gazprom at the end of the 1990s, but less than 40 percent share of the company. The finances of Gazprom were hardly transparent. Rem Vyakhirev and his team established a system that channel company's revenue to a privileged circle that hindered company's profitability. The company was not only an important financial source, but a potential foreign domestic policy instrument. It was supplying gas to for Russian households and industry as well as to former members of the Soviet Union like Ukraine, Georgia, Baltic states and European countries. Any discount or hike in prices had potential of policy implications. Furthermore, after the Gusinsky affair the company took the control of one of the main television stations in the country. All these factors put Gazprom at a position with great strategic importance for the Kremlin.

Reformers still had intentions to unbundle Gazprom, but the opportunity window had already been closed after Putin's election as the president. Anonymous (Interview on June 6, 2013) argues that

Chernomyrdin's dismissal from the government until Putin's coming to power was the toughest period for Gazprom. It was a very clear and open possibility that it can be structured and partially privatized. What kept it from happening was changing governments and president. As the reformists we made another attempt to unbundle Gazprom when Putin was elected, but Putin had shown very clear signs that he has very special personal interests in Gazprom he wanted to keep it as it is. So he became the new Chernomyrdin in a sort of sense. Gazprom was under a solid umbrella of protection.

For Putin, who put formation of national champions as a strategic target, control of Gazprom was a critical issue. In this regard, he was not only against the privatization of the company, but wanted to redesign the administration. Rather than trying to tame the old guard, he chose to change the top management team and appoint new figures from the pitersky group. Following his election as the president, Putin replaced Viktor Chernomyrdin with his campaign manager and former colleague

from St. Petersburg, Dmitri Medvedev, as the new head of board of directors (Tavernise, July 1, 2000). Putin was looking for loyalty in his power vertical, but the CEO of Gazprom, Rem Vyakhirev, was giving signals of acting autonomously and even against the Kremlin. Vyakhirev signed a letter criticizing the arrest of Gusinsky in June 2000 (Support for Arrested Media Tycoon, June 14, 2000). The next year 39-year-old economist from St. Petersburg, Alexey Miller, substituted Vyakhirev and became the new CEO. Putin himself orchestrated election of Miller by attending to the Gazprom meeting (Tavernise, May 31, 2001). Vyakhirev became the head of the board of the directors, but deputy head, Dmitri Medvedev became the new chair in 2002 when Vyakhirev left the company. Miller and Medvedev supported by the Kremlin restructured the company by reshuffling Vyakhirev's team and reforming the finances of the company. As can be seen from Figure 9, following these shuffling Gazprom's market capitalization, which was \$7.8 billion in 2000, increased to \$66.3 billion at the end of 2004.

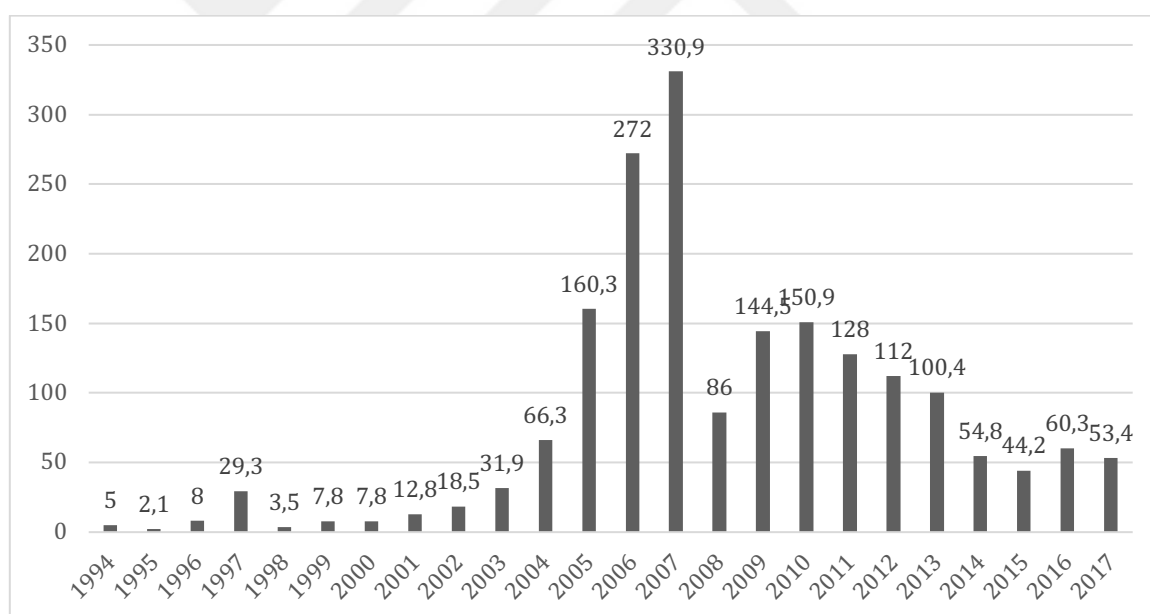


Figure 9: Gazprom's Market Capitalization (billions \$)

Source: Gazprom – Shares (Retrieved 2018, December 25, from <http://www.gazprom.com/investors/stock/>)

German Gref, the Minister of Economic Development and Trade, prepared a plan for privatization of Gazprom and fostering further competition in the market, but Putin and the new administration in Gazprom had plans of further consolidation of the state control (Whalen, May 31, 2001). The main priority was increasing state's share

in the company. Miller and Medvedev proposed merger of Rosneft with Gazprom. Asset merger of the two companies would lead to a giant company, in which the government share would surpass 50 percent threshold. For this purpose, another subsidiary known as Gazpromneft was established. The president of Rosneft, having close relations with Sechin smoothly avoided from the merger when they took over Yuganskneftegaz from Yukos auction in 2004²⁹ (Gustafson, 2012: 350). Subsequently, the government decided to purchase 10.74 percent stake for \$7.1 billion in cash. This purchase increased state control on Gazprom shares slightly over 50 percent (Russian State Gains Control of Gazprom, June 24, 2005). The interesting part of this case was that rather than using federal budgetary resources, Kremlin established Rosneftegaz as a vehicle, which holds 100 percent of Rosneft shares, to buy Gazprom shares (Rosneft Sets Ambitious Targets, July 1, 2005).

The merger plan with Rosneft failed, but Gazprom acquired another company that would make natural gas monopoly a serious player in the oil industry. In 2005, Gazprom took over Sibneft for 13 billion from Abramovich's Millhouse Capital (Ostrovsky, September 28, 2005). A siloviki, Alexander Ryazanov became the new CEO of the company (Rosner, 2006: 34). Then, renamed as Gazpromneft and another pitersky Alexander Dyukov became its new CEO.

Medvedev-Miller dyad governed the company until 2008. Putin chose Medvedev as his successor in 2008 and then the prime minister Viktor Zubkov became the new chairman of the board of directors. While he was a member of the board, Zubkov was also the deputy prime minister of Putin government. As a siloviki, Zubkov has been the chairman of the board of directors since 2008. Miller has been the CEO of the company, but Putin also established a balance of power between liberals and siloviki in the company.

Figures like First Deputy Prime Minister Igor Shuvalov continued to bring up the issue of privatization of Gazprom arguing that along with Rosneft the gas monopoly can be privatized within 7-10 years period (Gazprom, Rosneft May be Privatized, June 2, 2017). However, there is a little impetus about curtailing Gazprom's

²⁹ This will be elaborated further in the next section.

monopoly. The monopoly has 68 percent share of gas production in national level (Gazprom Annual Report 2017, 2018: 66). The export strategy is still based on Gazprom's pipeline infrastructure and the company acts as a gatekeeper. Players like Rosneft criticizes Gazprom's position, demands third party access to the pipeline system.

There is no change in Gazprom's monopoly in the pipeline system, but recent developments in liquified natural gas (LNG) technology and market opened a maneuvering space for other producers, which are uncomfortable with the current setup. A legislation passed from the Parliament in 2013 gave independents and other state companies right to export natural gas via LNG terminals in Russia (Gorst, November 22, 2013). Nevertheless, there are only two companies that qualify the requirements of the legislation, Novatek and Rosneft. In 2004 Novatek became Russia's biggest independent gas producer (Stern, 2005: 25). Among Novatek's stakeholders there is Gennady Timchenko a member of Putin's inner circle. Rosneft on the other hand, controlled by the state and led by Igor Sechin. The lobby of these groups against Gazprom's monopoly in the Kremlin was influential in the passing of the law.

Gazprom also further develops its LNG capacity on the coasts of Baltic Sea, the Black Sea and Pacific Ocean (Vladivostok) (Gazprom Annual Report 2017, 2018: 103). In fact, its partnership with international energy companies in developing domestic reserves help the national champion to develop such capacity (Yergin, 2011: 40). After facing serious charges of environmental violations in Sakhalin-2 project Shell and its Japanese partners decided to sell a majority stake to Gazprom in 2006. After the purchase the allegations dropped and the consortium started to export LNG to the global markets as of 2009.

In the last 20 years, Gazprom proved to be an important political and economic instrument for Kremlin. It funds election campaigns, its TV channel serves to the interests of the Kremlin and also reaching to remote areas of Russia it provides subsidized gas to Russians. After Putin's coming to power, the state took the majority control of the company and with restatization of Sibneft Gazprom became an important oil producer. Recently, the company's capitalization dropped to \$53

billion with the downward trend in the hydrocarbon markets. However, its privileged position still continues in Russian politics. Özdemir and Karbuz (2015) argue that Gazprom monopoly in the pipeline system can be challenged in the future, considering the fact that its rivals managed to get a partial liberalization in the LNG. It seems that Rosneft, having access to the Kremlin via a strong figure like Igor Sechin and being the largest energy company in Russia, has gained some leverage against Gazprom. A company that was stripped off of its assets in the 1990s evolved into a national champion. In the next sub-section, I will examine the evolutionary path that Rosneft pursued during the Putin period.

4.3.3. The Restatization: Taming Oligarchs and the Formation of a National Champion

Putin's first term was about the centralization efforts in the political sphere, but liberalization reforms in economic level. The Kremlin introduced a flat income tax rate at 13 percent that simplified the taxing system in the country. Moreover, the started process of privatization in the second half of the 1990s persisted. After Putin's reelection for a second term, the reform process made a U-turn in Russia. In the new system, neo-liberal policies of the 1990s lost momentum and the system evolved into a more state-led capitalism with dominant role of the state in the economy (Tsygankov, 2014: 117). This can be seen also in the energy sector. The privatization was laid aside and rather restatization efforts that strengthened state-owned corporations became the main theme.

In Putin's first term, the state privatized shares in Slavneft, and Onako (Russia's TNK Says Ready to Bid for More Oil Stakes, September 20, 2000; S&P Revises Sibneft, TNK Ratings After Slavneft Buy, December 20, 2002). After the privatization of these vertically integrated oil companies, Abramovich's Sibneft, and Fridman's TNK strengthened their production capacity and reserves in Russian energy sector. In fact, Putin had an image of pro-market leader in this period, but had a clear stance about drawing a red line between the economic elite and the politics. He gave his message that oligarchs might keep the assets they captured in the 1990s as long as they abide by the new rules put by the Kremlin in the July 2000 meeting. In fact, for some oligarchs the new order was not that problematic, but even

reasonable. “Comparing Putin with the reformers or socialist, he was an attractive choice as he was representing the middle way. Reformers would be bringing foreigners to Russian market and so further competition; communists might take back the gaining of the privatization, but Putin could give them chance to consolidate their position” (Interview with Anonymous on July 6, 2013).

Some of the economic elite had ambitions to consolidate their position in the expense of the political elite’s interests by meddling with politics. They ignored the given message in 2000 and preferred to follow their own path. Among these symbolic names there were Boris Berezovsky and Mikhail Khodorkovsky. Berezovsky had to flee the country as early as 2000, and left his assets to his partner Roman Abramovich. After his departure the Kremlin strengthened control on the media and gained a leverage on shaping public opinion.

Khodorkovsky’s case has some similarities with Berezovsky, but more complicated. Khodorkovsky became an active and ambitious political and economic player in 2000s. Through certain channels he became an influential lobbyist in Duma. His energy company, Yukos, was already an influential company in the Duma. One of the board members of Yukos, Vladimir Dubov, became the chairman of the tax subcommittee after the 1999 Duma elections. Dubov was an influential organizer and Khodorkovsky started to make payments to the parliamentarians in return of voting in line with Yukos’ interests (Interview with Anonymous on January 10, 2015). In Berezovsky’s case I mentioned earlier that it was easy to reach out to members of the Parliament through financial means to maximize someone’s political interest. Nevertheless, Khodorkovsky’s ambitions became even more discernable prior to 2003 elections. Khodorkovsky and Yukos approached to liberal political parties Yabloko, Union of Right Forces and the Communist Party with promises of providing funds for elections in exchange of naming candidates (Oil Groups Weigh Their Options for Political Sponsorship, June 23, 2003). Yukos had also different channels within Unity Party and Khodorkovsky’s activism was interpreted as an effort to control the whole legislative organ via the parties in the State Duma. His political statements criticizing the dynamics in Russia and demanding more transparency started to be inferred as messages about his political ambitions particularly for the 2008

presidential elections (Wheeler, July 19, 2003; Jack, 2006: 212).³⁰ Yukos became such an influential political actor that the Kremlin started to face resistance in the Parliament in passing laws. This became even more visible in the new tax reform bill in 2003. Not surprisingly, Russian General Procurator's office opened a probe against Yukos in July. Following the probe announcement Putin, took a deliberate stance supporting the General Procurator. He said that "Even softer issues [in Duma] cannot pass today, because those who are not interested in their passing block them. And they do so efficiently" (Rusenergy – Putin Wants Yukos Leverage Withdrawn from Duma, July 21, 2003).

Some insiders claim that Khodorkovsky's meddling with Duma politics and blocking draft laws was the main factor behind the taken steps against the Russian oligarch (Interview with Anonymous on January 10, 2015). Some others claim that there are also other factors that might have played role, which were Khodorkovsky's autonomous actions at international level (Interview with Anonymous on May 18, 2013). Before the investigation, Khodorkovsky was pursuing several strategies to turn Yukos into a global company. Khodorkovsky had some ongoing negotiations with Chevron and ExxonMobil on further merger possibilities since 2002. This was perceived as offering Russia's strategic assets to American originated international companies. Additionally, he was talking with Chinese CNPC and Sinopec about building a pipeline from Russia to China and exporting oil. All these were political moves that contained issues related with foreign policy and domestic balances in Russia. For instance, talks with Chinese and American companies as an independent player that excluded Russian government could have been seen as violation of the rules that Putin stated in July 2000. Additionally, Khodorkovsky's pipeline initiative would be conflicting with plans and the status of the pipeline monopoly Transneft. In fact, While the talks on a pipeline to China was ongoing between Yukos and Chinese authorities Transneft announced a \$5 billion pipeline project that would reach out to Pacific coasts (Xie & Zhao, December 31, 2002).

Even after the probe started, Khodorkovsky did not follow Berezovsky and Gusinsky and fled the country. He rather chose to remain in Russia. He also started to make

³⁰ He was not necessarily started to be taken as a potential candidate, but a political actor with capacity to name president and prime minister in 2008.

tours in different parts of Russia and give speeches. Finally, he was arrested in October 2003. The arrest had instant implications on the political sphere. Figures, who were critical of the investigation and the arrest like the Head of Presidential Staff Aleksandr Voloshin resigned and Prime Minister Mikhail Kasyanov was dismissed (Baker & Glasser, February 25, 2004). These people were important figures of the Yeltsin administration and their leave contributed further homogeneity of the Putin elite.

After the arrest, Yukos faced with charges of tax evasion and its assets were stripped off in the following years through state auctions. The international observers covered the topic under the title of “the Yukos Affair” and this became one of the main topics about Russia for a couple of years. Anonymous (Interviewed on January 10, 2015) argues that:

Kremlin decided that from an economic point of view it would be more likely to have not only private companies, but let's majority to be private and some of them to be governmental. So that you can compare different models to see what it is better. Khodorkovsky gave them a gift when he started his political attack. And in the end, he was crashed. They crashed him because Khodorkovsky opposed informal control of the oil sector by the government and pay taxes. They had to crash him due to political reasons. Yukos was suddenly in the hands of the government and they had to decide what to do with the company.

The state share in the oil sector shrunk throughout 1990s. Khodorkovsky case brought the opportunity of a new design and some actors within the state took the advantage to use it in their favor. The first auction took place on December 19, 2004. The Baikal Finance Group, which was an unknown company, came out from nowhere and won the bidding for \$9.4 billion. Three days later, Rosneft announced its acquisition of Baikal Finance Group. Thus, Rosneft became the new owner of Yukos' most valuable assets, Yuganskneftegaz. Putin's (Walters, December 24, 2004) statement about the takeover was a reflection of the Kremlin about the restatization:

Today the state -- using absolutely legal market mechanisms -- is ensuring its interests. I consider this perfectly normal... We all know perfectly well how privatization at the beginning of the '90s was conducted and how some market

participants got multibillion state assets using different tricks, including some violations of then-existing legislation.

This statement shows that the new elite in the Kremlin was not comfortable with the privatizations of the previous decade. And they had their own ways to equal the balances between the oligarchs and the state. Not surprisingly, in another auction Rosneft's subsidiary, Neft-Aktiv, won the bidding for Yukos' other key assets in Eastern Siberia in 2007 (Blagov, May, 8, 2007).

In the auction process, its former president Sergey Bogdanchikov played a crucial role with Igor Sechin. Sechin is one of the closest figures of Putin and an important figure from the siloviki ranks. He was the Deputy Head of the Executive Office in 2004 when he was appointed as the chairman of the board of directors (Sechin, has been the CEO of Rosneft since 2012). Khodorskovsky accused Sechin of being behind the campaign against him (Belton, April 25, 2006). Khodorkovsky's arrest was part of a political process, and there was only one bidder in the auction. Putin's advisor Andrei Illarianov criticized the auction as the fraud of the year and further claimed that "We [Russia] have made a change from the inertial model of economic development to interventional model" (Putin's Advisor Calls Yuganskneftegaz Sale "Fraud of the Year", December 28, 2004). The auction could be problematic, but the tandem between these Bogdanchikov and Sechin not only prevented Rosneft to turn into a subsidiary of Gazprom, and made the company the biggest energy company in Russia.

Yukos Affair is an important case of restatization of the oil sector in Russia. Khodorkovsky failing abide by with the new rules of the game was eliminated by Russian law enforcement units. Chairman of the Lukoil Valery Graifer in an interview told that "We at Lukoil know how to act in our limits. Khodorkovsky didn't know the limits. He didn't realize that when power went from Yeltsin to Putin, things had changed. A lot had changed" (Maass, 2004). In fact, Lukoil's Alekperov had a competitive affair with Rosneft in the early 2000s. But he chose to cooperate with the state company after witnessing Putin's position in the meetings organized with oligarchs by the Kremlin. Instead, Khodorkovsky chose to oppose Putin administration and this was ended with his arrest and Yukos' restatization.

Before the acquisitions, Putin had already become a strong supporter of Rosneft. He did not hesitate to show this in different platforms. When the president met with oligarchs in February 2003, Khodorkovsky criticized Rosneft acquisition of Northern Oil (Severnaya Neft) at an inflated price and blamed the acquisition as being an example of corruption in the state. Putin supported the acquisition stating that Rosneft needed to increase its insufficient reserves and questioned the problematic character of Yukos' acquisition of super reserves (Putin Says Purchase of Severnaya Neft Should be Looked into, February 19, 2003).

Rosneft was the object of privatization in 1990s, and in the early 2000s its main aim was recapturing domestic assets. Under Putin administration Rosneft left behind Gazprom and became the largest energy company of Russia. An important share of its stakes sold to foreigners to generate funds for the company's acquisitions. As of 2017 BP Russian Investments Limited and Qatari QH Oil Investment LLC holds respectively 19.75 and 19.5 percent of the shares (Rosneft Annual Report 2017: Sustained Growth, 2018: 247). However, the state still keeps the majority stake in the company.

BP became a Rosneft shareholder after the TNK-BP deal in 2013. Rosneft bought TNK-BP from BP and Alfa-Access-Renova consortium (AAR) for \$55 billion. It agreed to pay \$28 billion to the AAR for their 50 percent stake in the company whereas BP received 19.75 percent stake in Rosneft and \$12.48 billion in cash from the deal (Gosden, March 21, 2000). The next year, Russian government seized the control of another private oil company owned by holding company Sistema with a court decision claiming that Bashneft, before its sale to Sistema in 2009, was privatized illegally in the early 2000s (Hoyle, October 31, 2014). After the takeover, the state decided to privatize the controlling stake of Bashneft and the company was sold to Rosneft for \$5.29 billion in 2016 (Russia Completes Sale of 50% Stake in Bashneft to Rosneft, October 12, 2016). The interesting dimension of the sale was a state company bought another state company using its financial sources. Observers from Eurasia group claimed that the motive behind the sale was treasury's need for cash in unfavorable economic conditions, but Kremlin had no intention to liberalize the oil sector (Antonova, October 12, 2016).

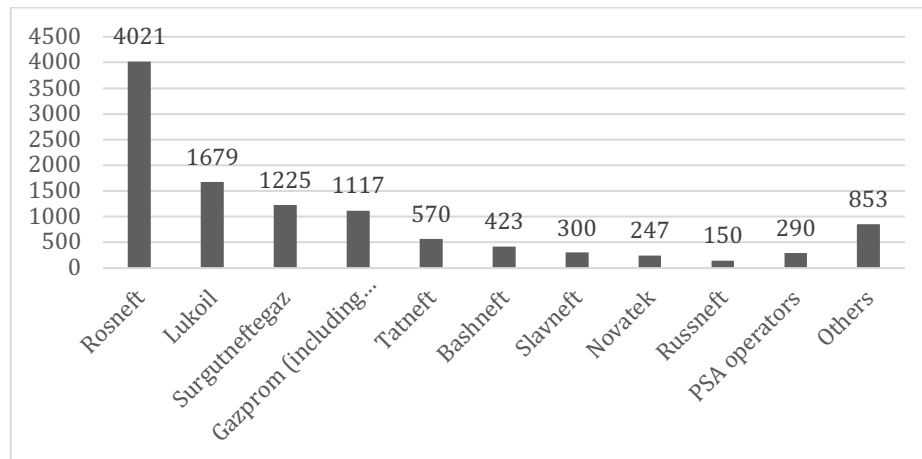


Figure 10: Russia's Oil Production by Company in 2016 (thousand barrels)
Source: U.S. Energy Information Administration based on Bloc Research
<https://www.eia.gov/beta/international/analysis.php?iso=RUS>

Once a mediocre state company, Rosneft became the largest listed company in the world. It produces 41 percent of Russian crude oil and 6 percent of global production (Rosneft Annual Report 2017: Sustained Growth, 2018: 8). Looking at the acquisitions of Rosneft in the last decade and a half it took the control of privatized companies in Russia. Kremlin chose the way of creating two national champions rather than a merger. Gazprom and Rosneft today control more than 50 percent of the sector. Thus, under the Putin period the balances have tumbled down for the economic elite and the restatization made the state the dominant actor in hydrocarbon sector once again. In the acquisition of Yukos and Bashneft, law enforcement units played critical roles. In both of these cases the problematic character of the privatization in the transition period articulated by high level figures in Russian politics. This understanding in fact a reflection of the siloviki group's point of view which was mentioned before.

In fact, only two major companies managed to survive from the 1990s, these are Surgutneftegaz and Lukoil. After Bashneft's acquisition the top four companies produce almost 80 percent of the crude oil in the sector (Figure 10). The state dominates the sector, and there are claims that question privately-owned national energy companies' ownership structure and autonomy. Regarding Surgutneftegaz there are claims that Putin has taken over the controls of the company (Harding, December 21, 2007; Interview with Anonymous on June 6, 2013). Lukoil's expansion policy no more covers new domestic fields in Russia, but mainly based on

projects abroad. In this regard, the state managed to take under control the hydrocarbon sector throughout the 2000s and 2010s and tamed the oligarchs through law enforcement units.

4.3.4. Current State of Affairs in Russian Energy Sector

Hydrocarbon sector has become a critical industry for Russia as in the Soviet period once again. The crude oil production recovered in the 2000s and surpassed 10 million barrel per day threshold in 2007. The average daily production in Russian federation was 11.25 million barrels in 2017 (Figure 8). The domestic consumption is about 28.6 percent of the production and the remaining part is being exported as crude oil or refined products. Natural gas production also reached a record high in 2017 and became 635.5 billion cubic meters. The domestic consumption is about 66,7 percent with 424 billion cubic meters (BP Statistical Review 2017). The bulk of natural gas production belongs to Gazprom.

Natural gas and oil rents³¹ represent about 37.8 percent of the export revenues as of 2016 (Figure 11). This number excludes the production cost and refined products, so the share of oil and gas revenues is much higher in Russian exports. The hydrocarbon revenues represent an important share in the foreign trade and there is a similar picture for fiscal revenues. After simplifications in hydrocarbon tax, there are two main taxes taken from hydrocarbon products. These are mineral extraction tax and export duties. These revenues made up almost 40 percent of the federal budget (Figure 12). As expected, the share of oil revenues is even higher than gas. Yermakov and Kirova (2017: 4) estimates the share of natural gas revenues between 3-7 percent between 2005 and 2016.

³¹ I made the estimation by based on World Bank data. The share of natural gas and oil rents in exports= {[Oil rents (%) + Natural gas rents (%)] x GDP in current prices}/Exports in current prices.

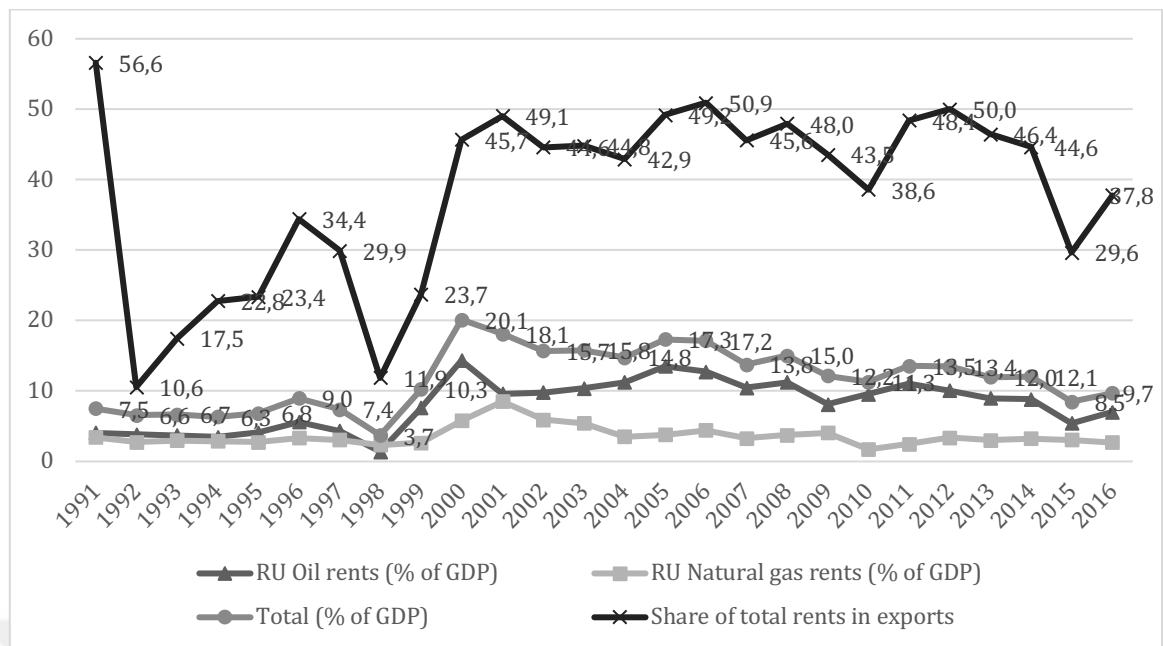


Figure 11: Natural gas³² and Oil Rents³³ in Russia between 1990-2016 (% of GDP)
Source: World Bank

Even though the share of the natural gas is lower than the oil it has also had a more political character for Russian politics. LNG exports are a thriving area for Russian gas industry, whereas the bulk of the gas exports transmitted via pipeline systems. The main customers are located in Europe and Russia managed to preserve its market share in Europe even Gazprom signed new contracts in Western Europe. While expanding its operations it has started to construct new pipelines in the last decade that became part of a bigger political debate in European politics like Nord Stream, and Turkish Stream. Brussels, looks for possibilities of establishing a more competitive liberal market with limited dependence on third parties. However, these projects are seen aggressive incentives to preserve Gazprom's dominance in the European market, while giving political leverage against Russia's neighbors. Since these pipelines bypassing traditional transit countries like Ukraine and reaches to the final consumer. Ukraine, which played on its unique position managed to get advantageous prices for Russian natural gas for some time, have almost lost its leverage recently. Facing certain challenges in Europe, Gazprom also turned to the East. It signed agreements with China to supply natural gas from its fields in Yakutia

³² Natural gas rents are the difference between the value of natural gas production at regional prices and total costs of production.

³³ Oil rents are the difference between the value of crude oil production at regional prices and total costs of production

and Irkutsk for 30 years through Power of Siberia pipeline system starting from December 2019 (PJSC Gazprom Annual Report 2017, 2018). Compared to European market, gas sale to China is moderate. Yet, this gives Gazprom chance to diversify demand structure and find new customers for its fields in the Eastern Siberia.

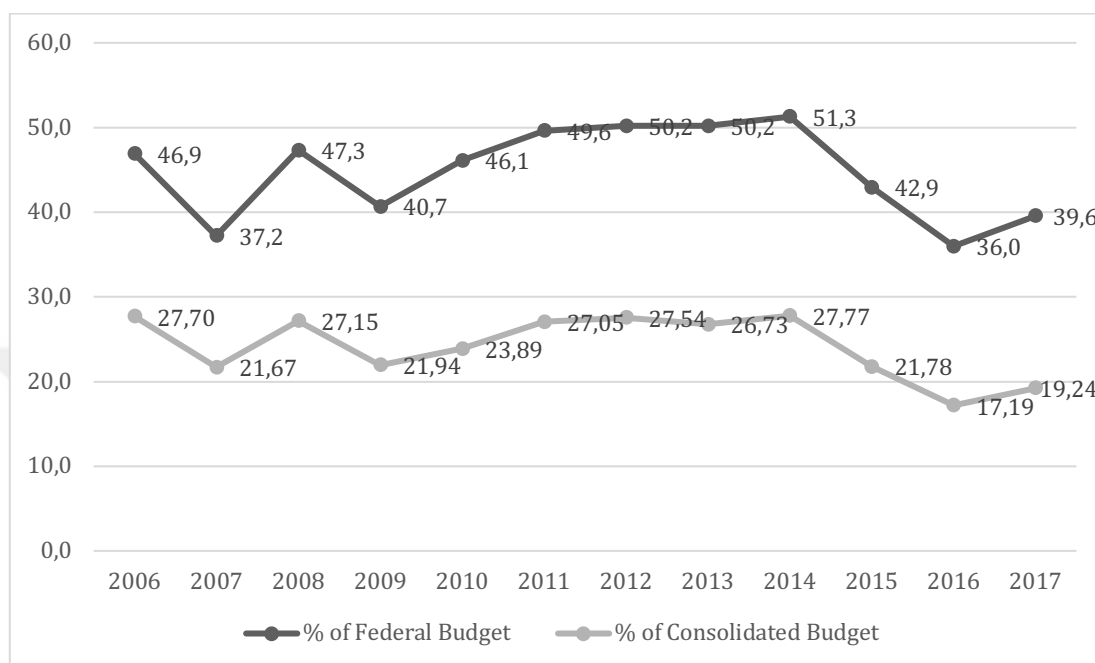


Figure 12: Oil and Gas Revenues as Percentage of Federal and Consolidated Budget
Source: Ministry of Finance of the Russian Federation

Compared to Gazprom, oil companies had a lower profile in the foreign policy. Mostly they preferred to develop domestic reserves, which were more attractive after the privatization with green and brown fields in their assets. Lukoil has been the most active privately-owned national company. It pursued an active strategy in the Caspian Basin particularly in Azerbaijan and Kazakhstan throughout the 1990s and continued to expand its operations in the Middle East and Africa 2000 onwards (Poussenkova, 2010).

As a former director of Rosneft's Sakhalinmorneftegaz in Russia's far east Bogdanchikov was hesitant about operations abroad, but Sechin had a different view about Rosneft's role in Russian foreign policy (Gustafson, 2012: 355). Sechin gradually weakened Bogdanchikov and then eliminated him in 2011 (Aslund, June 21, 2013). Sechin pursues a more aggressive strategy abroad than his predecessor. Rosneft recently became the flagship of Russian foreign policy. The company

operates in different areas abroad such as providing services, refining, exploration and production both in natural gas and oil sectors.

Rosneft seems to have a global strategy. It operates in all continents except Australia. Its presence in countries like Venezuela, Cuba, China, Egypt, Iraq and Vietnam is interesting considering the US interests in these countries.³⁴ Rosneft enters into these markets through production share agreements, joint ventures with national or international companies. These operations make Russia part of the political developments in these areas. For instance, Russia is not only a part of ongoing Syrian war, but has recently become one of the active energy players in the Eastern Mediterranean through several agreements. Paying \$1.1 billion to ENI for 30 percent stake, Rosneft became part of a consortium in 2017 between Italian ENI and BP to develop region's biggest offshore natural gas field, Zohr (Rosneft Annual Report 2017, 2018). Moreover, Novatek, which is known with its shareholders' close relations with Kremlin, as a member of a consortium with ENI and Total signed an exploration and production deal for developing Lebanon's offshore fields (Khrachie, December 14, 2017). Even though Russian Soyuzneftegaz signed a deal to develop offshore reserves and stepped back later in 2015, Russia and Syria signed an energy cooperation framework in January 2018 (Katona, February 14, 2018). Along with the recently discovered offshore fields in Cyprus and Israel, the region has a big potential for the next decade for Europe's diversification projections, which puts the region in a potential competitor position for Gazprom. Considering Russian pipeline projects, like Turkish Stream, and its active stance in the Middle East and Eastern Mediterranean with its energy companies, Russia seeks for gaining a strong leverage of shaping the market dynamics rather than remaining as a passive player. Moreover, through joint ventures in the Eastern Mediterranean with top tiered companies, Russian companies gain further experience about offshore drilling.

While taking an active stance abroad recently, Russia has a more conservative stance about foreign presence in the energy sector. Anonymous (Interviewed on June 6, 2013) argues that

³⁴ For more information about Rosneft's international operations please refer to Rosneft Annual Report 2017: Sustained Growth (2018).

The government wants to control and limit the extent of the involvement of foreign companies in the energy sector. There is an informal number being articulated, which is 20 percent for direct foreign partnership. 20 percent is a level that you have some presence, have access to decision making and you cannot block decisions. Only observer role and contributing to technology. This is why there is no major new deals.

In fact, I have come across with this “20 percent” through my research trip in Russia. There is a consensus about foreign presence as long as they provide necessary technology to develop challenging offshore and onshore reserves (Interview with Anonymous on May 18, 2013; January 10, 2015). However, the Western sanctions against Russia after Russia’s annexation of Crimea in 2014 put serious impediments before provision of high-tech equipment to Russia. The US have much tighter sanctions and targets energy companies Rosneft, Lukoil, Surgutneftegaz, Gazprom Neft, Gazprom and Transneft along with six banks Bank of Moscow, Gazprom Bank OAO, Russian Agricultural Bank, Sberbank, VEB and VTB Bank.³⁵ The EU sanctions also put restrictions before equipment exports for offshore development and hydraulic fracturing.³⁶ “European energy sanctions do not apply to agreements made before September 12, 2014” (Van de Graaf & Colgan, 2017: 62). Sanctions do not have short term impacts on Russian production, but due to aging oil fields Russia needs better equipment to develop new fields in deep water basins or reserves with challenging geological features. Facing difficulties to access high-tech equipment it is estimated that Russian production might fall to 7.6 million barrels per day in 2025 (Ashford, 2016: 120). Even though the long-term prospects seem dimmer for Moscow, currently rents from hydrocarbon sector contributes to country’s financial resistance by providing necessary funds for the economy.

The state companies are governed by strong figures with direct access to the Kremlin. Still it is hard to ignore government’s position in overseeing the sector. Deputy Prime Minister, a pitersky and a former chief of the staff, coordinates the

³⁵ For more information about US sanctions please refer to US Department of Treasury. (2014). Announcement of Expanded Treasury Sanctions within the Russian Financial Services, Energy and Defense or Related Materiel Sectors, <https://www.treasury.gov/press-center/press-releases/Pages/jl2629.aspx>.

³⁶ For more information about EU Sanctions please refer to EUropean Union. (2014). EU SANctions Against Russia over Ukraine Crisis, https://europa.eu/newsroom/highlights/special-coverage/eu-sanctions-against-russia-over-ukraine-crisis_en.

federal policy on the fuel and energy complex. The Ministry of Industry and Energy was divided into two ministries in 2008, under the presidency of Medvedev. The Ministry of Energy, headed by Alexander Novak, is in charge of drafting and implementing legal regulation and policy. The Ministry of Finance is responsible for taxes and The Ministry of Natural Resources and Environment follow the issuance of licenses and compliance with license agreement (US Energy Information Administration, October 31, 2017).

5. CONCLUSION

Russia differs from other energy rich countries in the post-Soviet region with the hybrid ownership structure in the energy sector. Privately-owned national energy companies mushroomed throughout the 1990s and seized the majority share in production and reserves. In the 2000s, the sector's structure changed dramatically with a strategy of restatization of the hydrocarbon sector through different instruments. In terms of ownership structure of oil sector, Yeltsin and Putin periods have asymmetric characters. Interestingly, gas sector remained under the control of the state after the dissolution of the Soviet Union, and state's control and ownership consolidated further in the 2000s. Thus, looking at the ownership structure in hydrocarbon sector it is hard to talk about a unique state policy. Rather elite preferences were critical in policy making process and shaped the ownership structure in the energy sector. Each actor took the advantage of the shaky dynamics in the transition period to pursue his agenda and maximize his interests. This makes it important to look at the elite structure in Russia.

It is easy to distinguish certain advantages of Russian elite by examining the institutional structure of Russia. Russia was the center of the Soviet Union. Thanks to the capital's institutions with power of designing policies and exercising authority, compared to the peripheral states of the USSR, the elite in Moscow had a higher capacity. These people had far better access to international capitalist system and knowledge about the mechanics of liberal economy. Gorbachev's reforms further expanded their area of maneuverability by giving them chance to engage with foreign trade and establish private enterprises. When the Soviet Union was dissolved there were actors in Russia who had already accumulated a serious amount of capital,

which was not possible in the USSR until late 1980s, and knew how to move on the path of liberal economy. Furthermore, KGB and Communist Party elements favored these actors by providing financial support and protection. These people became new actors who were looking for maximizing their interests in the post-Soviet period. They represent the economic elite in the country, known as oligarchs.

The events that followed one after another brought Yeltsin to power. Yeltsin was a successful Communist Party politician who was recruited to Moscow from Sverdlovsk. He had progressive stance with a critical tone, but Gorbachev excluded him from Communist Party's inner circle. His exclusion from the inner circle and Communist Party's recruitment policy left him in the cold since his presidency was not a product of an organized strategy. He came to power as a result of a reactionary movement against the Communist rule and recruited members of his team within the dynamics of the transition period. Throughout his presidency he worked with people from different backgrounds with diverse worldviews.

It is hard to talk about stability of Russian governments under Yeltsin's rule. Having loose relations with these people, Yeltsin made frequent shuffles within the government as a political compromise due to absence of a strong support in the Parliament. He was not a member of a political party, and yet it was hard to talk about an institutionalized party culture or discipline that Yeltsin enjoyed after the dissolution of the Communist Party. Thus, in the absence of party support, he was running a government composed of actors coming from diverse background. He tried to orchestrate the transition period under the dynamics of the transition period with weak political elite integration. It is hard to talk about a broad consensus between legislative and executive bodies about "what it is to be done and how it is to be done". Moreover, there was still a threat of old system's revival as the opposition groups started to gain popularity due to reform failures and incapability of Yeltsin's entourage to reach out to people via political parties. This created a favorable environment for actors with will and capability to pursue maximization of their interests.

Yeltsin and members of the reformist group in the cabinet openly argue that they aimed to overturn the system to prevent the old guard to come back to power. One of

the main targets was to destroy the Communist institutions and build a liberal economy. Instead of a gradual reform process, they opted to move fast. This opened some windows of opportunity along with certain loopholes within the system for actors to take advantage of. Reformist team's liberalization policies deliberately shaped an environment to craft new stakeholders, who would become the supporters of the new system with fear of losing their assets in a possible change of political power. It is easy to see this scheme in the energy sector, especially for the oil industry.

Russian oil industry was restructured in two phases. In the first phase, insiders had leverage in terms of shaping the legal frame and gaining the control. In the second phase, the privatization of the oil sector continued as Yeltsin administration looked for the support of oligarchs before the 1996 elections. This created a natural alliance between oligarchs and Yeltsin administration. Oligarchs, who became big bankers thanks to perestroika and shock therapy reforms, gained the control of oil companies in rigged auctions. At the end of the Yeltsin era, vertically integrated oil companies had already emerged and privately-owned national companies were producing more than 50 percent of crude oil in Russia. While the oil sector privatized and divided into pieces, the gas sector remained under the control of the state.

State's control on gas industry prevailed in the 1990s. Viktor Chernomyrdin had already managed to frame a monopolistic frame for gas industry back in 1989, and kept the industry intact taking the advantage of being the longest served premier during the Yeltsin period. At the end of the 1990s, Gazprom was a monopoly, but exploited by the managers within the company who were close figures to Chernomyrdin. Thus, different actors pursued different models for the energy sector in the 1990s, and sought to maximize their interests in different tones by taking the advantage of transition dynamics in Russia. the 1990s was really abrasive for Russian society due to political and economic turmoil. Reformists managed to prevent a setback in the political transformation, but this created an economy controlled by oligarchs and was hardly gained a competitive character. Bankers chose to invest in extractive sector with sweet potential of profit.

Putin came to power with the support of oligarchs and Yeltsin's entourage. Putin was politically an unknown figure, but he managed to accumulate people throughout his career. Unlike Yeltsin, he had already brought people from his own network to Moscow and managed to take the control of the Russian secret service, the FSB, before becoming the president. Moreover, the groups who supported Putin as Yeltsin's successor, established a political party, the Unity, to support him in Duma. When he was elected as the president in 2000, he had already a base to step on in the legislative level and a network of people to appoint to the critical positions both in the Kremlin and the government.

Political elite around Putin had a stronger integration than Yeltsin's elite. Rather than struggling with political conflicts, Putin pursued policies of centralization and concomitantly took the control of the media. The centralization made the federal structures stronger, and weakened others.

Russia had been struggling with the problem of providing resources for the economic development for some time. Putin and members of his network had a common view that energy sector was privatized in a controversial scheme and the state had to reestablish control due to financial reasons. Putin appointed members of his elite network to critical positions in the energy sector and the government brought a new tax reform to control fiscal revenues of the energy sector. Economic elite had different positions about these efforts and some chose to cooperate whereas some like Khodorkovsky decided to resist. In the end, the state passed the tax reform, took the control of the sector by using different means like expropriation, buyouts, and rigged auctions. The liberal group within the pitersky did not support methods like expropriation, but siloviki did not hesitate about the use of law enforcement units as an instrument to gain control on private assets. In his second term, the state had already established control on more than 50 percent of the oil sector and people loyal to Putin became new managers in the energy sector. In parallel, Putin reestablished control on Gazprom by reshuffling the management of the company and increasing the state's ownership to 50 percent plus one. In this period, the energy companies became important instruments of foreign policy and finance.

Foreign actors have a limited role in the new design of the energy sector under Putin's rule. They can have access to Russian market with a minority stake in the ventures or holdings as long as they provide the needed technology. Thus, the Kremlin acts as a gate keeper while giving access to foreigners to its strategic assets. The presence of foreigners even shrank further after the western sanctions against Russia, but this did not prevent Russian companies to cooperate with foreigners in the projects abroad.

To conclude, national private ownership thrived in the oil industry throughout the 1990s, but only a few privately-owned national companies managed to survive under Putin's rule. Yeltsin administration with weak political elite integration used crown jewels of Russian industry as bargaining chips to gain support of newly emerged economic elite to preserve his position and prevent a possible rollback. Privatization schemes in Russia were hardly transparent and accountable, but contributed to the recovery of the production in hydrocarbon industry and restructuring of the sector in a competitive manner in line with the global trends in the energy sector. The state became open to manipulation by the economic elite in this period, who were hardly paying their taxes. The trend reversed under Putin's rule. The state reestablished control on the hydrocarbon industry under Putin period through fiscal means and restatization strategy. However, it is not the state as a black box that managed to do this. It is mainly political elite within Putin's network who pursued the restatization strategy. Even though there is a consensus about the importance of reestablishing control on the sector, members of Putin's network pursued different means. Hardly, the control on the energy sector eliminated problems of good governance. There are problems of crony capitalism, clientelism and corruption within the sector. Vladimir Anonymous (Interviewed on June 6, 2013) claims that stronger state control under Putin's rule does not necessarily mean that different groups within Putin's network were against privatization. However, they seek to undermine the competition and with no interference from outside, it is easier to give certain concessions, licenses, or contracts through state companies to businessmen close to the Kremlin. Others claim (Interview with Anonymous on January 10, 2015) that control on the energy sector is necessary to give support to the agriculture sector, the polar region and to the military. Thus, without facing any difficulties, using the state companies, the state can easily subsidize certain sectors, regions, or institutions. In fact, both of these are

symptoms of the rentier state. State dominance in the energy sector undermines the transparency and efficiency of oil and gas resources.



CHAPTER 4

THE CASE OF AZERBAIJAN THE RESTRUCTURING OF ENERGY SECTOR IN THE PERIPHERY

1. INTRODUCTION

In this chapter, I will examine the process of restructuring of the energy sector in Azerbaijan with a particular focus on hydrocarbon resources. I argue that peripheral legacy of Azerbaijan, under the USSR, has shaped its elite structure and prevented a privately-owned energy companies to emerge in the energy sector after the independence of the country. Even though state institutions faced a great challenge due to rise of nationalist popular movement at the dawn of independence, the movement fell short of substituting the established elite. Following a short period of counter-elite rule in Azerbaijan, the established elite restored its authority. The established elite under the rule of Heydar Aliyev did not face serious challenges from economic or political elite. Peripheral characteristics of the country determined dynamics of the political economy. Elite diversity and elite capacity were low. Mono-crop economic nature and lack of access to the international markets did not allow a vibrant economic elite to emerge in Azerbaijan and the petty businessmen were far from turning into economic elite to demand share in the energy sector.

Even though there were some attempts of privatization of the energy sector during the transition period, the state preserved its control on the energy resources and the sector. Lack of a serious challenge from different elite groups and historical economic legacy of the peripheral state were effective in this result. As the control of the state on the sector consolidated in time, the State Oil Company of Azerbaijan Republic (SOCAR) emerged as a national champion. SOCAR with its upstream and downstream capabilities is a product of reforms undertaken during the 1990s and the early 2000s. It turned out to be the state-owned company that makes the negotiations with foreign companies, generates wealth in Azerbaijan's economy. Controlling this

giant, the state's role in distribution of wealth has strengthened in time and Azerbaijan's rentier state characteristics have become more visible in the 2000s after the country's oil and gas have started to flow to international markets in larger volumes.

Within the framework of the argument given above, this chapter is composed of three parts. In the first part, I scrutinize the historical background of Azerbaijan's independence with a particular reference to its peripheral characteristics and the institutions in the country. In this part, I also discuss the rise and fall of *Azerbaijan Xalq Cebhesi* (Azerbaijan Popular Front) as a counter elite movement and how it paved the way for old elite's consolidation of power under Heydar Aliyev. In the second part, I will focus on political elite integration under the Aliyevs' regime in comparison with their predecessors. This part is composed of three sections, in which I examine the political elite integration within the framework of institutional context, structural integration and value consensus. This part shows that Heydar Aliyev and his son, Ilham Aliyev, took the advantage of the Soviet legacy and clan networks under their rule and established a crony capitalist network around the presidential office. The search for stability and lack of fragmentation in ideological level helped them to preserve their power throughout the 1990s and 2000s. In the last part of this chapter, I look at the process of how the state consolidated its control on the energy sector and which reforms have been undertaken since 1991. This part shows the emergence of SOCAR as a national champion and how the state took the advantages of the petro-dollars to maximize its power in the country.

2. From Regime Breakdown to the Failure of the Azerbaijan Popular Front (APF) to Transform Counter Elite to Established Elite (1980s-1993)

Socio-political dynamics of 1980s shaped the transition process in the political sphere after the collapse of the Soviet Union. As in other member states of the USSR, the Communist Party was eliminated from the scene in Azerbaijan, but this was not a smooth process. Rising nationalist wave in the country evolved into a social movement with the deepening crisis in the Nagorno-Karabakh. This paved the way of emergence of a counter elite movement. Not being able to embrace the challenge, the Communist Party of Azerbaijan had to share the power with the social

movement. In this part, I will look at the rise and fall of counter elite in Azerbaijan by giving a historical context of political changes in the country. In this regard this part consists of four sections. In the first section I will look at Azerbaijan's status in the USSR as a peripheral state and the set-up of its institutions. In the second part, I will scrutinize the APF's rise as a social movement and in the third section present an insight about how it failed to replace the established elite in the early 1990s. Lastly, I will portray the dynamics that prepared Azerbaijan Popular Front's loss of power and the continuity in strong elite integration in the country.

2.1. Peripheral Legacy of Azerbaijan Soviet Socialist Republic

Ideological character of the communist bloc determined the institutional structure in peripheral states. According to Hunter (1994: 17) "the Soviet political system, which was repressive, overly bureaucratized, and based on the Communist Party, also caused the political and institutional underdevelopment of the ex-Soviet republics". The member states were the satellites of the center and administered by Moscow. Under this design, Azerbaijan had limited access to resources, policymaking process and institutions in the center. Naturally, it had a receptive character within the system that adopted the policies designed and dictated by Moscow.

The economic policy of the USSR was relied on industrialization, and specialization in a fashion of division of labor. In this design, natural resources determined the pattern of economic development in Azerbaijan. The economy of the country was mainly relied on agricultural products and energy sector (Alaolmolki, 2001). The economy was not developed in a diverse fashion in industrial terms and mainly producing raw materials to be consumed in other member states (Herzig, 1999: 120).

Economic system of the USSR was built upon the interdependence among the republics. Azerbaijan SSR was producing cotton and in return it was receiving meat and wheat from Russia (Aliyev's address to the TGNA on May 6, 1997). This interdependence had some constraints on the economy in local level. Moscow failed to provide the basic needs of Azerbaijani society from time to time while the situation in other Caucasian countries were better. For instance, there was shortage of meat and butter starting from the late 1970s, while the picture was rosier in Tbilisi

and Yerevan, even rationing was introduced in 1984 for certain products when the situation got worse (Aldstadt, 1992: 183).

As part of the totalitarian regime, Azerbaijan SSR had a strong party leader (party secretary), a strong secret police system, monopoly of control on the mass communication channels like radio, press, and motion pictures, and hegemony on the economy that relied on agriculture and energy sector.³⁷ In this regard, the institutional system of the state was similar, but rather a simpler version of the Russian SSR.

Security forces of Azerbaijan had limited capacity. Azerbaijani officers had limited access to the higher echelons of the Soviet Armed Forces. Azerbaijanis were represented less than Slavs within the army, due to several reasons like language and education barriers as well as the army policy (Ball, 1994; Wimbush & Alexiev, 1982). This was more obvious prior to the 1980s that the majority of Azerbaijanis were conscripted in non-combat units like construction (Szayna, 1991: 29).

Azerbaijan's elite formation under this institutional context had certain peculiarities. First, the Communist Party membership was a critical factor that determined the power structure within the system. In other words, to have access to power sources or attend to circle of elites, membership to the Communist Party of Azerbaijan was a *sine qua non*.³⁸ Second, party secretariat was standing on the top of the system and party secretary was taking his power from Moscow. Depending on the personality, family ties, and other networks this position could become even stronger. Third, the intelligence service was powerful in local level and was an important channel to provide access to means of power. Fourth, social elite or intellectuals were under the control of the system, and had limited access to power. They were active in cultural sphere and their works were under the control of the Communist Party's propaganda unit. In this regard, they had a more receptive character.

³⁷ All these institutions take their power from the Communist Party, in other words from Moscow.

³⁸ Membership to the party did not mean that the person who became a member was a full-hearted communist. Rather it was a kind of a pre-requisite to have access to the benefits of the system and protection. Some Azerbaijanis even say that they met with real Communists when they came to Turkey in the 1990s (Interview with Anonymous on May 11, 2015)

Bureaucratic institutions were rather passive and open to manipulation by the Party. Nevertheless, the party, party secretary, or intelligence service were relying on Moscow and they were receptive to the orders coming from the capital, but still had some certain level of autonomy in the administrative level.

In macro level, Moscow had power of reallocation of resources, control on the military power and ideological means. The autonomy of the member states was defined within the limits of Moscow's power and will. Its power of domination had already started to take shape in the 1920s. The Stalin period created a legacy of terror and redesigned the elite structure by its oppression and cultural policies. Until Mikhail Gorbachev's introduction of perestroika and glasnost reforms the iron hand of the state on the political and cultural spheres persisted (Bessinger, 2002: 52).

The acuteness of Soviet's problems became one of the main challenges for Gorbachev administration, but solutions under the existing design were almost impossible. Corruption, black market, and other problems in the economic and social sphere were increasing the pressure on the Communist regime. The picture was not so different in Azerbaijan. The shortages became part of daily life.

Developments in the Caucasus in the second half of the 1980s and change in political environment brought new dynamics that challenged the power of the communist elite and produced a counter elite from the ranks of social elite. This paved the way of a power shift in a short period of time. Nationalism was a major factor to undermine the power of the Communist Party in the region. People started to organize around nationalist ideas and these groups turned into main challengers for the authority of the Communist Party. Gorbachev's reform packages and outbreak of the Nagorno-Karabakh conflict prepared a favorable atmosphere for a counter elite movement to gain momentum, known as the APF.

2.2. Rise of the APF in Time of Political Turmoil

Political opening (glasnost) in Moscow accelerated nationalist/popular movements in the Baltics and the South Caucasus. "Forty-seven large demonstrations took place in

the Soviet Union” between 1985 and 1989 and most of them were in the Baltics and the Caucasus (Tuminez, 2003: 116).

Even though the revival of nationalism in Azerbaijan preludes prior to 1988, the Nagorno-Karabakh issue was a strong impetus for this to turn into a popular movement. The movement turned into an anti-communist bloc composed of mostly social elite and these people succeeded to take support of the society in the post-1990. Social change that spontaneously emerged in the system weakened the power of the Communist Party in Azerbaijan and prepared a problematic change in power after the dissolution of the USSR.

In fact, political momentum in Azerbaijan has roots that go back to the early 20th century. Baku witnessed a lively intellectual atmosphere around the debates of pan-Turkist, pan-Islamist, and pan-Socialist ideas until the Communist rule established in 1922. Nevertheless, under Stalin’s rule Azerbaijan suffered from a massive repression and this caused a deep trauma in the society as the intellectuals were exiled or killed in the 1920s and the 1940s (Gahramanova, 2009, pp. 781-782). It took almost three decades for a national consciousness to sprout once again. In the 1960s, university students at Baku University started to convene with nationalist motivations. These clandestine meetings organized by youngsters like Abulfaz Elchibey, Alim Hasayev, Malik Mahmudov, and Rafik İsmailov, but short-lived under the repressive control of the communist regime. These people later would be prominent figures of nationalist movement and founded the APF (Demirtepe, Laçiner, 2004, p. 188).

Founders of the APF were mainly born in the 1930s. They did not fight in the World War II, but grew with the memories of Moscow’s oppressive policies on the society. These faced with prohibitions and limitations regarding freedom of thought and associations. The system prevented nationalist movements to institutionalize during the 1960s and 1970s.

Glasnost reforms of Gorbachev presented a new favorable ground all around the Soviet Union. This was a break-through to change the oppressive atmosphere. Yet, the impacts of glasnost did not reach to the shores of Absheron peninsula overnight.

Kamran Bagirov, who was the leader of Azerbaijan SSR and successor of Heydar Aliyev, avoided to address perestroika or glasnost in his speeches and was slow to implement the reforms in the republic (Kehnemui, 1993: 27). In fact, the Communist Party of Azerbaijan was not in hurry to embrace glasnost, while it was safer to concentrate more on economic reforms within the context of perestroika (De Waal, 2003: 128).

Historical novels had already started to be published in Baku since the early 1980s and the interest on the culture and the history of Azerbaijan turned into researches in the academia with references to the condemned figures by the Communist ideology (Demirtepe, 1997: 144; Rorlich, 1984: 95). Micro level efforts started gain a wider range of interest in social level as the intelligentsia started to focus on the historical role of national Azerbaijani bourgeoisie and intelligentsia before the Soviet rule. Biographies and articles began to appear in different publications about historical figures like Hajji Zeynelabidin Taghiyev, Mehmet Emin Resulzade, Ahmet Agaoglu and so on (Süleymanlı, 2006, p. 215). This activism in the cultural sphere within the intellectual circles helped certain sensitivities to take form about the national identity. Yet, the demand for independence was not the case, up until the dispute with Armenia became a national concern. As the Nagorno-Karabakh issue spiraling down to a national conflict, national sensitivities were evolving into political mobilization within the society.

New associations mushroomed in the public sphere where poets, writers, university students found chance to rediscover the peculiarities of their identity, culture, language and religion in parallel with the developments in the Nagorno-Karabakh. “According to one survey, Azerbaijani’s [sic] ‘informal’ organizations, i.e., those with no legally recognized status, numbered close to forty at the end of 1988. Of this number only a few had been in existence prior to outbreak of the ethnic conflict” (Swietochowski, 1995: 196).

Nagorno-Karabakh Autonomous Oblast for a long time had been a matter of dispute between the Armenian and Azerbaijani community under the umbrella of the USSR. This caused certain disputes between these two communities even in the 1960s. Armenian community demanded attachment of the Nagorno-Karabakh to Armenian

SSR for several times and the tension between the communities even evolved into clashes in 1968 in Khankendi (Stepanakert) (Mutaflan, 1991: 118-119).

Nevertheless, the tension started to increase once again as Moscow gradually loosened its pressure on political freedoms with Gorbachev reforms. Subsequently, the existing dispute turned into an armed conflict progressively starting from early 1988.

On February 20, 1988 the deputies of the Nagorno-Karabakh Soviet voted for a resolution to transfer the control of the oblast from Baku to Yerevan. This decision had negative consequences in Sumgait, an industrial city outside of Baku, where “more than” 32³⁹ people lost their lives due to events broke out after the decision that turned into clashes between the two communities (Mutaflan, 1994: 151; De Waal, 2003: 40).

Sumgait was established in the 1940s for Azerbaijanis, who came from Armenia, and there was an Armenian minority living in the same site. However, the number of Azerbaijanis increased rapidly as a result of incoming refugees from Armenia in the second half of the 1980s (Özkan, 2008: 583). This rapid change in social structure of Sumgait coupled with rising tension between two societies led to a social explosion in the end. Following the Sumgait incident, the trauma affected the minorities respectively, which caused more than 100.000 of Armenians and Azerbaijanis left their host countries until the end of 1988 (Lodge, November 29, 1988; Popeski, December 6, 1988).

Moscow took some political decisions to control the rising tension in the Caucasus. After the clashes in Sumgait, Gorbachev appointed new party leaders in Azerbaijan and Armenia. Protégé of Heydar Aliyev, Kamran Bagirov was replaced with Abdurahman Vezirov, and Armenian leader Karen Demirchian with Suren Harutiunian (De Waal, 2003: 58-59). Moreover, Moscow established a committee to examine the dispute and decrease the tension.

³⁹ The official number of the losses in Sumgait is 32, but Thomas De Waal and Claude Mutaflan argues that the numbers might have been understated by the officials.

As the political efforts were taking shape, a company from Armenian SSR without informing the authorities in Baku started a construction in Shusha, a district of the Nagorno-Karabakh, by only taking the approval of the Communist Party authorities of the oblast. This paved the way of a protest wave in Azerbaijan as of November 1988. Thousands of people went out to the streets and gathered in Lenin Square, known as Azadliq Square after the independence. The crowd started to protest the central government in Moscow of not fulfilling its constitutional responsibilities to protect national borders. The weeks-long protests were taken under control by the security forces in December 4-5, 1988 (Lodge, December 5, 1988). Following the intervention of security forces, more than 2500 party members were disciplined and expelled from the Communist Party (Over 2,500 Azeri Communists and Officials Penalised for Unrest, January 16, 1989).

Bölükbaşı (2011: 68) argues that not until the emergence of the Nagorno-Karabakh issue, nationalist-political momentum within the society took the form of an anti-communist profile. The Communist Party of Azerbaijan was incapable of managing the deepening crisis. Consequently, the APF emerged as a serious challenger in the political sphere. This moved the fault lines in Azerbaijani politics that would lead to a leadership change under the communist rule and had impacts on the post-independence period.

At the beginning, First Secretary of the Communist Party Vezirov rejected the application for recognition of the APF as a legal entity, claiming that the Communist Party and the APF had similar objectives so there was no necessity for a new political formation (Ünal, 2001: 2). This was a natural reaction of an authoritarian administration against a rising power, which had a potential to move the balances within the system. Yet, the oppression of the Communist rule was losing its grab on the society as national revival was shaped by rising tension with Armenia and repressive policies of Moscow. This helped the APF to increase its popularity in the society and gave it the power of mobilizing people. This way, the movement became an influential political actor that attracted more people each and every day.

3. The APF's Contestation for Power: Failing to Replace the Established Elite

The APF was not an elitist movement rather it had a character of an umbrella organization. It gained power while the Communist regime collapsing and dispute on the Nagorno-Karabakh was turning into a war between Armenia and Azerbaijan. The discontent on the developments in Nagorno-Karabakh was expanding within the society and causing deepening criticisms against the Supreme Soviet of Azerbaijan.

The distinguishing feature of the base of the APF was that most of these people were not from the ranks of the Communist Party of Azerbaijan (Altstadt, 1992: 205). As indicated before the Communist Party was the source of power under the Soviet regime, but the APF evolved into a center of power itself by succeeding to mobilize people on the streets. Among its ranks there were social democrats, communists, nationalists, students, and others (Swietochowski, 1995: 199; Hüseyinli, 2001: 163). Moreover, people who were sent to jail or had to pay dues of being active during November-December events in 1988 played a spearhead role during the establishment period (Altstadt, 1992: 204).

There were 240 participants from 30 different regions of Azerbaijan in the first congress of the APF on July 16, 1989 (Tahirzade cited in Cafersoy, 2001: 16). The delegates approved the program and elected Elchibey as the leader of the movement. Following this, it started to organize strikes and meetings to mobilize the society to protest Vezirov administration's passive stance on the developments in the Nagorno-Karabakh (Altstadt, 2003: 6). Among these the most prominent one was the railroad strikes coupled with others in petrochemical and energy industry that blocked the supplies to the Nagorno-Karabakh, Armenia, which caused shortages like fuel, chemicals and machinery (Azerbaijan Strikes Continue for Fifth Day, September 8, 1989). These strikes caused a big pressure on Vezirov administration both in economic and political terms.

Strikes ended in October 1989 and the APF gained a political leverage as it proved its power during these events. In return of ending the railway blockade Vezirov agreed to fulfill 10 conditions of the APF among which there were lifting the military

curfew, legalizing the APF, and holding special session in the Azerbaijani Parliament to pass a new sovereignty law which also includes right to secede (Keller, October 13, 1989).

This was a great success of the APF. It was established a couple of months ago and managed to dictate its demands to the Communist administration. In this sense, the recognition of the APF as a legal entity was important. The power of influence of the APF as national platform to defend the rights of Azerbaijanis was extending while the Communist Party of Azerbaijan was trying to act in parallel with Moscow.

As having a loose structure, it was hard to preserve the integrity within the APF. Oktay Sultanov (cited in Cafersoy, 2001: 58) argues two strong blocs emerged within the movement in time as liberals and radicals. İsa Gamberov, Tofiq Gasimov, Sabit Bagirov, and Hikmet Hacizade were the prominent names of the liberal group and they were defending an evolutionary method for reaching the aim of independence. Whereas radicals like Etibar Mammadov, Nimet Panakhov, and Rahim Gaziyeu were in favor of a revolutionary model. This camping led to a division within the APF. Mammadov and Gaziyeu left the executive organ and established National Defense Council with Panakhov in January 1990. This was an important fracture, but the executive body of the APF embraced this decision to prevent any reflection of weakness by announcing Mammadov and Gaziyeu had the authority to establish the council with the participation of Elchibey (De Waal, 2003: 90; Cafersoy, 2001: 22).

As the APF was trying to force the Communist administration to pursue a more active stance in the Nagorno-Karabakh issue, the fragmentation within the society reached to a dangerous level in January 1990. Armenian Supreme Soviet had adopted several decisions that violated Azerbaijani control in the Nagorno-Karabakh. After the resolution of December 1, 1989, which annexed the oblast with the Armenian SSR, Yerevan accepted a program for social and economic development of the Nagorno-Karabakh on January 9, 1990. These decisions were violating the sovereignty right of Azerbaijani SSR on the oblast and ongoing violations of security in the neighboring regions along with these steps were causing unrest in Baku. Gorbachev administration condemned and voided Yerevan's decisions on January 10

and declared the steps taken by Azerbaijanis to control the situation as illegitimate (Kremlin Blasts Armenia, Azerbaijan Over Territorial Dispute, January 10, 1990). Armenian Parliament's response was to adopt another law that gives Yerevan the right of veto Soviet laws those against the interests of the Republic (Conradi, December 11, 1990).

As Moscow was losing control on the ethnic conflict, the parties started to weapon smuggling and form their self-defense units. Moreover, the clashes spread outside of the Nagorno-Karabakh. Several officials with Armenian origins were kidnapped in Shaumian and as a response Armenians kidnapped 40 Azerbaijanis (Peel, January 11, 1990). But the most dramatic development happened in Baku on January 13-14, 1990 when the anti-Armenian protests evolved into violence. Some groups tried to evacuate the apartments of Armenians living in the city and in two days period dozens were killed and more than hundred people were wounded during these events⁴⁰ (Remnick, January 17, 1990; Azerbaijan Nationalists Say Party Has Lost Control, January 19, 1990). Moscow decided to control the situation by using the forces of Ministry of Defense, Red Army and the KGB units and issued state of emergency (Keller, January 15, 1990; Dickie, January 16, 1990).

For this purpose, initially 11000-12000 security forces, of which almost 5000 were Red Army troops, were sent to Azerbaijan with the permission to shoot when necessary (Dahlburg, January 16, 1990; Peel, January 18, 1990; Imse, January 17, 1990). People attempted to prevent the deployment and advance of the Soviet forces. Thousands went to the streets to protest the Communist regime in Baku and called for an end to Moscow's rule (Killings Turn into Uprising in Azerbaijan..., January 19, 1990). Yet, Moscow was decisive to take the situation under control by use of force and decided to send more troops. The troops advanced into the capital by removing the human-made barricades on the road and opened fire to civilians. According to estimates the number of troops reached to more than 24000 when they entered to Baku on January 20, 1990 (Hamilton, January 20, 1990; Soviet Troops Fire on Nationalists, January 20, 1990).

⁴⁰ The number of people who were killed in these events span between 30 to 72 in different sources.

Soviet forces' use of fired-arms against civilians caused hundreds to be wounded and officially 83 people⁴¹ to lose their lives (Evans, January 21, 1990). Following this event, the APF called for a general strike in the country until the security forces to be withdrawn from Baku and burial of the "martyrs" on January 22 (Lyons, January 21, 1990). This dramatic event would be remembered as the "Black January" (*Qara Yanvar*) in Azerbaijan's history.

On January 22, millions of people convened on the streets to bury their martyrs (Goldberg, January 22, 1990). It was a parade of power for the APF and a sign that Vezirov lost his authority on the society when the tanks ran on the streets of Baku. People started to resign from the Communist Party. The use of violence against civilians not only cost the leadership to lose legitimacy, but also affected the social base of the Communist Party. As the authority of the party was shaken in the mainland, Nakhchivan oblast declared its independence from Moscow (Nakhichevan is a Tiny Republic which Looks to Iran and Turkey, January 22, 1990). Under these circumstances Moscow dismissed Vezirov and appointed Ayaz Mutallibov as the Secretary of the Communist Party of Azerbaijan.

After his appointment, Mutallibov was elected as the first President of Azerbaijan SSR on May 18, 1990 (BBC, May 21, 1990). Mutallibov had the support of Moscow, but he was appointed during a chaotic period to rule a country. The Communist regime was facing big challenges of existence throughout the USSR. Thus, he had to govern the Republic with limited support from Moscow. The APF was gaining popularity in Azerbaijan and the Nagorno-Karabakh issue had already become a chronic problem. Under these circumstances the country went for national elections for the Supreme Soviet in September 1990. It was a multi-party election and non-Communist candidates were running for seats in the Parliament. The APF was also running for the elections under the umbrella of Democratic Bloc, where prominent names like Isa Gambar, Etibar Mammadov and others convened together (Bölükbaşı, 2011: 158-159).

⁴¹ The APF sources claimed that the official numbers were lower than the actual number of the people killed. According to them hundreds of civilians were killed in Qara Yanvar.

Even though the non-Communists were also running for the elections it is hard to define elections as transparent and democratic. “[S]everal APF candidates were jailed and two were murdered a few days before the elections” in 1990 (Altstadt, 1992: 224). Under these circumstances, the Communist Party of Azerbaijan won the majority of the seats. Still the elections had symbolic importance; it was the first time in the Communist history of Azerbaijan that non-Communist Party members won seats in the Supreme Soviet. This would give non-Communists the chance to take politics beyond the streets. Another crucial dimension of the elections was Heydar Aliyev’s return from Moscow to his hometown Nakhichevan as an elected politician.

Mutallibov succeeded to strengthen his political position by adopting a cautious stance until the power shift in Kremlin in August 1991. But the failed coup d’état attempt in Russia became a major challenge for him. Mutallibov was in Tehran during the attempt of coup d’état and he welcomed the developments and blamed Gorbachev because of his policies (Azerbaijan President Welcomes Gorbachev's Removal, August 19, 1991). With these statements, Mutallibov took a position along with the coup designers. Hunter argues that Mutallibov’s supportive statement for the coup caused him to lose the trust of “Yeltsinites” (Hunter, 1994: 70).

The coup deeply damaged the fragile rule of Moscow over the member states further and Azerbaijan became the sixth country to declare its independence on August 30, 1991 (Boulton, August 30, 1991). Following the declaration of the independence, Mutallibov was elected as the first President of Azerbaijan in an unopposed election on September 8, 1991. The APF leader Elchibey harshly criticized the presidential elections as being undemocratic and called for a boycott, but this did not have any effect on the results (Le Cornu, September 8, 1991; Opposition in Azerbaijan Protests Presidential Vote Former Communist Chief..., September 9, 1991).

While Muttalibov was trying to keep up with the pace of change, the USSR was passing through a great transformation due to political crisis in Moscow. After the dissolution of the Communist Party in Moscow following the unsuccessful military coup, the Communist Party of Azerbaijan was also dissolved on September 14, 1991 (Le Cornu, September 15, 1991). As a result, the APF was being represented in the Parliament and emerged as a critical political actor as having the power of

mobilizing people whereas the Communist Party dissolved and its supporters had limited influence on the society.

The APF gained further power following a helicopter crash in November 20 in southern part of Nagorno-Karabakh. There were 22 passengers and among them there were the head of Shusha as well as Russian and Kazakh officials who came to the region to seek for possibilities of peace between Azerbaijan and Armenia. This incident increased the political pressure on Muttalibov and forced him to prorogue the Supreme Soviet meetings and accepting opposition's demand on establishment of National Council (*Milli Shura*) composed of 50 members. This meant change of power balance in Azerbaijan politics. The general elections held in September 1990 were rigged and Communists succeeded to preserve their power in the legislative branch, but this decision forced them to share power with the opposition as Muttalibov was facing rising tension in the Nagorno-Karabakh (Goltz, 1999: 114; De Waal, 2003: 162).

At the end of 1991 Azerbaijan was an independent country with its newly elected President Ayaz Muttalibov. Nevertheless, the Communist Party was dissolved and it was the sole political institution as the main source of political power during the 70-year of Communist rule. The new leader had to manage with the problems of the Nagorno-Karabakh problem and rising nationalism along with the state building process. Muttalibov was the president, but the dissolution of the Communist Party undermined his power as the hierarchical institutional mechanism had gone.

Ayaz Muttalibov tried to reestablish links with Moscow while strengthening his power in Baku, but Khojali massacre in February 25, 1992 was a turning point both for the president and Azerbaijan. More than 1300 civilians were killed and the massacre ignited the outrage against Muttalibov. He was criticized of being incompetent to defend Azerbaijanis and forced to resignation. The National Council called for the emergency convention of the Supreme Soviet. He could only resist until March 6, 1992 against the increasing pressure against him and finally resigned. Academician Yaqup Mamedov, who was then the newly elected speaker of the Supreme Soviet, became the acting President of Azerbaijan for the interim period

(Killen, March 9, 1992). Then, the Parliament took the decision of making presidential elections in three months' time.

On the way to the elections, the Nagorno-Karabakh conflict continued to deepen and expanded towards the towns those are not within the borders of the autonomous region, like Sussha, Agdam and Askeran. As a result, Mamedov also started to face increasing political pressure, but he nor had the support of the society, nor the APF. Taking advantage of Mamedov's political weakness, the Supreme Soviet reinstated Muttalibov as the president in May 14, 1992 at an emergency session (Steele, May 15, 1992). In fact, this shows in spite of the dissolution of the Communist Party, the established elite was still strong in political terms.

Muttalibov's first decision was cancelling presidential elections in June and declaring state of emergency, but he could not succeed to remain at power for so long. Thousands of APF supporters gathered next day in front of the Presidential Palace and he had to flee to Moscow. Following Muttalibov's overthrow; Isa Gambar was elected as the acting President until the elections. (O'Ballance, 1997: 62). Moreover, National Council took over the control and discredited the Supreme Soviet (AFP, May18, 1992). Thus, Muttalibov, who was the leader of Communist Azerbaijan, became a trivial actor for Azerbaijan's politics after his failed attempt to reclaim power. This was also a failure for the Supreme Soviet of Azerbaijan, which was dominated by former Communist Party members.

This was an attempt of regaining power by the former Communists, but they failed because they had lost the public support long time ago. The elections were carried out as expected in June 7. Elchibey was elected as the President of Azerbaijan by taking almost 60 percent of the votes (Seward, June 8, 1992).

Fall of Ayaz Muttalibov and election of Abulfaz Elchibey as the next president of Azerbaijan has a symbolic importance. Following the failure of bringing back Ayaz Muttalibov the opposition strengthened its equal footing via the National Council. Elchibey became the first non-Communist leader of Azerbaijan and both he and the APF gained access to presidential authority, which was a big obstacle for them

before. Yet, the Nagorno-Karabakh issue still remains unresolved on the table along with the socio-economic problems of the newly established state.

The APF and Elchibey proved themselves in terms of mobilizing people and challenging the established elite in Azerbaijan. The main position of the APF had been to play an opposition role instead of taking responsibility to govern since its establishment. January 1990 was a critical juncture for Communist Party to lose legitimacy within the society as the use of force caused civilians to lose their lives, but helped the APF to gain further popularity. Entering to the Parliament after the elections in September 1990 and then the establishment of National Council, which gave the chance of balancing the Communists in the administration, strengthen the APF's political power in legislative mechanisms. In other words, the shift in power balances removed the obstacles in front of the APF, but the new political dynamics was not easy to tackle with for a counter-elite movement. The APF was a loose organization that brought different groups together. Instead of bringing people around crystallized values and objectives, the main motivation for its constituency was opposing the Communist regime and incapacitated policies towards the Nagorno-Karabakh conflict. Moreover, the APF's leaders were members of the social elite, lacking political experience. It had the support of the streets, but it lacked human resource equipped with necessary experience and capability in bureaucratic and political level.

These deficits caused the APF and Elchibey government to face with serious problems following the elections. In economic terms the country encountered with serious problems due to decreasing output, particularly in the energy sector. The oil production had entered a declining trend the total production was 11.2 million tones for 1992. This was 2 million tones less than 1989 production. The existing wells were being closed and not being replaced due lack of investment (Azeri Oil Sector Crisis, May 8, 1992). As a result, the current level of production was only used for domestic production and not enough to bring export revenue for the country. On the other hand, the war on the Nagorno-Karabakh was getting warmer and this was causing the existing limited sources to be channeled to the battlefield.

Subsequently, the APF government had to start vitally important reforms of state building in time of war and it had to operate within the limits of poor financial and human capital to cope with rising challenges. Instead, the APF people were working based on goodwill, but even most of the high-level positions were not filled with high-qualified (*pishekar*) people who had experience in state bureaucracy (Interview with Anonymous, September 6, 2013; September 5, 2013; İrfan Ülkü's interview with Bahtiyar Vahabzade, August 31, 1993).

In the end, the APF faced with many difficulties in economic, security and political terms. The movement rose to power with the support of the streets with its nationalist and anti-communist discourse. However, coming to power with the social support was not enough to establish control on the state and preserve political power without necessary means. Even though president of the newly independent state had changed, cadres in the state institutions remained mostly untouched and political appointments were not enough to mobilize these institutions as the new ministers had almost no experience of government and limited access to the people in bureaucracy. Lack of a disciplined army and ongoing war in the western part of the country was posing threat to regime security. There was a tsunami coming against Elchibey and the APF, but they had limited resources to resist against the upcoming challenge.

3.1. Falling Counter Elite and Continuity in Strong Elite Integration

The APF was a nationalist movement and its leader Elchibey had a strong Turkic emphasis in his domestic and foreign policy. The nationalist characteristic and anti-Communist stance of the movement shaped anti-Russian foreign policy of Azerbaijan. There were several issues that conflict with Russian interests in Azerbaijan like the future status of Russian troops in Ganja and Azerbaijan's negotiations with the Western companies on Azerbaijan's energy resources. Baku rejected CIS membership in September 1992 and demanded withdrawal of Russian soldiers from the country. Moreover, bypassing Russian companies, Baku started to seek ways of signing oil energy contracts with the West (Skibinskaya, June 4, 1993). These were steps that would definitely curb Russian dominance on Azerbaijani politics in militaristic and economic terms. Goltz (1993) argues that the decisions that undermined Russian presence in the country changed the trend in the battlefield.

Baku had started to advance on several fronts, but this did not take long and Moscow chose to manipulate certain cliques inside Baku.

Initial Russian reaction was to control the situation by using its links within Azerbaijan to preserve its dominance in the country. Russia had succeeded to form links not only with Muttalibov, but also Defense Minister Rahim Gaziyeu. Elchibey revealed Rahim Gaziyeu's relations with Russia and in a closed meeting of the Parliament he shared the Defense Minister's telephone talks of with Russians (Ülkü, 2000: 49). In spite of Russian ambassador to Baku's efforts to protect Gaziyeu, he was disqualified in February 1993. As a response, Russia froze Azerbaijan's accounts in Russian banks and moved together with Armenia in Kelbejar's occupation. (Cafersoy, 2001: 106). Moreover, as Russian troops withdrawing from Ganja, they left their arms to Surat Huseynov's control instead of Azerbaijan's Defense Ministry.

Huseynov had close relations with Gaziyeu and Muttalibov. He was a former factory director, but made a fortune through some illegal activities and later became the chief of a paramilitary group to fight Armenians. He was one of the actors who played an important role to advance Azerbaijani troops in the battlefield against Armenians. Self-appointed colonel, Huseynov had autonomy with his armed men, between 2000 to 3000, in the absence of a disciplined army.

After Gaziyeu's fall, Elchibey also sacked Colonel Huseynov and blamed him for several defeats in the Nagorno-Karabakh (Azeri President Sacks Commander after Defeats, February 23, 1993). Huseynov left the battlefield and retreated to Ganja to the barracks of Russian 104th Airborne Infantry (Goltz, 1993: 114). Russians withdrew from the country earlier than planned and Huseynov got access to Russian army's weapons at the end of May 1993 (Azerbaijan on Military Policy and Concern over Speed of Russian Withdrawal, June 3, 1993; Balmforth, June 9, 1993). Following this, Huseynov started a riot in June and captured the control of Azerbaijan's second biggest city, Ganja. Afterwards he began marching to Baku with his forces on June 5, 1993 (Rafaelli, June 7, 1993). Concomitantly, Elchibey sent a plane to Nakhchivan and invited Aliyev to Baku. The envoy turned back empty handed, but later Elchibey insisted for Aliyev to come to the capital and sent the

envoy a couple of times more. Aliyev, decided to leave for Baku on June 9, 1991 and following the resignation of Isa Gambar he was elected as the speaker of the Parliament on June 15 (Xalq Qəzeti, July 6, 1993, No: 105).

As Huseynov marching towards Baku, the pro-Elchibey troops withdrew back to the capital. In his statements to the press, Huseynov conditioned the resignation of the President to stop his march (Azerbaijan Rebel Leader Rejects Talks with President, June 23, 1993). Subsequently, Elchibey left Baku for his hometown Keleki village in Nakhchivan on June 18 without informing anybody. A high-level bureaucrat says that he was one of the few people who saw him the night before he left the city, but even he did not have any idea about his plans to leave the capital (Interview with Anonymous on September 6, 2013).

Leaving Baku was not an official resignation for Elchibey, but caused a power vacuum. There was an ongoing war with Armenians and the newly independent state had to re-establish its institutions and tackle the existing problems. Aliyev stepped forward to take the responsibility, but this also meant the end of Elchibey period. As the speaker of the Parliament, Aliyev stated in his press briefing on June 20, he tried to do his best within the limits of his authority, but of the leader of the country and the commander of the Armed Forces was not in Baku and this created a grave challenge to tackle the problems (Aliyev Press Conference - Elchibey Still in Control, Aliyev not Exceeding Powers, June 23, 1993). Aliyev was giving the message that he was acting within the limits of the rule of law, but he needed more power to control the situation if Elchibey would not return.

Aliyev stepped forward at the right time to fill the power vacuum. At a time when each and every leader in the last five years period failed one after another. He had certain advantages compared to his predecessors, but he also had to consolidate his power.

Heydar Aliyev was not the President of Azerbaijan when Elchibey left the capital for Keleki in 18 June 1993, but he had the capacity of the speaker of the Parliament. This was an important advantage for Aliyev in political terms since his new position constitutionally gave him the power of assuming the responsibility of the president in

case of his absence. Nonetheless, he lacked the legal and legitimate authority to act in full capacity of the president before being elected by the society.

Aliyev pursued a three-phased strategy to become the president. These were waiting Elchibey to turn back to the capital while managing the ongoing state crisis; stripping off Elchibey's power and testing his popularity among the society with a vote of confidence by taking the support of the Parliament; and going to the presidential elections. Throughout this process Elchibey made certain statements from his hometown, but did not come to the capital to assume his responsibilities. In the end, Aliyev's strategy smoothly eliminated Elchibey and carried him to the presidency.

In the beginning of 1990s, roughly there were two main blocs in the Parliament. One group was former Communist Party members and the other was belonged to non-Communists with nationalist stance. Aliyev was away from the Baku politics for a long time and he was not part of the existing divide that took shape in 1990 onwards. However, he needed the support of the Parliament to manage the crisis within the limits of politics. He did not push for it, rather chose the political dynamics to work naturally. But he was also not shy to give the first signal that he was ready to govern the state.

Aliyev declared he would assume the responsibilities of the President the day after Elchibey left the capital (Nouaille, June 18, 1993). This was a critical move in time of uncertainties to give message to the society and the elite that Aliyev was ready to lead the way out of the crisis and he made this by reiterating he was acting within the limits of the constitution (Aliyev Press Conference - Elchibey Still in Control..., June 23, 1993):

Several foreign information programmes claimed, particularly after my television appeal to the people, that Geydar Aliyev had assumed presidential authority, but that is illegal and cannot be possible. I wish to inform you at this time that the president is in Azerbaijan and I have not assumed his duties. Nor can I do so.

This was not only a statement for the domestic audience, but circulating in the foreign press. Aliyev was giving the message to the world that he knew the rules of the game and just acted within the limits of the rule of law. While Aliyev was

cautious about his statements, the debate in the Parliament about the impeachment of Elchibey gained momentum. After the appeal for the president to turn back to Baku on June 21, the Milli Majlis gathered in June 23, 1993 and head of Istiqlal Party Etibar Mamedov presented a draft resolution for impeaching Elchibey and transferring his power to Aliyev (Milli Majlis Debates Impeachment of Elchibey, June 25, 1993). The resolution discussed in the Parliament under the threats of Huseynov who demanded the resignation of Elchibey. In the end, the Parliament voted for Elchibey's impeachment by 33 votes in favor, three against and one abstention; ten Popular Front deputies loyal to Elchibey walked out before the vote was taken (Azeri Deputies Vote to End President's Powers..., June 25, 1993; Former Azerbaijan Communist Chief Given Presidential Powers, June 25, 1993). Finally, the Resolution No. 608 transferred the Presidential power to Heydar Aliyev.

Following the decision of the Parliament on his removal from the power, Elchibey also emphasized that the people brought him to power and people should give the decision to take him down (Elchibey Ousted by Baku Parliament, June 25, 1993). In this sense, one of the handicaps of Aliyev was that he was given the power by the Parliament, but he also needed the approval of the people for his legitimacy. The Parliament took a decision of a national vote of confidence in Abulfaz Elchibey at the end of July (Azerbaijan Calls Confidence Vote in Fugitive Leader, July 29, 1993). The referendum was held at the end of August and only 2.1 per cent of the voters supported him while 97.5 per cent voted against him with a turnout of 92.02 per cent (Xalq Qəzeti, 3 September 1993, No: 135). Following the approval of the results of the referendum the Parliament was set to next presidential elections in October.

The presidential elections were held at October 3, 1993. The APF called for the boycott for the elections, but this had limited impact. Aliyev received 98.8 per cent of the votes (Xalq Qəzeti, October 8, 1993, No: 155). The two other candidates were Zakhir Tagiyev, a businessman and head of the fringe Humanitarian Party, and Kyarar Abilov, who heads the United Azerbaijan Party.

Even before the elections, change in political atmosphere can be easily seen from the printed issues of Xalq Qəzeti. Aliyev started to appear at the first page in each issue

starting from the beginning of July. His appearance on international media or his diplomatic meetings with foreign delegations were the main topic of the newspaper. Almost half of the 4-paged newspaper was spared to messages of world leaders for Aliyev following the election on October 20 issue of the Xalq Qəzeti. Thus, Aliyev incrementally built up his legitimacy in political and social sphere with a well-designed strategy.

Rise of former-Communist leader to the presidency once again had some political implications and meanings. First, the fall of Elchibey from power with the engagement of the Parliament and then a national election helped him to minimize and, up to a certain extent, eliminate debates on legitimacy. Secondly, the non-Communist bloc failed helping Elchibey to protect his position, and rather some of them chose to remove the obstacles before Aliyev's rise to power. Considering the fact that Etibar Mamedov was the person, who proposed the resolution to impeach Elchibey and transferring power to Aliyev, was critical to show Aliyev took not only the support of unknown figures, but also charismatic names within the political sphere. Fall of Elchibey not only eliminated the romantic leader from the Azerbaijani politics, but also practically meant dramatic loss of power for the APF. Third, well-known figures did not run for the presidency against Aliyev rather chose to step aside or boycott the elections.

This was a beginning of a new period in Azerbaijan. Heydar Aliyev who left the country in 1982 took over the leadership after a long break of eleven years. Throughout this period five different leaders; Bagirov, Vezirov, Muttalibov, Mammedov and Elchibey, governed Azerbaijan. Elchibey was the first democratically elected leader, but several dynamics prepared his fall from the presidency. Some of these dynamics were related with the characteristics of the APF and others on the conjectural developments in the country. Elchibey came to power with a support of a social movement, but the APF movement was lacking the governing experience. A Member of the Parliament (Interview on September 9, 2013) explains this phenomenon as:

Elchibey's team was not formed of *pishekars* (well-qualified personnel). The APF sought for loyalty in its appointments, but these people professionally were not capable enough to carry out responsibilities that they were appointed to

do...Moreover, the APF had no ideological, economic, or foreign policy perspective and this deficiency deepened the problems and prevented a smooth transition in the country.

The APF failed to evolve into an elitist structure from a counter elite movement to substitute or co-opt the established elite. Additionally, the legacies of the Communist regime prevailed to be an important barrier for Elchibey as he pushed for a new system with his limited sources.

The ongoing war with the Armenians was the soft underbelly of the regime. First, it was consuming the limited financial resources of the government, which was necessary during the state building process. Second, the chaotic structure of the battlefield was an advantage for warlords to gain political and economic power. The final straw was Huseynov's march to the capital and the direct security challenge forced Elchibey to leave the presidential office for Keleki.

In spite of existence of favorable atmosphere for Aliyev, the country was facing grave territorial problems. In the south, the Talish leader Alikram Humbatov declared independence whereas Armenian forces easily advanced in the battlefield and took the control of territories of Azerbaijan other than Nagorno-Karabakh. He easily engaged with the problem in the southern part of the country and took the problem under control. Nagorno-Karabakh was bigger than the Talish problem and needed to be dealt carefully considering the fact that the issue has shaped the political scene in the last five years. Aliyev would be focusing on this problem, while investing in political consolidation in Azerbaijan. His past would bring some advantages for him throughout this process. However, Aliyev's turning back to Baku politics meant the fall of the APF after failing to replace the established elite whereas strengthening the power of Aliyev's old network's hold on Azerbaijani politics.

4. Strong Elite Integration with Weak Confrontation under Aliyevs Rule (1993 Onwards)

Azerbaijan was in a conflict with Armenia when the USSR collapsed in 1991. This prevented a normal transition process to start in the country. Azerbaijan was on the edge of turning into a failed state due to setbacks on the battlefield and attempt of

coup d'état of Surat Huseynov. Under these circumstances Heydar Aliyev replaced incumbent President Abulfaz Elchibey in summer of 1993. The period that has started with Heydar Aliyev paved the way of a state building process to go on in a relatively stable fashion with the rise of Aliyev network based on his close circle, while it meant the fall of the counter elite movement, the APF.

In this part, I will examine the elite structure. For this purpose, this part consists of two sections. In the first section I will look at the very characteristics of political elite integration in the country under Heydar Aliyev and Ilham Aliyev. In the second section, I will scrutinize the context of political economy of peripheral Azerbaijan by looking at the privatization process in the country and the socio-economic features of elite formation to have a deeper understanding of the elite structure.

4.1. Construction of the Aliyev Regime: Strong Political Elite Integration

Heydar Aliyev's rise to power was different than his predecessors because of his formal and informal networks in Azerbaijan. Before being the party secretary, he was the boss of the intelligence service of Azerbaijan. He ruled the country for 13 years as the party secretary and later became a member of the Politburo in Moscow. Coming from Nakhichevan, he had strong family links with powerful clans in the country. Above all, Aliyev was a strong leader who had a vast experience in politics as being a person who had been in the higher echelons of the Communist politics since the 1960s. All these factors turned into advantage and helped him to consolidate his power after becoming the new leader of independent Azerbaijan in 1993.

Aliyev was successful to convert these advantages into assets rather than liabilities. First, his legacy in the country's institutions was not totally destroyed during his absence since 1982. Thus, he had familiarity with the cadres in bureaucratic and political level. In the political sphere he faced with some challenges, but due to social and political dynamics in the country it was hard to talk about a well-established or institutionalized political opposition against him. Second, Aliyev had a peculiar advantage of having access to informal network structures such as strong clan networks, which was an important asset for him in the absence of well-established

formal networks in the country. Lastly, in value basis Azerbaijan's peripheral dynamics shaped the value systems in the country; rather than an environment divided into camps of different values, ideas were taking shape around nationalism or new concepts like open market economy, capitalism and democracy. Still these remained in a discursive level and did not play a crucial role in terms of dividing political spectrum into different blocs. Old communists became new anti-communists, the concepts changed, but used as slogans rather than turning into new policies. Throughout this period the figures remained the same. In the end, all these factors served to the interest of Aliyev and instead of facing challenges from different elite groupings he consolidated a strong network of elites loyal to himself. After Heydar Aliyev's 10-year rule, his son Ilham Aliyev became the fourth President of the Republic of Azerbaijan in 2003. Ilham Aliyev preserved his father's legacy and continued to work mostly with the same cadres by making some modifications. In this regard, his period can be described as period of continuity rather than transformation.

In this part, the political elite integration under Aliyevs will be examined within the framework of institutional context, structural integration, and value consensus. Looking at these components it can be seen that Aliyev led the period with the cadres that came to position during his rule and there was no conflict of different positions in terms of ideas or values in state building process in Azerbaijan. The very basics of the system has not changed rather consolidated under his son's, Ilham Aliyev's, rule. Rentier state features of Azerbaijan has become more apparent with windfalls in the oil market and increasing oil and gas production in the 2000s. The economy's dependence on oil has contributed to the peripheral characteristics and choked the development of autonomy of political and bureaucratic institutions further.

4.1.1. Institutional Context of Political Elite Integration During Aliyevs

Soviet past of Azerbaijan shaped institutional context of the country as these institutions and their elite managed to survive in the transition period. During the Soviet period the administrative system in Azerbaijan had a rigid, hierarchical, and deeply personalized nature. Party secretary was a strong figure, but institutions, other than the party and the intelligence agency (KGB), had an underdeveloped character

under the dominance of the secretariat. After the independence, Muttalibov and Elchibey failed to transform the system and the state institutions remained intact. Thus, historically shaped bureaucratic and political institutional basis set up a certain framework for Aliyev to operate when he came to power.

Heydar Aliyev's personal skills and links helped the former Communist leader to consolidate his power easily and resist challenges against him (Interview with Anonymous on May 11, 2015). Aliyev was the head of KGB in the 1960s until he was appointed as the First Secretary of the Communist Party of Azerbaijan SSR in 1969. He stayed in this position until he became a Politburo member in 1982 in Moscow. Aliyev replaced Veli U. Akhundov to restructure the system. The economy in Azerbaijan SSR failed to show a good performance after the World War II, due to organized corruption shaped by mafia networks.

Aliyev's KGB career was critical in his past. Being one of the few centers of power in the peripheral Azerbaijan, the KGB was special apparatus of the party to control the society, which had a strong legacy from the Stalinist period. Aliyev had the advantage of forming a team and have access to delicate information.

After becoming the party secretary, Aliyev followed a policy of promoting people loyal to him while he was the KGB boss and the party secretary. During his rule he made a dramatic shuffling in the cadres and appointed people close to him. Political elite in the republic changed almost entirely under Aliyev's rule between 1969 and 1982 (Willerton, 1992: 194-195). Aliyev "was responsible for appointing and promoting members of the state bureaucracy...many of whom assumed senior positions when Azerbaijan gained its independence in the 1990s" (Rohozinski, 2005: 12). His appointees remained intact "as long as his supporters remained in power" even after his leave for Moscow, but some non-KGB oriented Nakhichevanis were singled out after Bagirov's fall (Altstadt, 1992: 180-181).

Compared to his successors, Aliyev was more advantageous when he came to power in 1993. Thanks to his supporters in different levels of state institutions he had natural access to different bureaucratic mechanisms. Just after coming to the office in 1993, he replaced ministers of defense, internal affairs, and foreign affairs with

people from his past, and also appointed loyal bureaucrats in these ministries with whom he shared a common working language. Most of these people had been educated and socialized in the same Soviet institutions (Radnitz, 2012: 62). In this regard, what Elchibey failed to do in state building process was an easier task for Aliyev. He had better access to the pool of human resources, and he chose to establish a system around the presidency based on loyalty.

Both Muttalibov and Elchibey failed to form a team during their rule. One of the main reasons of Aliyev's success was -apart from Bagirov- none of his successors could catch the chance to survive in the leadership of Azerbaijan for a long period of time due to political imbalances in the country. This limited the damage to be done on Aliyev's legacy in the bureaucracy.

When Aliyev left Baku for Moscow, he left his protégé, Kamran Bagirov, as his successor. He preserved his power of influence with Bagirov in Azerbaijan up until 1988. Yet, Bagirov lost his power when Gorbachev decided to curb Aliyev's power in Moscow. Gorbachev discharged Aliyev from his position in the Politburo following his heart attack in 1987. He was appointed to a passive position and kept under control in Moscow. Following Aliyev's pacification, Gorbachev also discharged Bagirov and appointed Abdurrahman Vezirov as the First Secretary of the Azerbaijan Communist Party. Gorbachev was expecting Vezirov to pursue policies that will undermine Aliyev's influence in Azerbaijan's politics.

Nevertheless, Vezirov was a poor choice. He was not fluent in Azerbaijani and as a diplomat he lived abroad for a long time before coming to power and he was a stranger to the country and the society (Barylski, 1994: 394; Interview with Anonymous on September 4, 2013). He was hardly popular in the country. He was seen as a proxy of Gorbachev. In the second half of the 1980s, being perceived as Moscow's man was something negative because there was a wide belief in the society that Gorbachev planning to give Nagorno-Karabakh to Armenia (Interview with Anonymous on 17 December 2013).

After taking the charge, Vezirov gave start to certain inspections about Aliyev period and found out certain problems of manipulation (*pripiska*) on cotton production.⁴² This initiative remained futile and the attempt of undermining Aliyev's prestige through the investigation fell short. During his 20-months stay in power Vezirov failed to implement large scale policies that would shuffle the cadres employed during Aliyev period. Several reasons can be articulated here, but the most prominent one was the rising ethnic dispute in the Nagorno-Karabakh oblast. It had political implications on Baku politics; it occupied the political agenda more than any other thing in the administrative level and also consumed Vezirov's limited political popularity rapidly.

Vezirov's rule ended at the beginning of the 1990 and Ayaz Muttalibov replaced him. Muttalibov's period coincides with the dissolution of the Soviet Union. After coming to power Muttalibov synchronized his policies with Moscow, but change of power in the capital did not help him to survive politically against the nationalist wave coming against the Communist ideology.

Vezirov and Muttalibov had to focus more on controlling the unrest in the society and facing the challenge of rising nationalist movement, the APF. As explained in the previous part, problems in social and political level forced Communist leaders of Azerbaijan to come closer to Moscow or choose for harder measures to control the social upheavals. These strategies had certain political consequences for these leaders to lose their seats and the APF leader Elchibey to take over the leadership after the independence.

Elchibey stayed in the presidential office for one year. He had to focus on the conflict with Armenia and the dynamics of breaking away from the USSR. Yet, he had limited human resource to lead the country out of this chaotic spiral. In one of his interviews with Adalet Tahirzade (2001: 84-85) Elchibey stated that Ministry of National Security (KGB), Ministry of Interior Affairs, and Ministry of Defense

⁴² This issue is known as *pripiska* (manipulation on production figures). Some low level officials were sentenced due to this corruption scandal whereas party leadership went almost unpunished. For further information refer to Hann, C. M. (Ed.). (2003). *The Postsocialist Agrarian Question: Property Relations and the Rural Condition* (Vol. 1). Münster: LIT Verlag Münster.

worked against his government. He further said that it was easy to change the minister or high-level staff, but they faced with certain constraints to substitute mid-level personnel with their alternatives due to lack of experienced human resource.

Elchibey was leading a social movement with nationalist euphoria rather than an elitist cadre who had experience on state governance. Thus, he had a limited maneuvering political space and tools to implement his policies with a team that had enough experience and capability to rule the country. Rather he had to face with resistances in bureaucratic and political level. In the end, he was left alone when a warlord challenged him from Ganja.

Elchibey needed at least three to five years to leave behind the existing constraints, but his rule survived only for one year. Kamrava (2001: 231) argues that it is hard to ensure the loyalty of rank-and-file bureaucrats, but bureaucracy was less malleable in Azerbaijan. Thus, Elchibey could not survive with a bureaucracy whom he had limited access. Elchibey argued that these mid-level staff faced with a shock when the social movement gained momentum, but in three to four months' time they recovered and cooperating with Russian intelligence started to undermine his government's power (Tahirzade, 2001: 84-85). It is hard to blame each and every bureaucrat to conspire against Elchibey, but it seems that he lost the base that he could step on shortly after he came to power. In the end, Elchibey came to power with a serious popular support, but could not stay for long. Just like his successors, Elchibey's appointments in the state apparatus were very limited. He managed to make changes at the high-level positions rather than a dramatic shuffling.

The APF was a counter elite movement and its members succeeded to take down the Communist Party. However, having insufficient resources to fill the power vacuum with people who had limited access to state apparatus, the APF failed to stay on power in the transition period.

The period between 1982 and 1993 was in the advantage of Aliyev since his successors/predecessors had limited time to make serious changes in the system. Still he needed to take the control in his hands after coming to power. Due to ongoing war with Armenia and collapse of the Soviet Union the whole system was in transition.

“Monopoly on the use of force had collapsed to such a degree that power in 1993 was roughly commensurate with the number of armed men a person controlled” (Cornell, 2011: 84). The political environment can be described as the Hobbesian state of nature in Azerbaijan. In the absence of a leader in the capital who had control on the system, it was unlikely to tackle menace emerging from different directions.

A former factory manager, then became a warlord, Surat Huseynov was one of these figures that had armed man under his control. His rebellion in Ganja was a turning point that forced Elchibey to fall, but paved the way for Aliyev to turn back as a powerful politician. When Elchibey left Baku, Aliyev took over his responsibilities as the speaker of the Parliament, but he was not alone on top of the state. Huseynov also had political ambitions. In one of his interviews to international media Huseynov said that "a power vacuum has been created and the reality of today's situation does not allow the chairman of parliament to take responsibility on himself...so I am obliged to take all responsibilities and powers on myself" (Reuters, June 22, 1993; Associated Press, June 22, 1993).

Using different political channels, Aliyev indirectly pushed for Elchibey's resignation in this interim period while legitimizing his position. His insist on becoming the speaker of the Parliament was a strategic move; this way he could take over the responsibilities of the presidency in the absence of Elchibey.

Elchibey's leave for Keleki paved the way for Aliyev's reach to power. He took the support of the Parliament and became the acting president as Elchibey stripped off his authorities by the Parliament in June 1993. This was a major political victory for Heydar Aliyev, showing that he had the support of the Parliament.

Aliyev received two-third majority of the Parliament. However, it should be noted here that in 1993 the former Communist Party members were still controlling half of the seats and the rest of the delegates were the people who actively struggled for independence in the last five years' period. Thus, for these people Aliyev was a known face and seen as an important alternative, and the old-guard played a critical role.

Even if Aliyev had a political support of the Parliament, the state institutions were in a shabby situation and there was an ongoing war. Primarily, non-institutionalized structure of armed forces was not something favorable for Aliyev as Huseynov was threatening the capital with his men. After Aliyev took over the office he met with Surat Huseynov in Baku for several times (Aliyev and Guseynov Meet in Baku and Affirm Their Commitment to National Accord, June 28 1993; Guseynov Discusses Government Role at Meeting with Aliyev, June 29, 1993). Aliyev did not hesitate to let Huseynov to take over the position of Prime Minister with an authority over Ministry of Defense and Ministry of Interior (Rebel Leader Named Prime Minister of Azerbaijan, June 30, 1993). This helped him to keep Huseynov under his control and let “the national hero” to take the burden of any failure in the battlefield.

Unlike Aliyev, Huseynov was a new face in Baku. His experience and network within the state institutions cannot be compared with Aliyev’s. As being a former factory manager, he had limited experience to deal with the politics of the capital. These facts isolated Huseynov in the cabinet and also within the institutional structure as he came to the office with his own capacity, but no loyal team to help him take the control of the ministries. Once in a while he was going to his stronghold, Ganja to organize another plot against the president (Ülkü, 2001: 215). As the young prime minister was working on different plots, Aliyev took this as a chance to eliminate political challenges from outside and inside while consolidating his power in institutional level.

As soon as being elected, Aliyev focused on a ceasefire agreement between Armenia and Azerbaijan along with the energy deals with foreign companies. The ceasefire would have impact of downsizing the social unrest linked with the ethnic conflict, pave the way of stability for new energy deals and decrease the potential of a conflict in domestic politics. In this regard, Aliyev opened a new page with Russia and agreed to attend the Commonwealth of Independent States (CIS) (Azerbaijan now officially CIS member, September 24, 1993; Azerbaijan Joins CIS, Hopes for Cooperation, September 24, 1993). Later, Moscow prepared the necessary conditions for a ceasefire with Armenia and an agreement was signed in May 1994 (Ljunggren, May 16, 1994; Kasım, 2009: 34).

The ceasefire and co-opting Huseynov helped Aliyev in two ways. First, the ceasefire helped Aliyev to eliminate any synchronized move against him from inside or outside using the Nagorno-Karabakh issue as in the case of Elchibey. Second, integrating Huseynov to the official mechanisms, Aliyev had chance to oversee Huseynov and gain sometime to strengthen his hold on security forces against a possible revolt.

There was no full-fledged army under the control of Baku during the Soviet period. Furthermore, Azerbaijanis had limited access to military establishment in the USSR. Azerbaijanis were conscripted in the Red Army, but were given inferior jobs. Thus, neither there was a regular army with a strong hierarchy in the post-1991 within the borders of Azerbaijan nor the necessary human resource with a military experience who had positions in the higher echelons of the Red Army. Under these circumstances paramilitary groups and corruption were valid currencies in the military sphere when the war broke out with Armenia. Rasizade (1997: 278) summarizes this phenomenon as:

Azerbaijan's ragtag military, hardly deserving the name of a regular army, navy, or air force, has a record of ineffectiveness, low morale, entrenched corruption throughout its ranks, mass draft dodging, stolen ammunition and resold weapons, unfed and ill-trained conscripts (with exception of the black-clad presidential units), and abuses by the military brass who build personal villas or simply siphon off resources from war appropriations.

Under these circumstances, Aliyev primarily focused on the discipline and morale, as there was an ongoing war within the borders of Azerbaijan. Nevertheless, the problem was so grave that there were organizational problems. He "staged a series of open trials of high-ranking officials and generals, revealing high treason and betrayals ranging from the surrender of Azerbaijani towns in a bid to topple the government in Baku, to selling –via Georgia – Azeri gasoline to fuel Armenian tanks" (Rasizade, 1997: 278). Aliyev told İrfan Ülkü (2001: 202-203) in one of his interviews that the main reason of the failure in the battlefield was the absence of a regular army with an organic link to the state:

Different groups fought against Armenians without any coordination. Armenians took this as an advantage to occupy Azerbaijan's territory...Another problem was the deserters

from the Army. When I came to power there were several suggestions like death penalty to stop this phenomenon. Rather I chose to make a call to these people and said that I would pardon fugitives if they turn back to the army...Moreover, I told the society and soldiers that nobody would come to save us, we had to protect our motherland together.

Aliyev was wise enough to invest into the control on the armed forces. Bayulgen (2010: 100) argues that “Aliyev was able to sustain his unchallenged rule by controlling the ‘power ministries’: the army, the Ministry of Internal Affairs, and the Ministry of National Security”. In fact, this had its payoff when Surat Huseynov with Rovshan Jevadov, the commander special forces of Ministry of Interior Affairs (OMON), attempted a coup d’etat in September 1994. The armed forces stood against this move and took sides with the president (Ülkü, 2001: 224; Van Der Leeuw, 2000: 186). Considering the neutral stance of the military forces in June 1993 when Huseynov threatened Elchibey, this was an important indicator to show difference in Baku one and a half year later. This was not something happened spontaneously. In fact, Aliyev’s concentration on corruption within the army helped him to eliminate disloyal personnel and substitute them with loyal ones. This way he had a better control on the armed forces.

It is important to note here that apart from taking the support of the army on his side, Aliyev also mobilized the society to defend the republic. Appearing on national television he called people to convene in front of the Presidential Palace and blamed Huseynov of the plot (Azerbaijan Leader Says Coup Being Prepared, October 5, 1994; Aliyev Appeals to Nation for Support After Fall of Gyandzha, October 6, 1994). Thousands of Azerbaijanis responded to Aliyev’s call in the midnight. Rovshan Jevadov unexpectedly declared his loyalty to Aliyev and took over the security of the crowd (Javadov Responds to Aliyev's Call for Support; Apparently Loyal to President, October 6, 1994). Subsequently, Huseynov who was trying to mobilize his forces once again in Ganja was left alone. Huseynov’s forces took the control of the airport and key government buildings, but could not resist long against the loyal forces to Aliyev (Lieven, October 6, 1994). In the end, the situation was taken under control in Baku and Ganja.

The failed attempt of coup d'état cost Huseynov his political career. Huseynov, who was seen as Russia's man inside the cabinet, was sacked off from the prime ministry by the Parliament (Bird, October 6, 1994). Whereas Aliyev's survival from this crisis consolidated his power. This crisis was a show of strength for the president as he succeeded to take the support of the institutions and the public. On the other hand, the coalition between others against the president was so fragile that Jevadov sold Huseynov out in this case. This also shows that while Aliyev had control on the bureaucratic elite, his opponents had a weak integration among them.

Even if Jevadov's first attempt with Huseynov failed, the commander of OMON committed another plot in March 1995. The uprising was taken under control with the coordination among the state institutions like Ministry of Defense, Army, Ministry of Interior Affairs and intelligence forces (Aliyev's speech, 1995, March 19). Moreover, "a special battalion comprised solely of troops from Aliyev's native region of Nakhchivan -a form of praetorian guard- was called up to defend the president, leading to a shootout that killed the mutineer [Jevadov]" (Radnitz, 2012: 63). Following this event, the Parliament took the decision of dissolution of OMON (Reuters, March 14, 1995; AFP, March 14, 1995). This way an armed group that was used against Aliyev twice was eliminated from the system.

At the end of Aliyev's first term the president survived from several assassinations and attempts of coup d'état. Looking at these cases and Huseynov's revolt in Elchibey period, informal armed forces that gained power with the rise of Nagorno-Karabakh conflict sought access to power by taking down the existing leader. The plotters were leading armed men, but lacked bureaucratic or political support. Considering Surat Huseynov, he was an ambitious factory manager who became a warlord during the Nagorno-Karabakh war, but when he became the prime minister, he failed to create his own team within the cabinet or in bureaucratic mechanisms. Jevadov was heading OMON and he was the Deputy Minister of Interior Affairs, but he invested in informal security networks and tried to expand the number of OMON personnel. Both Huseynov and Jevadov were motivated to take down the existing administration rather than trying to share the power via different channels (Interview with Anonymous on May 11, 2015). Moreover, their attempts remained futile as they failed to take the support of other institutions. Aliyev, who invested in loyalty of

security institutions, took also the support of the Parliament and the society, succeeded to take down these challenges. Here, it is also important to note that the Parliament played a crucial role while eliminating both, Huseynov and OMON. It also took side with Aliyev when Elchibey was falling from power, but it was mainly Aliyev to mobilize the society to convene in front of the presidential palace. In this regard, the institutions, which fell short of defending Elchibey gained power in a year period, but Aliyev's charisma within the public was an important factor against these plotters.

As a former Communist leader, Aliyev was aware of the power of the presidential office. Yet, the constitutional framework that determines the limits of power of the president and other institutions was not changed after the independence. Rather “the 1978 Constitution had remained in effect, except as amended by the Independence Act of October 18, 1991” (Kamrova, 2001: 228). After sustaining stability in the frontline with the ceasefire and signing some agreements with energy companies in 1994, Aliyev focused on the constitutional change. The constitutional committee prepared its first draft in October 1995 and then the new constitution was adopted in November 12, 1995 after a referendum held together with parliamentary elections (Kamrova, 2001: 228; Aliyev's Party Claims Victory in Azerbaijan Elections, November 15, 1995; Central Electoral Commission Reports Over 90% of Voters Backed Constitution, November 22, 1995). The 1995 Constitution “centralized the government while concentrating the majority...of power in the hands of executive branch, namely the President” (Baranick & Salayeva, 2009: 210). As discussed above the presidency in Azerbaijan was traditionally the strongest institution even during the Soviet period. The new constitution further strengthened the president by giving him “wide powers on the paper and even wider ones in practice” (Economist Intelligence Unit, 1999: 8) whereas the parliament “is largely given a reactive role” (Kamrova, 2001: 229). As the Parliament could only preserve a reactive power, position of political parties was also limited within the system. According to the election law, while 25 seats were spared for proportional representation, remaining 100 seats were for deputies those were elected for five-year terms in single-seat constituencies. Moreover, the requirement of parties to collect 50 thousand signatures at least from 75 out of 100 constituencies to run for the elections is another barrier for opposition parties (OSCE, 1996: 10). Thus, the opposition parties

having limited access to power lost ground in time rather Aliyev's party, Yeni Azərbaycan Partiyası (the New Azerbaijan Party - YAP), took advantage of the system. In the end, failing to institutionalize their power bases, opposition parties could not emerge as alternatives within the system whereas Aliyev succeeded to consolidate his power further in the Parliament (Alkan, 2010: 110).

Economic dynamics were not favorable in Aliyev's first term or the social problems like corruption in many sectors prevailed, but still the society chose to support Aliyev. He was seen as the last resort in the political arena with skills and advantages he had from his past. They "believed...[he] was the man with no non-sense policies the country needed in order to get the economy recovered and the war finished by whatever means" (Van Der Leeuw, 2000: 182; Interview with Anonymous on September 6, 2013).

In sum, absence of strong institutions and Aliyev's leverage on the existing ones helped the Azerbaijani leader to consolidate and then preserve his power within the system. Indeed, he had to face certain challenges before he consolidated his power, but also took the advantage of the support of critical institutions like the intelligence service, security forces and the parliament. The presidency once again became the main source of power in Azerbaijani politics. Aliyev succeeded to strengthen presidency's position, as an institution, by eliminating non-institutionalized challenges coming from informal networks. He took the support of the society in this process, but also the support of existing institutions by rewarding loyalty for him by appointing people to critical posts in the bureaucracy and keeping the army subservient by limiting available resources for barracks (Kamrova, 2001: 230).

Unlike Elchibey, having a long-term career as a Soviet politician, Aliyev knew the rules of the game and also the people in different echelons of politics and bureaucracy. In the end, rather than paving the way for emergence of new and strong institutions in Azerbaijani politics he consolidated the power of traditional institutions, particularly the presidential palace. His policies of shaping a loyal bureaucratic system within the state paved the way of clan politics and then this became a prelude to crony capitalism.

His son, Ilham Aliyev, pursued similar policies with his power to maintain the very basics of the system. He also invested into the network that he inherited from his father and built up a crony capitalist network around the presidency rather than developing the institutional capacity of bureaucratic and political institutions. In 2009, the limitation before a person's serving two terms as the president of Azerbaijan was removed after a national referendum with some other amendments that will tighten the control on media freedom in the country (Azeris End President's Term Limit, March 19, 2009; OSCE, December 2013: 5). Tightening his control on the system, under Ilham Aliyev's rule strong political elite integration prevailed whereas no significant fragmentation in institutional context emerged.

4.1.2. Structural Integration among Political Elite During Heydar Aliyev

Traditionally, regional networks, clans, or groupings have been informal communication channels that provided certain advantages to the members of the group in political and economic level in Turkic Republics. These were embedded elements of politics in even under the Soviet rule. Starr (2006: 8) contends that "based on close economic and political ties and accent...these regional networks are extremely powerful, reflecting the diverse emirates and local power centers of earlier centuries". As part of his reforms, Gorbachev tried to undermine the power of local networks and appointed reliable representatives of Moscow to these countries. Gorbachev's efforts fell short of fulfilling this ambitious transformation in the political level. Consequently, these networks survived in the post-Soviet period in different tones, including Azerbaijan (Cornell, 2011: 82). In this regard, regional networks present a peculiar insight to understand the structural integration of elite in Azerbaijan.

While forming a loyal and effective team around him, Aliyev instrumentally used regionalism in the 1970s. Nakhichevan and Yeraz⁴³ clans were the main elements of this policy. When he came back to power in 1993, he re-adapted his old model on the basis of what he left behind. The logic was the same: in order to make the system work once again, Aliyev chose the safe way of having a loyal team around him and

⁴³ The term is derived from combination of Yerevan and Azerbaijani. It is used to refer Azerbaijanis from Armenia.

decided to work with clans for this purpose. Farid Guliyev (2012: 118) explains this phenomenon as “the country is governed by a strong leader and several clan networks”. President is the main figure that stays in the center and enjoys the support of these networks in political terms.

Regional networks preserved their functional role during the post-Soviet period as a result of necessity. “The dominance of the Communist Party and the totalitarian character of Communist rule resulted in the destruction of civil society and the absence of institutions that mediate between government and governed...this particular type of governance generated a network of bureaucratic fiefdoms or mafias” (Hunter, 1994: 12). In the absence of formal channels, regional networks prevailed and helped to overcome problems of transaction in a system with organizational issues. These can be identified as sustaining the legitimacy of the ruler, absence of a well-functioning bureaucratic system, and distribution of resources. In these terms, regional networks helped the ruler to sustain and consolidate his rule, find loyal cadres with the reference of clan identification to work with, and distribute the resources through these channels. In return, the loyalty of these groups helped the ruler to eliminate political challenges and control/orchestrate politics and social expectations.

There are regional and ethnic groupings in Azerbaijan. Bahodir Sidikov (2004: 69) argues among these, Nakhichevanis, the Yeraz and the Kurds are influential in Azerbaijan’s politics. However, the Kurds are relatively less influential than the others. Referencing to Zurab Todua (cited in Sidikov, 1995: 69) he also argues that there are the Ganja, the Karabagh, and the Baku-Shirvan clans, but these clans failed to turn into organized groupings from regular regional communities.⁴⁴ A symbiotic relationship reemerged between the Presidential Palace and regional groupings of the Nakhichevan, the Yeraz, and the Kurds after Aliyev’s coming to power. He was looking for loyalty in the state institutions of post-Soviet Azerbaijan. Clans took advantage of Aliyev’s support, in return clan-based relationship became one of the main sources of legitimacy and power for the President.

⁴⁴ Svante Cornell (2011: 168) also talks about the Graz clan from the southeastern Georgia, but I have not come across with this clan during my field research and within the literature as a powerful clan network in Azerbaijani politics.

There are two factors that define structural integration among Azerbaijani elite under Heydar Aliyev's rule. First, Aliyev had similar institutional background with formal network groups within the system. As being a former KGB agent and the Secretary General of the Communist Party of Azerbaijan, he had access to bureaucratic and political strata in Azerbaijan. Second, he had natural advantage of having informal links to clan networks in the country. These two factors both had historical background, but gained more importance after he became the leader of Azerbaijan once again in 1993. Formal links of Aliyev was discussed in detail in the previous sub-section within the framework of the institutional context. The emphasis will be on informal networks in this sub-section.

Heydar Aliyev was born in Nakhichevan in 1923. His father Alirza Aliyev was born in an Armenian town, called Sissian and his parents later migrated to Nakhichevan (Interview with Anonymous in December 17, 2013). Thus, he had both access to Nakhichevan and Yeraz clans. Historically, these clans were strong in terms of group integration and had access to political circles in Baku. When Aliyev came to power in 1993 his access to these groups along with his legacy in Azerbaijan's institution gave him important leverages in the politics.

As discussed previously, Heydar Aliyev substituted Veli U. Akhundov in 1969. The main aim of Moscow was to overcome the obstacles within the system. Prevalence of informal networks in the Soviet period curbed the efficiency and caused low level of economic development. Aliyev pursued an active policy to eliminate Akhundov's legacy in the first five years of his rule, but finally the informal networks of Akhundov period was replaced with Aliyev's. Aliyev did what Moscow expected from him by removing almost 80 per cent of the party and administrative staff and eliminated the old network, but filled these positions with personnel from the KGB, Nakhichevan and Armenia and later established a network of his own (Massner, 2011: 6; Willerton, 1992: 210).

Gorbachev attempted to change the clan-based politics in Azerbaijan. He substituted Aliyev's protégé Bagirov with Vezirov in 1988, but as Vezirov failed to stay in power for long, Nakhichevan and Yeraz clans' dominance in the bureaucratic level

did not change tremendously. Vezirov took the support of Karabagh clan, but this was not enough to balance pro-Aliyev clans. Rather, Sadykov argues this paved the way of inter-clan fighting which ended up with power change in Baku (Interview with Sadykov on June 24, 2013 in Contact.az). Vezirov's successor Muttalibov had a similar faith. As being a representative of Baku-Shirvan clan, his rule did not last long and. While trying to deal with political crisis in the country, he failed to take the support of different informal networks that would help him to stay in power.

Clans were important in formation of political parties after the independence. Memedov (2003: 327) argues that political parties mostly are not identified with ideologies or their names rather the regional groupings that hold critical positions. The parties or political figures that lack the political support eliminated from the political scene. For instance, the APF had a weak organizational structure and failed to take support of regional groupings, as a result the APF government could not resist the opposition of different regional groupings and lost power.⁴⁵ According to Musabeyov (2003: 42), Surat Huseynov, who became the PM in 1993, also fell short of basing his search for power on economic, ideological, or political terms even though he had the support of Ganja clan.

Nakhichevanis and Yerazis were strong within the system thanks to the long period rule of Aliyev and then his protégé Bahgirov. But other clans failed to evolve into strong networks like Nakhichevan and Yeraz clans during. The short period of rule of their leaders or political instability during the transition period helped Nakhichevanis and Yerazis to protect their positions whereas the others failed to find a sustainable position within the system.

Looking at the higher echelons of politics, the domination of Nakhichevanis and Yerazis can be seen easily in Heydar Aliyev's rule after the independence of Azerbaijan (Cornell, 2011: 169). There was a symbiotic relationship between Aliyev and these clans preserved their positions as strong networks until the elections in 1998 (Interview with Anonymous, 17 December 2013).

⁴⁵ Anonymous (Interviewed on December 17, 2013) argues that the Yeraz clan was also strong in the APF.

Under Heydar Aliyev's rule some prominent names from Nakhichevan clan can be mentioned as Ramiz Mehdiyev, Resul Guliyev, Namik Abbasov and Ali Nagiyev. Respectively they assumed the positions of the Head of the Presidential Administration, Speaker of the Parliament, Minister of National Security, and Minister of Social Welfare and Labor. Here some prominent figures from Yeraz can also be mentioned like Minister of Health Ali Insanov and Murtuz Aleskerov as the successor of Resul Guliyev.

As Aliyev consolidated his power, the presidential office became the main artery of decision-making and the transactions. The Head of the Presidential Administration, Ramiz Mehdiyev, together with Aliyev's brother Jalal played a crucial role with a sophisticated intelligence unit in terms of holding and collecting critical information on personnel (Radnitz, 2012: 63). The collected information was used even in the low-level appointments of bureaucrats and provided subordination of bureaucracy. In other words, there was a top down staffing of like-minded people from similar network backgrounds within the system. Ramiz Mehdiyev who became one of the strongest figures in Azerbaijan politics controlled this collection of information. He is known as the head of the Nakhichevan clan in the bureaucracy with access to power via the presidential palace and preserved his position during Ilham Aliyev period (Mammadov, 2004).

Using clan-based networks to reestablish the state system was an efficient way for Aliyev during the 1990s (Norwegian Helsinki Committee, 2009: 17; Doyle, 2009: 110). He chose to promote his family members along with clan networks in political level. In the elections of 1995, his son Ilham Aliyev, his brother Jalal Aliyev, his son in law Mahmud Mamedkuliev became members of the Parliament. Moreover, his close associates Rasul Guliev, Arif Rahimzade, and Yashar Aliyev became the speaker and the deputy speakers of the Parliament and the presidential staff like Ramiz Mehdiyev, Eldar Namazov and Fatma Abdullazade joined to the club (Graff, May, 31, 1996; Economist Intelligence Unit, 1996: 30). Loyalty was an important requirement of the system and up to a certain extent corruption was also acceptable, but these illegal activities were closely followed and noted down to be used when necessary (Seyidov, 2006: 100). This way the method of carrot and stick was

guaranteeing the loyalty of its members to Aliyev with some political and economic interests along with the threat of arrest or expropriation.

Under Ilham Aliyev's first term regional clans started to lose power incrementally. Crony capitalist network, which started to emerge under Heydar Aliyev's rule, became more apparent. Ilham Aliyev decided to make some fine tunings in the network that he inherited from his father. He made some changes in clan-based coalition in his first term. While making a shift in coalition formation, Ilham Aliyev chose "more urbane, Baku raised individuals, often successful businessmen, near him" (ICG, 2010: 3). This was actually an attempt to consolidate his political power. There was an unwritten contract between his father and the old guard, but Ilham Aliyev chose to establish his own political network with loyal people to him rather than his father.

Ilham Aliyev was grown up in Baku and took his education in Moscow. Thus, it is not a surprise that he chose people from Baku and tried to balance the conventional power of the old guard with people loyal to him, while preserving the Nakhichevan clan's weight in the political sphere.

The most affected clan from Ilham's new policy was Yeraz. Its informal patron Ali Insanov was arrested in the eve of 2005 parliamentary elections. Former Minister of Health, Ali Insanov was accused of organizing a coup against Ilham Aliyev and collaborating with former head of Azerkimya, Fikret Sadigov, to bring Rasul Guliyev back to the power (The Former Minister of Health and Former Chair of "Azerkimya"... , November 2, 2005). Moreover, Murtuz Aleskerov, who was another prominent name of the Yeraz clan, was prevented to be re-elected as the speaker of parliament (Cornell, 2011: 169).

The new network was formed according to the loyalty of its members, but this did not mean elimination of the old guard totally from the power. Ramiz Mehdiyev remained in his position as the representative of old guard and secretary general of the presidency. The new president's wife's family, Pashayevs, started to gain power in the system in the expense of Yeraz clan. This can be seen from Wikileaks cables as well. A cable written in January 2010 claims that Pashayevs from Baku are among

the most powerful families in Azerbaijan in political and economic terms. Ilham Aliyev's wife Mehriban Aliyeva is shown as the leading figure and the family is stipulated to have influence in non-energy sectors, academia and the ministries of health, culture and tourism, education, and youth and sport (US Embassy Cables: Who Owns What in Azerbaijan, December 12, 2010). In the end, Ilham Aliyev also continued to work with a loyal team around the Presidential office with some modifications. Nakhichevan clan and the Kurds remained to be important elements of this network while Mehriban Aliyeva's family Pashayevs started to be influential within the system. The crony capitalist characteristics of the system has become more visible with the increasing flow of funds thanks to hydrocarbon business.

In sum, rather than investing in formal institutions, Aliyevs chose to strengthen the system by taking the presidential palace into the center. This policy provided certain advantages for Heydar Aliyev to rule the country without having to face with institutional challenges while he was trying to re-establish the rule and stability in the country. He cooperated with the existing clan networks as he did in the Soviet period and his choice of using these networks helped the clans like Yeraz and Nakhichevan to preserve their importance in socio-political terms. Rather than investing in institution building based on merits and competition, choosing the safer way, Aliyev eliminated possible threats against him by reinvesting in clan politics. The regional networks helped him to preserve the homogeneity of power base within the political and bureaucratic circles. Taking the advantage of his past in Azerbaijan, Heydar Aliyev further strengthened the existing structure by investing in personnel who would be loyal to him. Structural integration further gained a cohesive character at the end of these policies and rather than facing any challenges he consolidated his power easily in the center.

Ilham Aliyev made some fine tunings within the system. The Nakhichevan clan sustained its power, but Yeraz clan faced with some challenges in the 2000s after the death of father Aliyev. Ilham Aliyev sidelined the Yeraz clan while integrating Baku circles and his wife's family into the network. As a result, family ties and patronage relations also started to match the importance of regional networks. In other words, the clan network based in regional groupings started to evolve into a more interest-based clan network known as Aliyev clan in time. Still, both Heydar Aliyev and

Ilham Aliyev invested in structural integration. This helped them to rely on a loyal network that bring them efficiency and security within the system. The structural integration turned into a power vertical that the system continued to function around the presidential office. In return, members of this network enjoyed the very blessings of the crony capitalist system.

4.1.3. Value Consensus Around ‘Stability’

Azerbaijan had the characteristics of a peripheral republic under the USSR. As Shils argues, instead of having a basis for promoting ideologically innovative debate, Azerbaijan had a passive character. There was a strong control and censorship of the regime in Azerbaijan SSR. The *perestroika* policies promoted nationalist ideas to flourish once again in the second half of the 1980s and helped the rediscovery of Azerbaijani identity, but remained futile to pave the way of other political ideas or ideologies in political circles. Even though different values and ideas started to flourish in the country after the independence, these ideas failed to blossom within political parties or elite circles. Indeed, the environment was unfavorable for different ideas to emerge and to be embraced by different circles due to ongoing war with Armenia and lack of political stability. As a result, Aliyev had no big challenges to deal with such as a fragmented political sphere with different values or ideologies waiting their demands to be fulfilled.

Aliyev came to the capital when the country was at the edge of civil war as Surat Huseynov was threatening the capital from Ganja. Under these circumstances the main priority of the public and the elites were bringing peace and stability to the country. This paved the way for a search of a reliable leader rather than promoting the development or clash of different values in Azerbaijan. Aliyev was seen as an important actor whom everybody could count on and had potential to deliver the very expectation of the society. In an interview, Elchibey states that “Aliyev had a popular base in Azerbaijan; a certain part of the society wanted to see him in Baku. In order to prevent a civil war, we were counting on him and chose him to unite forces” (Tahirzade, 2001: 89). Thus, even Elchibey himself counted on Aliyev and it was no surprise that Aliyev was able to take the support of both the representatives of the old regime and some members of the counter elite when he came to the

capital. This way, he easily took the office of the chairman of the Parliament. Later, his move to eliminate Elchibey and take the presidential office was only faced with a passive opposition by the representatives of the APF (Interview with Anonymous on May 11, 2015).

After the independence no strong alternatives with strong programmes and social base emerged in Azerbaijan. Goltz (1999: 282) describes the political environment in the late 1992 as “elephantitis of democracy”, where “there were no less than 30 parties, some of significance, many of none”. After 1989 several political movements appeared in the political scene. The APF was one of them. The movement was a coalition of different groups and it was only in 1995 it was institutionalized as a political party (Türk, 2013: 151). Thus, rather than a consolidated institution with well-framed values other than nationalism, it had a loose structure. That is why “[m]ost of the major opposition parties have their roots in the Popular Front” (Cornell, 2001: 122).

Nationalism became the main currency in Azerbaijan in different tones. The fall of Communism and the Karabagh issue fed nationalism in a way that it was something normal for parties with large popular support to use it in their party programmes. Nevertheless, political parties with relatively larger popular support in the 1990s like Musavat Party and Milli İstiqlal Partiyasi (National Independence Party) were one-man led organizations and “the differences among them center more on personalities than on political ideology” (Cornell, 2001: 122). For instance, some members of the Milli İstiqlal Partiyasi led by Etibar Memedov, were calling themselves as nationalist, liberal, anti-communists, but during the internal meetings of the party these people had hardly any well-established notion about free market mechanism and unintentionally they were advocating policies based on Marxist economic system (Interview with Anonymous on December 17, 2013). In fact, ideology was a loose concept in Azerbaijan even during the Soviet period. People were becoming the members of the Communist Party, not because they were full-hearted Communists, but this was the only way to take the advantages of the system or protect them from the regime (Interview with Anonymous on May 11, 2015; Interview with Anonymous on September 4, 2013).

Even though the very basics of certain ideologies had some faults among the ranks of party members, there was still a consensus in the political sphere about the principles of establishing a new state. “The hegemonic position, which both the government and the main opposition forces claim to adhere to, is a commitment to building of a secular, liberal, democratic republic where citizenship is the basis for membership in the national community” (Cornell, 2011: 164). This was actually not something unique to Azerbaijan; in fact, these were the main themes in most of the post-Soviet countries. Admiration for these concepts and ideas coming from the West were something normal for the countries just became independent, but also need for taking the support of the Western world was another factor to make these concepts popular in the post-Soviet geography, and Azerbaijan was not an exception.

After coming to power Aliyev used the term of democracy in different occasions too. For instance, during American Ambassador Richard Kozleric’s visit Aliyev stated (President Aliyev Meets US Ambassador, June 23, 1994) that “I believe that our loyalty to democratic principles in our republic, the launching of democratic and economic reform, the measures to take our country along the democratic path...all testify that the Azerbaijani Republic is walking, and will continue to walk, on the path of democracy”. Yet, as the democracy ratings of Azerbaijan were falling, the weakness of the opposition parties could not pave the way of a competitive political environment (Economist Intelligence Unit, 1997: 6).

Ideological divide became less important for power relations (Cornell, 2011: 166). Rather, having access to power or not became the main determinant factor of division in politics. Heydar Aliyev’s New Azerbaijan Party has become the strongest political party in Azerbaijan thanks to its leader and change in political system while others were losing power.

The reform on the electoral law before the elections of 1995 limited the share of political parties with 25 seats out of 125 and remaining 100 seats were spared for candidates elected on majority basis. Moreover, several implementations such as disqualification of some political parties like Musavat from the elections worked in disfavor of the opposition. Consequently, limitations in competitiveness of the political system and weakness of the opposition, political parties fell short of turning

into institutions for elite networking and remained as one-man led organizations mostly knitted with clan networks. This prevented different ideas to emerge from institutional structures within a sophisticated political system to challenge the existing ruler. The increasing control on information channels and formation of a patronage system also served to the interests of the ruling party (Bunce and Wolchik, 2011: 178).

YAP, which was established in 1992, became the biggest political party in the Parliament after the elections of 1995 and has succeeded to preserve its position since then (Website of Yeni Azərbaycan Partiyası, accessed on August 9, 2015). The party became an umbrella organization for old guards of the regime, who became the new democrats after the collapse of the Communist rule, as well as others who wanted to take advantages of being part of the ruling power. Thus, the leader's dominance in the party continued and party affiliation has become more of a credit in political and economic spheres for its members. As the dominance of YAP over political sphere became more visible, maneuvering space for others became narrower.

The peripheral characteristics of Azerbaijan have not changed under Ilham Aliyev's rule. Azerbaijan was not a satellite of a Communist bloc, but its rentier state characteristics has become more visible as it turned into mono-crop economy as a major oil exporter. This brought further financial resources for Aliyev administration, whereas opposition groups being away from the power for long term has been marginalized (Gould & Sickner, 2008: 753). Ilham Aliyev's supporters preserved to be loyal to the system not because of the ideas or values that he represented, but rather the informal networks and financial interests played a major role. This helped Ilham Aliyev to preserve strong elite integration as his father did under his rule. As a result, no serious division emerged after 2003.

To conclude, nationalism was the common ideological basis during the transition period of Azerbaijan. Turkic identity has evolved into Azerbaijani identity in time, but in different tones most of the parties used nationalist ideas in their party propaganda. When Heydar Aliyev came to power the euphoria of nationalism was leaving its place to search for peace and stability and Aliyev was accepted as an actor

to lead the country out of the crisis. Even though he faced with some challenges, these were mainly power struggles rather than having ideological basis. On the one hand, Aliyev also used the popular concepts or ideas like democracy, market economy and this helped him to be perceived as a leader to deliver the needs of political circles. On the other hand, he was an actor that helped old guards to transform their positions into new ‘democrats’ and preserve their position within the system by supporting Aliyev’s rule. In time, Aliyev and his party consolidated their power in expense of opposition groups and changing political dynamics and presence of clan politics narrowed the maneuvering space of political parties. Thus, rather than emerge of alternative ideas or values within the system Aliyev had chance to strengthen his position further. Here, one should also underline the peripheral characteristics of Azerbaijan. Being under the control of the Soviet rule, intellectually and economically, Azerbaijan did not have the necessary infrastructure to become cradle of new trends and ideas. Rather it had a passive role during the Soviet rule and this also reflected in the transition period. Political parties were established in the 1990s, but most of these were one-man led organizations rather than having an institutional framework. Taking advantages of support of the old guard, and the opposition groups up until consolidating his power, Aliyev barely faced ideological challenges. This also shaped the privatization and economic transformation process. Rather than taking into account demands of different interest groups, Aliyev had chance to implement a top-down process to determine the new economic structure in Azerbaijan. His successor, Ilham Aliyev, also faced no serious challenges. The opposition groups have become trivial as challengers in political sphere as they lacked necessary resources. In spite of competition of different values or ideologies in Azerbaijani elite circles, it was more interest based elite networking around the president. Under these circumstances, as in Heydar Aliyev’s period, Ilham Aliyev’s rule did not have to tackle with a serious fragmentation due to differences in values. For the elite, stability has been the only valid currency to preserve their interests within the system, which meant acting with the President rather than acting against him.

4.2. Weak Elite Confrontation: ‘Small Stakes-Small Players’ in Peripheral Azerbaijan

After the dissolution of the USSR, the integrated economic structure in the Soviet space was broken and the new independent states took the control of the assets within their territory. The system break down negatively affected their economic values. Assets in the USSR had low economic competitiveness due to being elements of an integrated economic system. When the system collapsed the production network also collapsed. As a result, most of the factories or enterprises stopped their operation or downsized their operations. The issue was even graver in peripheral states as these assets were less developed than the ones in the center, and due to Soviet economic model, some of these assets became idle after the independence. Similar patterns can be seen in the post-Soviet Azerbaijan. Value added production in Azerbaijan was limited. Agricultural production and hydrocarbon sector were the main pillars of the economic activity. There were small and medium scale enterprises in other sectors, but these were hardly competitive in economic level or capable to satisfy the demand in domestic level. Facing economic constraints, the governments of Azerbaijan implemented privatization programs in the 1990s both to generate some revenues for the treasury and also make necessary reforms for transition to market economy.

Abulfaz Elchibey kicked off the privatization process on January 7, 1993 with the adoption of the law No. 445. Nevertheless, the process could not be carried out smoothly and became obsolete due to the fragile political situation in the country. Only part of the state public housing and taxi parks were privatized up until Elchibey's fall. After coming to power Aliyev suspended the process due to the wartime conditions (Yunusova, 2012: 24, 25).

Aliyev administration prepared another privatization program in July 1995. The target was to privatize 70 per cent of the state assets up until the end of 1998. Primarily, small-scale privatization was carried out and then the next stage started with voucher privatization (IMF and World Bank, 1997: 8). In this period, the privatization was important for reforming the economy and getting the support of the IMF. Azerbaijan's economy was in bad shape and the country was in need of the

credit that would be provided by the IMF. Thanks to the start of economic reforms and the small-scale privatization, Baku received \$229 million from IMF in 1996 (BBC, March 14, 1996; AFP, December 21, 1996).

Similar to the privatization process in Russia, Azerbaijani government adopted a voucher-based privatization. 32.000.000 vouchers issued and they were distributed to the society for the period of 1995-1998. Nevertheless, certain limitations were drawn for the privatization of state enterprises. According to the law No. 1120, which was adopted in September 1995, there were five different types of state property: i. Some of these facilities were prohibited to be privatized; ii. Privatization of some assets were subject to permission of the President of Azerbaijan; iii. Some could be privatized by the decision of the cabinet of the ministers; iv. Some could be privatized by the State Privatization Committee (SPC) upon a consent with local executive bodies; and v. the remaining were subject to compulsory privatization. Looking at these five different groups mainly low-tech industrial facilities of textile, food and wood industry; small retail or wholesale business organization; bakeries; tourism facilities; or pharmacies were subjects of compulsory privatization. Whereas big assets like radio and television organs, bio-chemical and petro-chemical industry, energy industry, and several other industries were kept out of the compulsory privatization and their sale was subject to the president's permission.

While state enterprises were the object of privatization in the post-1995 period, in the next phase, the real estate under the control of the state was privatized. Law No. 878-IQ regulated this process and brought some limitations before the privatization of strategic assets. Along with the efforts of creation of a market economy, the need for financial resources that would be coming from abroad and sale of assets were important incentives for the privatization process in Azerbaijan. However, the state pursued a selective policy in the privatization period and preserved its control on strategic assets. Thus, the privatization in Azerbaijan did not lead to redistribution of wealth that would pave the way for power shift in political level and generating cash for Azerbaijani economy. The president played a key role during the process as a gatekeeper. His domination over politics did not open maneuvering space for new players.

Even though the president's role was important in the 1990s to shape the dynamics of economic development it is hard to talk about a favorable base to promote emergence of new actors in national level. Lack of capital, absence of well-established economic elite and other factors limited the success of the privatization policy. In the end, voucher privatization failed to turn into a success story. The state could not recollect the vouchers, privatization could not create a momentum in the economy to promote economic growth. Rather the production declined in privatized enterprises, and the state preserved its control on the key assets.

Even though the privatization was also open to foreigners, Azerbaijan was not a popular destination for foreign investment due to several reasons. Azerbaijan was a war-torn country and its economy was not attractive in economic terms compared to other countries like Russia or Central Europe, and its luscious energy assets were shadowing other enterprises. In this regard, the foreigners were more interested in Azerbaijan's energy assets rather than its uncompetitive industrial enterprises. Some opportunist groups showed some interests in Azerbaijan's privatization process in this line in the second half of 1990s.⁴⁶

Domestic dynamics for the success of privatization were not favorable either. The business elite was mediocre. Even if there were some rich men in the country, these were local red directors of the Soviet era enterprises who managed to keep control on certain assets, or newly emerging businessmen mainly active in petty business. Anonymous (Interviewed on September 5, 2013) describes the era as a transition period with no *milyoncu* (millionaires) and mostly petty businessmen having limited capacity and channels of trade due to long Soviet rule. He describes the business environment in Baku in comparison with Moscow as:

Moscow was the center and going to Moscow was being in a different dimension. In Moscow, you could see foreigners coming from abroad, drink Pepsi Cola and have anything that you might hardly get back home, and so on. Trade volume was billions of dollars during the Soviet period and it was mainly orchestrated from Moscow. The capital had the necessary means like a strong banking sector, an army of bureaucrats who had good knowledge about the regulations

⁴⁶ Minaret group headed by Chezh businessman Viktor Kozeny collected vouchers in Azerbaijan to get control of SOCAR oil company during the privatization process, but ended up with a failure. This will be discussed below in detail.

and laws of international trade, and diplomats who can speak foreign languages French, German, English. For instance, Sberbank was a financial giant, which had branches abroad, employees who could speak foreign languages. Sheremetovo Airport was real hub that Muscovites could easily fly to different capitals by only taking their passports.

Baku was only a periphery (*uçkar*) of Moscow. The human resource was limited, the channels to reach abroad had to pass through Moscow, and being a periphery, the reforms adopted in the capital could only be implemented years later in Azerbaijan... Baku had limited access to the outer world and had little knowledge about business. The mobility was under the control of the Communist Party and Moscow. The Bina Airport in Baku today [known as Heydar Aliyev Airport] had no direct flights to countries other than the member states of the USSR. It was only in 1990 the first flight to Istanbul could be made and then to Dubai at the end of the same year. The communication devices were so primitive that the first fax machine came to Baku during Muttalibov's rule, before the communication was carried out with Moscow via telex machines... Even though perestroika period is known as the period of economic reforms in the USSR, the alternative labor market could only be formed in 1990, whereas the Gorbachev's directive dates back to 1987. One of the main reasons of this delay was when the decision was taken in Moscow it could only reach to the periphery after the approval of lower Communist organs in the hierarchy.

Having underdeveloped economic infrastructure and human capital, Azerbaijan had to deal with the challenges of the new era particularly with a limited state capacity. During the Soviet period business elite hardly thrived and they could only access to resources as much as Baku let them have. Demanding more was not within the scope of these newly emerging entrepreneurs. The new business elite nor had the capacity to bargain with the state to have more stakes, neither the capability to run big scale industrial conglomerates. People in Azerbaijan had just met with the capitalist system and it would take some time to adapt to the new rules of the game. Nevertheless, the Azerbaijani economy was in a bad shape. The economy had negative growth rates between 1992 and 1995. Thus, when the economic reforms kicked off, the economic elite were just taking baby steps rather than having necessary means to access to wealth and power. The state, particularly the presidential office, had a dominant role on the system. In the absence of high elite

capacity and elite diversity, the political elite chose to maximize its power by playing a redistributive role by prevailing its control on Azerbaijan's extractive institutions, instead of taking the risk of creating a liberal market economy. As a result, rather than sharing its control on the energy sector with national actors, the state collaborated with foreign companies, which had necessary capital and capacity to operate in Azerbaijani energy fields.

4.3. Restructuring the Energy Sector: Consolidation of State Ownership

Oil has a long past in Azerbaijan, but it has gained a commercial character in the 19th century and oil sector rapidly developed after the Russian government's permission for private entrepreneurs' operations (Yergin: 2007: 55). Following the Red Army invasion in 1920, the industry was nationalized and the Soviet administration took the control of 272 private companies (Bagirov, 1996: 24; Ryzaeva, 2015: 5). Up until the end of World War II, Azerbaijan was the main oil producer of the USSR. It lost its dominance in oil production in time. Since Moscow shifted the production to giant sites in Volga-Ural region and Western Siberia, and also invested less in Azerbaijan, Kazakhstan and Turkmenistan (Bayulgen, 2010: 91; Barylski, 1995: 218, Bahgat, 2007: 158). The exploration activities continued between 1970 and 1991 and big offshore discoveries of Azeri, Chirag and Guneshli were made in the Caspian by use of floating drilling rigs (Ryzaeva: 2015: 7). But Moscow made limited investment for development of these reservoirs. The policy of Moscow had two consequences. First, the oil production started to decline steadily after peaking in the 1960s. Secondly, even though there were some efforts to develop these reserves they were left almost intact for the post-independence period (Laurila, 1995: 14). This made Azerbaijan an attractive investment destination for foreigner in the post-1992.

The reforms in the sector have started under Muttalibov's rule and continued throughout the Aliyev period. The main goals were making the sector independent from Moscow's reach and restructuring the sector vertically to be able to compete with other companies in global terms. The political elite integration was weak in the early years of the independence, but evolved into a stronger character under Heydar Aliyev's rule. In an elite structure with low elite capacity and strong political elite integration, the new rulers easily increased the state's grab on the energy sector.

They opted to share the control in the energy sector with foreign oil companies rather than domestic actors. State dominance over the sector brought crucial financial and political advantages for the political actors of Azerbaijan. Ilham Aliyev did not make major changes in his father's setup, rather enjoyed the flow of oil money into the economy. This part is composed of two sections. In the first section, I will analyze policies of Muttalibov and Elchibey period and then in the second section I will focus on energy sector in post 1993 period under Aliyevs' rule.

4.3.1. Weak Political Elite Integration and Low Elite Capacity: 1991-1993

At the dawn of the Soviet Empire, Moscow was still influential on the republics' foreign affairs, but perestroika policies cracked the door open for cooperation with third parties. Slowly, some foreign entrepreneurs started to visit the Soviet Union to look for possibilities of cooperation in energy sector and Azerbaijan was not an exception.

In the late 1980s, Azerbaijan's energy sector was in decline after more than 100 years' of production; due to lack of investment, atomized structure of the sector and political uncertainty. After peaking at 23.5 million tons of oil in 1941, the production gradually decreased to 13.2 million tons in 1989 and then to 11.8 million tons as of 1991 (Seferov, 2005; BP Statistical Review 2015). Looking at the production performance between 1885 and 1995 there are two peak points. One of them is in 1940 during the war period and the other one is in 1960s as a result of taking offshore production online in *Neft Dashlari*.

The decline in oil output in the 1980s was a serious issue since it was the main source of income for Azerbaijan. Old equipment and technology fell short of keeping the output at a steady level and it was cheaper to develop onshore reserves elsewhere in the Union. Even though new offshore reserves apart from Neft Dashlari were discovered in 1979 onwards, because of technological deficit in the USSR and high cost of offshore development these reserves left underdeveloped. Commercial production has started only in Guneshli field in 1980, but the others left intact (Sagers, 1993: 1100).

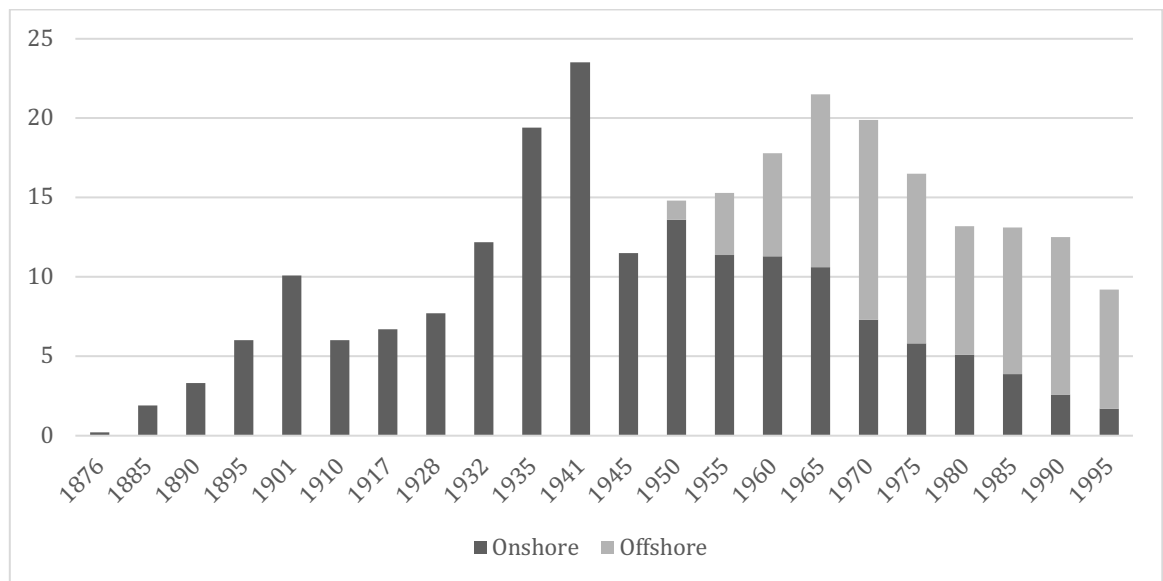


Figure 13: Oil Production in Azerbaijan between 1876 and 1995 (million tonnes)

Source: Seferov, R. (2005). Azərbaycan'da Petrol Üretimnin Tarihsele Sürre İçerisindeki Değişimi. *Türkiyat Araştırmaları Dergisi*, 18, pp. 285-297.

There were also socio-political implications of Moscow's exploitative approach to energy sector in Azerbaijan. In spite of energy sector's existence in Azerbaijan, the level of economic development was better in other Caucasian states and the Azerbaijani elite saw this as double standard. Sabit Bagirov in one of his interviews told that "Baku oil was sold for a price set lower than that for mineral water...oil drilling equipment is old and worn-out: Moscow didn't bother to reconstruct or modernize plants" (Chazan, December 1, 1992). Even Muttalibov who was trying to have balanced relations with the center, once accused Moscow of 'economic colonialism' referring to the unwillingness of the central ministry to invest capital in revitalizing the declining Azerbaijani oil industry and to Moscow's constant policy of underpricing Azeri oil domestically and selling it at world prices abroad" (Spatharou, 2002: 32). The state paid 120 rubles per ton of oil in 1991 whereas the cost of production was more than 130 rubles, and this price was equal to one pair of shoes (Hemming, 1998: 7).

Ramco Energy's Steve Ramp's visit to Baku gives a crucial insight about the situation of the energy sector just before the independence. Remp started his visits to the USSR in 1986 in pursuit of oil and after encountering an oil engineer in Moscow, who he had an interesting talk about offshore reserves in the Caspian, he headed to

Baku to have more information about the issue. Talking to oilmen in Baku, Steve Remp got access to considerable amount of data in 1989 and turning back to Aberdeen with this valuable information Remp contacted with BP (Sanjian, 1997: 7-8). This was an important development for Azerbaijan, because after this visit BP became really interested with the Caspian reserves. However, Remp's visit was also noteworthy in the sense that when he wanted to exchange his contact info with the oilmen in Baku, he gave his business card, but in return his Azerbaijani counterparts could only give a piece of paper by noting the fact that their operations were linked to Moscow and they needed to contact with the capital via telex (Interview with Anonymous on September 5, 2013). In other words, Baku had limited autonomy, no western business culture and limited communication channels and tools. Still these did not keep them away from sharing strategic data with their visitor from Aberdeen. The Western companies saw the untapped reserves as a crucial investment opportunity just after the collapse of the USSR. The energy sector was among the priorities of the presidential office too. The sector was seen as the main source that can provide necessary financial sources to provide the needs of the country. This cracked the door open for reforms just after the independence by the Azerbaijani administration.

The first President of Azerbaijan Republic, Ayaz Muttalibov, issued decree No. 481 in 3 December 1991 that would be the first step to restructure the hydrocarbon sector. The decree starts with a short introduction and rationale behind the decision of integrating the multi-structured sector under one umbrella:

The policy of violent exploitation of the oil resources in Azerbaijan for decades paved the way of crisis in the oil sector...the decreasing production causes deterioration of technical, economic and financial indicators and problems in the environment. Lack of an integrated system and coordination, and weakening stability causes waste in oil reserves and further worsens the situation. The current situation requires strict measures to be taken for full control of oil wealth by the Republic, reestablishing of resource management, rapid transition to market economy, and efficient use of resources.

The language in the decree No. 481 straightforwardly describes the shabby situation of the oil sector. It not only put the blame on previous policies, but also underlines the importance of reshaping the sector based on an integrated structure for efficient

use of resources with a special emphasis to transition to market economy. Parallel to the decree No. 481, several steps were taken concomitantly; Azerineft was established and Sinan Alisherifoglu Alizade, who was the mayor of offshore city of Neft Dashlari, was appointed as the president of the new state enterprise.

The decree united all the upstream operations under one umbrella. Azneft production association and Xəzərneftqazsənaye (Kaspmorneftegaz) production association united under the Azerineft. The former was responsible for onshore operations, whereas the latter for offshore operation (Sagers, 1994: 283). Additionally, Azerineft took the control of production associations of Xəzərneftqazgeofizkəşfiyyat", "Xəzərneftgeofizika", "Azərneftgeofizika", and Şelflayihətikinti. These were the associations expertizing on exploration and development of exploitation equipment for hydrocarbon resources. However, these industries were not in good shape either. Even though Azerbaijan was supplying around 60 percent of the oil equipment of the Soviet Union, the ongoing strikes linked with the Nagorno-Karabakh conflict negatively affected the industry and logistics of oil equipment (Soviet Troops Fire on Nationalists, January 20, 1990; Lyons, January 20, 1990).

Even after Azerineft took the control of Azneft and Kaspmorneftegazi, these associations preserved their autonomy. Azerineft's main role was carrying out high-level negotiations with foreign companies, but having limited human capital it needed to take support of the associations during the meetings (World Bank, 1993: 70). In fact, rather than having a vertical integrated structure, Azerineft was an umbrella organization with a loose control on these associations.

After the fall of Ayaz Muttalibov, the APF came to power and Elchibey government also took some steps to restructure the hydrocarbon sector in Azerbaijan. In this regard, the cabinet of Azerbaijan took the decision of taking the full control of Azərneftkimya production association on July 18, 1992 with the decree No. 402. This was a natural process after the dissolution of the USSR. Azerbaijan was taking over the control of enterprises within its territories among which there was also Azərneftkimya. Following this decision, the cabinet of ministers decided to bring limitations of transfer of control to third parties for some critical and strategic enterprises and sectors. The Decision No. 431 prohibited renting of several sectors

and state enterprises on August 10, 1992, including assets and reserves of the energy sector. These decisions actually meant strengthening state control on energy sector under the sovereignty of Baku.

Later, Azerneftkimya and Azerineft united under the umbrella of State Oil Company of Azerbaijan (SOCAR) by the presidential decree No. 200 on 13 September 1992. Elchibey also substituted Sinan Alizade with Sabit Bagirov, who was a close advisor to the president himself, as the new president of SOCAR. This decree is also the founding document for SOCAR.

After its establishment, the company has become the energy champion of Azerbaijan. The decision of establishing SOCAR was a continuation of Muttalibov's strategy to form a well-integrated energy company, but in a firmer fashion. The decree No. 200 in essence strengthened the integration among upstream units, whereas the newly established company with the refinery capacity of Azerneftkimya gained downstream capabilities as well (Telephone interview with Anonymous, 30 November 2015). In this sense, the company gained a vertically integrated characteristic from upstream to downstream.

Two important processes have gained impetus in 1993 for Azerbaijan's economy. First, the privatization law came into force in January 1993. The law perceived privatization of state capital and in this regard the President of Azerbaijan was authorized to present the privatization program to the Supreme Soviet before November 1st of each year. Second, the negotiations between international actors on developing the energy reserves of Azerbaijan have gained momentum.

SOCAR President Sabit Bagirov also authorized a group of experts to work on possibilities of privatization of SOCAR parallel to the program (Interview with Anonymous, September 6, 2013). Anonymous says that the team was working on a plan to privatize SOCAR at some point. But before the first program was presented to the parliament in November, Elchibey had to leave the capital due to Surat Huseynov's march to Baku in June 1993. Huseynov's coup d'état coincides with the time when a major oil deal was about to be stroke between SOCAR and western oil companies among which there were AMOCO, BP, Statoil, Union Oil of California,

Pennzoil, McDermoot, Ramco, and Turkish Petroleum from Turkey (Levine, June 21, 1993). Elchibey was planning to visit London to meet John Major at the end of June 30, 1993, which was going to be his first official trip to a major western state (Goltz, 1998: 356).

Up until the Aliyev government decided to keep energy sector out of privatization process, the initiative of privatization continued to occupy the agenda for a while. However, the government later established strong control on the energy sector. Yet, the initiative of cooperating with foreign companies to develop the energy resources prevailed even after the Elchibey period. Failing to strike the final deal, Elchibey government lost the opportunity to take the financial and political advantage of the oil windfalls. Elchibey's fall from the power and rise of Aliyev also meant a crucial change in politics of Azerbaijan. Aliyev not only managed to finalize deals with the international companies, but also continued the vertical integration of the hydrocarbon sector.

The developments of the period between 1991 and 1993 show that the predecessors of Aliyev have already started the restructuring of the energy sector, by bringing together several enterprises under one umbrella. Even though some technocrats under the rule of Elchibey took initial steps of privatization, this process could not be taken forward due to the attempt of coup d'état in June 1993. In other words, bureaucratic search of future prospects could not be taken further as the rule of Elchibey did not last long. Policies in the period between 1991-1993 laid the ground for uniting atomized structure of the sector inherited from the Soviet Union and the presidential decrees No. 481 and No. 200 sowed the seeds of establishing links between the Presidential office and oil and gas sector. Economic situation in the country set the tone of framework of cooperation between SOCAR and foreign oil companies, which would be based on product share agreements (PSAs). This framework implies that the government would be sharing its control on the hydrocarbon resources with foreign companies. One of the main reasons of this choice was lack of necessary financial and technical resources at domestic level to develop offshore reserves of the country and market them in the global market.

4.3.2. Strong Political Elite Integration and Low Elite Capacity: 1993-onwards

Thomas Goltz (1999: 268) shares one of his interesting conversations with Amaco's Baku representative, Ed Lake, that dates back to Elchibey period "If we spend ten, forty arrive – that is enough to transform this country into a little paradise. Everyone wins. But that is not the way it works here". Lake was indicating that the establishment wanted to keep the system as it was and this was impeding a possible win-win deal to be stroked. If everything worked normal, then the system would attract further investments in the service sector as in the other cases like in the Gulf. Main problem was huge amount of siphoning from the existing onshore and offshore wells and refineries due to lack of control on the system. In fact, this was normal for a country, which was facing political and security problems and inherited a system that was shattering apart from the Soviet period. However, the rich resources of Azerbaijan were still attracting foreign investors, but the ongoing political turmoil and uncertainty were important risks for the companies.

After coming to Baku, Aliyev consolidated his power by going to a referendum that will undermine the legitimacy of Elchibey and won the presidential elections in 1993. Afterwards he went for a constitutional referendum that would maximize the political power of the presidential office. Meanwhile, he maintained his focus on international negotiations with foreign companies that would give him both political and financial advantages in these meetings. He had the chance to signal that he was the main authority to give the last decision.

Aliyev took the control of energy portfolio upon coming to power. The founder of SOCAR, Sabit Bagirov, was replaced with Natiq Aliyev even before the presidential elections in 1993 with presidential decrees No. 687 and 701 respectively on July 13, and August 9, 1993. In one of his interviews Bagirov describes Aliyev's position as "After bringing in some European consultants at first, he took a close grip on the issue himself" (Mariott and Minio-Paluello, 2012: 59). His appointments also confirm this statement. His son, Ilham Aliyev, became the Vice President of the state enterprise on April 30, 1994 (Presidential Order No. 78). Ilham Aliyev was mainly responsible of foreign economic affairs of SOCAR. This was a position particularly tailored for the president's son with the Presidential Order No. 143 issued the same

day of his appointment. This way Heydar Aliyev consolidated his control from the inside with his son.

Unlike his predecessor, Heydar Aliyev was directly supervising negotiations with energy companies (Cornell, 2011: 219). In a short while, the presidential office became the main address for energy issue and this simplified so many things for the energy companies. Before the companies had to deal with the president, SOCAR bureaucrats and political parties (Mariott and Minio-Paluello, 2012: 59). This phenomenon reflects to the media reports in 1993 as “Although Azerbaijan and other former members of the former Soviet Union offer the opportunity to Western companies to tap into some of the world’s biggest oil fields, bureaucratic delays and the inability to complete contracts have slowed down the pace of development” (Azerbaijan Asks for Merger of 3 Companies' Oil Projects, May 24, 1993). The companies had been uncomfortable with being lost within the local politics while trying to carry out the negotiations. Thus, simplification of the process through the presidential office turned into an advantage for the foreign energy companies.

One of the main legacies of Bagirov and Elchibey period was the government decision to combine the contracts of three fields, Azeri, Chirag and Guneshli, under one umbrella as a united, mega development project in May 1993. This was the plan that “all participants of the negotiations agreed in late 1992 to establish a single infrastructure to reduce the costs of investment” (Sagers, 1993: 1101). Thus, with some shortcomings, newly established SOCAR had managed to reach an agreement with the investors. This gave Aliyev a working-framework during the negotiations 1993 onwards.

Aliyev authorized Natiq Aliyev and SOCAR to continue the negotiations with the foreign companies in February 1994 (Aliyev, September 16, 1994). The same year, Azerbaijan International Operating Company was established as a consortium with the participation of SOCAR, BP, Amaco, Exxon, McDermott International, Pennzoil, Unocal, Ramco, Statoil, TPAO, DNKL Oil of Saudi Arabia and Lukoil (Economist Intelligence Unit, 1997). The consortium signed the contract with Azerbaijan, known as “the deal of the century”, to operate in Azeri, Chirag and Guneshli on September 20 with some modifications to the framework prepared in May 1993. According to

the 30-year contract the consortium would invest 7,4 billion dollars and Azerbaijan would get 253 million tons of exploited crude oil (Aliyev, September 16, 1994).

Anonymous argues that “the deal of the century” was a political agreement rather than economic (Interview with Anonymous on September 4, 2013) Looking at the structure of the consortium, the balanced distribution among foreign companies with their country origins can be seen easily. Not only western firms, but also a Russian firm, Lukoil, found a place for itself in the consortium (Sadri, 2012: 389). This was a positive signal to Russia from Azerbaijan after Elchibey’s anti-Russian policies. This was a reflection of Aliyev’s balance politics contrary to his predecessors. After the decision to ratify the contract in the Parliament in November⁴⁷, the possibility of giving 5 percent stake to Iran came up into the agenda in Azerbaijan (Nerimanoglu, November 15, 1994). Later, the companies objected the decision of inviting Iran into Azeri-Chirag-Guneshli project and Azerbaijan decided to share its 10 percent stake out of 20 percent with Exxon from the US and TPAO from Turkey for 5 percent each (AFP, April 8, 1995).

This was actually the most crucial step after the independence of Azerbaijan in restructuring the very basics of the hydrocarbon sector in the country. The character of the agreement between Azerbaijan and foreign companies was a PSA. According to the agreement, oil revenue would be shared between Azerbaijan and the foreign energy companies. The companies’ role was critical to provide necessary capital and technology to develop the resources while Azerbaijan was in a dire position. Baku agreed to share its managerial and operational control on energy reserves. Foreign oil companies became the managers of the exploitation process “on behalf of the state rather than as owners” (Luong & Weinthal, 2010: 222).

The deal of the century is a crucial turning point in modern Azerbaijan history. Signing the agreement with the members of the consortium, Aliyev also managed to bring in foreign investment as suggested by Ed Lake to Thomas Goltz before. The country succeeded to bring in foreign investors to Azerbaijan to develop its energy resources with a modern approach. Even though Azerbaijan had a long history of oil

⁴⁷ Azerbaijan Parliament ratified the contract in 15 November 1994 with Parliamentary decision No. 924 and then passed law No. 933 about the ratification of the contract in 2 December 1994.

exploitation, deep resource exploitation and transportation of hydrocarbon resources to the global markets were beyond its financial and technical capacity.

One of the main peculiarities of this period can be identified as presidential office and SOCAR's dominance in the international energy negotiations. On the one hand, presidential office had an important political advantage as being historically the strongest institution in the country. There were neither big fragmentations nor challenges arising from the political sphere, bureaucratic mechanism or economic circles to implement energy policies, but political will of Heydar Aliyev to take the initiative in the energy sector. In this regard, energy policies were designed and implemented from the top and as the president consolidated his power of control on the state and the sector. Bayulgen (2010: 104) pictures political environment in relation with the sector as:

The absence of significant veto players and strong political parties and interest groups has insulated the ruling elite from any opposition to investment policies and offered foreign investors easy and direct access to decision makers. The regime provided 'one stop shopping' for investors; oil companies could negotiate the terms of the investment agreements with a few actors and bypass any potential opponents to those terms.

Appointing Natiq Aliyev and Ilham Aliyev as top brasses of the company, Heydar Aliyev consolidated his direct access to the company and international negotiations. Moreover, "the government, lacking personnel with the specialized knowledge necessary to take part in negotiations, did not have representatives on the table" (Kjærnet, 2012: 195). Until the establishment of Ministry of Fuel and Energy in 2001 "there was no clear demarcation between regulatory, policy and business bodies in Azerbaijan" (Kjærnet, 2012: 196). The motivation behind establishing a ministry responsible of energy was to separate the regulatory and operational duties (Bayulgen, 2010: 104).

SOCAR's structure has changed during Heydar Aliyev's rule. Oil and gas production associations were established to operate onshore and offshore under SOCAR with the presidential order No. 50 issued on January 10, 1994. The presidential decree No. 844 united these onshore and offshore production associations under the brand of

Azneft to operate within SOCAR and abolished the order No. 50. Also, the new charter of SOCAR was approved with the Decree No. 844. The charter emphasizes the peculiar role of the President of Azerbaijan and gives him the capacity of re-organizing or liquidating the company. The decree No. 844 is in force even today with some amendments adopted during Ilham Aliyev's rule.

Parallel to the reforms in energy sector Azerbaijan continued to sign new agreements with foreign companies. After Azeri-Chirag-Guneshli deal, another critical contract was about the development of Shah Deniz field, which is one of the biggest offshore reserves discovered in the 1990s. The signed deal in 1996 perceives development of Azerbaijan's vast offshore natural gas fields in cooperation with foreign companies. Just like the deal of century, another PSA was signed to develop Shah Deniz field. SOCAR is part of the consortium to develop the offshore reserves and the members of the consortium carry out management and operation of the reserves.

In his second term, which coincides to the period after 1998, Aliyev eliminated certain potential threats against him and blocked the debates about privatization stage by stage. In this period, elimination of the debate about privatization did not face a critical challenge from political or economic circles rather ended up preserving SOCAR's monopoly on ownership of hydrocarbon reserves while sharing the control with foreign companies.

Political culture and developments played an important role in Aliyev's decision to keep energy sector out of privatization process. Aliyev and his network had a long experience of governing of Azerbaijan in the Soviet period and during this period energy sector was the backbone of the economy. It prevailed its importance after the independence as the main source of income as an extractive institution for the state. During the privatization process some studies were made about SOCAR's privatization or division, but this did not happen since preserving state ownership was more preferable as the energy sector had "strategic importance" (Interview with Anonymous on September 4, 2013; September 5, 2013; September 6, 2013; September 9, 2013).

It is possible to define two advantages of keeping the ownership on energy resources by the state. First, considering the fact that the state had no serious alternatives other than the energy sector to finance expenditures. Oil revenues was a great advantage for Aliyev government in the processes of state and nation building. Second, after the collapse of the Soviet Union Caspian Basin has become a source of attraction for many international actors and Azerbaijan was one of the main destinations. Having direct contacts with these actors, brought international legitimacy and opened so many channels for Azerbaijan's integration into the international system. This was an advantage for Aliyev, who came to power in the middle of a war, just after a military coup that took down the elected President.

Political developments in the second half of the 1990s also prepared a basis for keeping the sector under the state control. In the political sphere there were charismatic figures, but they had already been tested by the society or lacking the advantage of having the support of an informal or well-institutionalized formal network, such as a clan group or a political party. Still, Aliyev faced the most serious political challenge in 1998 presidential elections. More or less in the same period he had to deal with a corruption case linked with a Czech businessman, Viktor Kozeny in the voucher privatization. Following these challenges, Aliyev made his position clear about not privatizing SOCAR under his rule.

In the elections of 1998, four popular figures from the early 1990s, Isa Gambar, Rasul Guliyev, Abulfaz Elchibey and Etibar Mamedov, declared their candidacy. Later, five figures, Gambar, Guliyev, Elchibey with Layla Shovkat Hajiyeva and Ilyas Ismayilov, formed a bloc called Movement for Democratic Elections and Electoral Reform and boycotted the elections criticizing Aliyev's undemocratic policies (Azeri Opposition Condemns Presidential Elections, October 13, 1998). Even though the opposition organized some impressive meetings, it did not come up with a joint candidate and failed to make a difference in the ballot box (Economist Intelligence Unit, 2000: 8).

President of Milli İstiqlal Partiyasi, Etibar Mamedov was the second runner-up in the elections of October 1998 by taking 11.8 percent of the votes. His campaign was built upon a nationalist-liberal discourse. He even managed to take support of some

petty-businessmen for his campaign (Interview with Anonymous on December 17, 2013). Still, Mamedov lost the competition in the first round. International observers and the opposition criticized the democratic standards of the elections, arguing that the numbers were rigged (OSCE, Council of Europe Slam Azerbaijan Election, October 12, 1998; Dzhindzhikashvili, October 12, 1998). Aliyev was elected as the president by receiving 90 percent of the votes in 1993, but his popularity decreased to 75 percent in 1998.

Supported by petty businessmen, Mamedov managed to form a momentum in the elections as a well-known face with an attractive discourse. Possibility of emerging new interest groups particularly in economic sphere and their support for his rivals perceived as a threat by Aliyev and he pursued more state-centric policies rather than liberalizing the economy as he advocated in his first term (Interview with Anonymous on September 5, 2013; Interview with Anonymous on 17 December 2013).

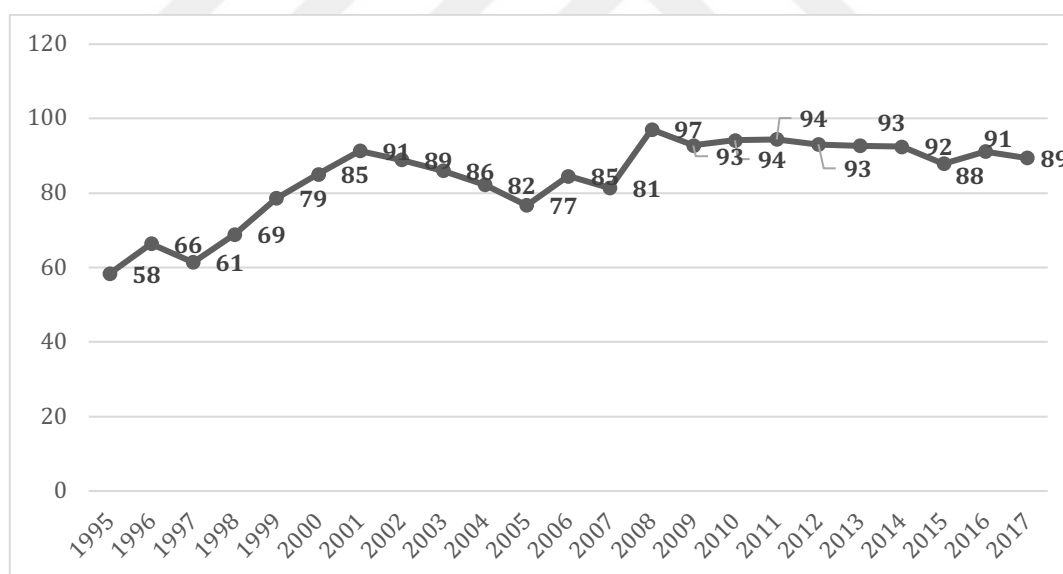


Figure 14: Share of Mineral Fuels, Minerals Oils and Products of Their Distillation in Azerbaijan's Total Exports (1995-2017)

Source: Azerbaijan Statistical Information Service, (<https://www.azstat.org/portal/>)

There were rich people in Azerbaijan, but these could not be described as economic elite who acted as an interest group (Interview with Anonymous on September 5, 2013; Interview on December 17, 2013). These people were mainly petty businessman operating in local level and had no well-established capitalist world-

view or means to develop their positions (Interview with Anonymous on May 11, 2015). As expected, it was hard for them to make pressure or manipulation on political sphere.

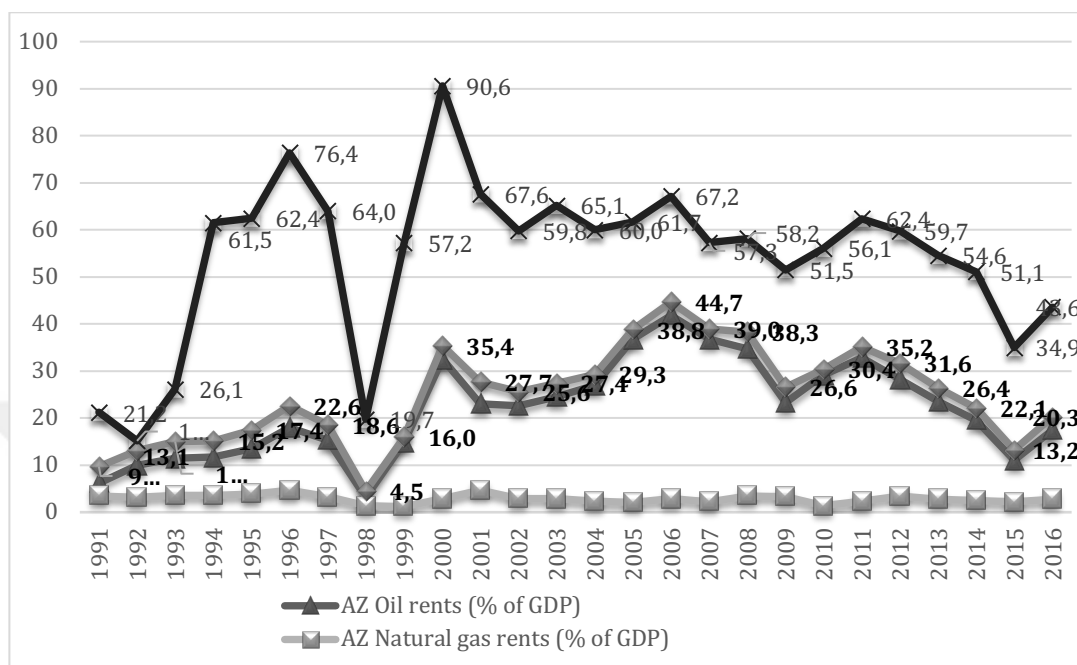


Figure 15: Natural gas⁴⁸ and Oil Rents⁴⁹ in Azerbaijan between 1990-2016 (% of GDP)

Source: World Bank, World Development Indicators

Furthermore, no such oligarchic type of structures blossomed in Azerbaijan as in Russia after Aliyev forced mafia to leave Baku, when he came to power in 1993 (Interview with Anonymous on September 4, 2013). This environment left the government as the only dominant economic actor and this has become more visible as the state started to receive revenues from oil deals. It has become the sole dominant actor in economics. Share of oil and oil products in Azerbaijan's exports surpassed 90 percent share in 2001. Moreover, as can be seen from the Figure 15, oil and natural gas rents had 9.7 percent share in GDP in 1991. This share steadily increased until the collapse of the oil market in 1998, and then made a peak in 2006. As of 2016, the share of natural gas and oil rents in the exports⁵⁰ and the GDP was

⁴⁸ Natural gas rents are the difference between the value of natural gas production at regional prices and total costs of production.

⁴⁹ Oil rents are the difference between the value of crude oil production at regional prices and total costs of production

⁵⁰ I made the estimation by based on World Bank data. The share of natural gas and oil rents in exports= {[Oil rents (%) + Natural gas rents (%)] x GDP in current prices}/Exports in current prices.

43.6 and 20.3 percent respectively. From a broader analysis, the share of mineral fuels, minerals oils and products of their distillation was even higher at 91 percent in the exports of the country (Figure 14). The sector dominates the economy, but only 1 percent of the workforce is employed in energy sector whereas 50 percent is employed in agriculture sector (Ciaretta & Nasirov, 2012: 283). Like in rentier economies, hydrocarbon sector limited the diversity in the economy and it has become more energy exports driven economy as the oil produced in the Caspian marketed in global markets.

Even though there was no strong pressure from inside about the privatization of SOCAR, a Czech businessman, Viktor Kozeny, brought the issue up to the agenda in the late 1990s. He managed to raise a serious fund with his Wall Street partners and it is stipulated that he collected 25 percent of the vouchers in Azerbaijan starting from 1997 by spending 200 million dollars (Weiss, 2009: 124; Urban & Glovin, February 7, 2006). However, the privatization did not happen and Kozeny faced with lawsuits against him. Czech businessman also sued Heydar Aliyev and Ilham Aliyev in New York, claiming that they deceived him (Lowe, November 22, 2002). It seems that there are so many unknowns about the affair between Kozeny and Azerbaijani authorities.⁵¹ Looking at the reports it can be seen that Kozeny developed a special relationship with the deputy head of SPC, Barat Nuriyev, but the issue of SOCAR's privatization faced with a blockade from Aliyev's advisors and himself. SOCAR's president Natiq Aliyev and Ilham Aliyev also criticized the idea of SOCAR's privatization and argued that some service providing outlets of the company might be privatized, but the privatization principal units were not on the agenda as accounting almost 50 percent of the state budget (Azeri Petroleum Complex will not be Privatised, January 5, 2000; German, November 11, 2002; SOCAR Opposes Privatisation of the Principal Production Units, November 8, 2002).

⁵¹ Kozeny claims that Aliyev and his son wanted lion's share from SOCAR's privatization and upon this request he transferred two thirds of Oily Rock company to the President. Oily Rock was a company established as a vehicle to be used during the privatization process in Azerbaijan by Kozeny and other investors. For further information please refer to LeVine, S. (2000, 7 September). Payoffs Alleged in Soured Azerbaijan Oil Deal --- Filing by Czech Promoter Says Investors Knew; Plaintiffs Rebut Charge. *The Wall Street Journal*.

This debate on SOCAR's privatization cost high-level bureaucrats to their careers in the end. Heydar Aliyev sacked head of the SPC, Nadir Nasibly, and the deputy head, Barat Nuriyev at the end of the 1999 (Reuters, December 6, 1999). In Fortune Magazine Peter Elkind's (March 6, 2000) report stipulates "[u]nbeknownst to the Westerners, Nuriyev and others at the SPC were engaged in a power struggle with Aliyev's economic advisers, who opposed privatizing SOCAR anytime soon. Nuriyev's side lost--and he was ousted from the government". Heydar Aliyev put an end to the debate on privatization unequivocally at the end of 2000. He said that "Oil industry may not be privatized in Azerbaijan. It should remain under control of the government...Oil industry will not be privatized during my presidency" (Turan News Agency, November 3, 2000).

Kozeny affair shows that some links established between foreign actors and some state representatives. However, this coalition failed to reach to their ultimate goal of SOCAR's privatization. There can be many reasons of this failure. Kozeny and his friends might have been conned by Azerbaijani actors, while as outsiders they were dreaming of an easy profit because of transition period dynamics in the country. On the other hand, they might have pushed for the privatization by getting into a corrupted affair, but it seems that they failed to overcome the barrier of anti-privatization bloc among whom there were high-level authorities of SOCAR and the president himself. Still, it is hard to make guesses about the background of Kozeny case, but when I asked about privatization of SOCAR during the Aliyev period during my interviews I faced with some questions in return "Why would Aliyev privatize SOCAR, while having chance to keep it for himself" (Interview with Anonymous on September 9, 2013).

After a decade long rule in Azerbaijan, Heydar Aliyev passed away in 2003. His son, Ilham Aliyev, was elected as the new president. When he came to power Ilham Aliyev was 42 years old, but had the advantage of his father's legacy.

While making some fine tunings in the established elite network, Aliyev also continued restructuring of energy sector. The Ministry of Fuel and Energy renamed as the Ministry of Industry and Energy in 2004 and Natiq Aliyev appointed as the new Minister in 2005. Natiq Aliyev was the long-term President of SOCAR and

Ilham Aliyev worked with him during his father's rule. Thus, his appointment as the new minister of energy was not a surprise. Rovnaq Abdullayev replaced Natiq Aliyev in SOCAR. Abdullayev is known as a strong figure of Nakhchivan clan and claimed to be the nephew of Beyler Eyyubov, who is the charismatic figure of Kurdish clan (Gojaye, 2010; 13; Lussac, 2012: 145). Aliyev appointed deputy President of SOCAR, Valekh Aleskerov as the Deputy Speaker of the Parliament and his friend Elshad Nasirov as the new Deputy President of SOCAR (Lussac, 2012: 145). In a way, following his father's steps Ilham Aliyev strengthened his political power by promoting people from his previous career to critical positions. Thus, he also preserved his control on SOCAR by appointing people that he knew before.

Energy sector has become more important in economic and political terms following the first barrel of oil from the Caspian reached to Ceyhan port of Turkey for exports in 2006 and Baku-Tbilisi-Ceyhan pipeline has become the main route for Azerbaijan's oil. Azerbaijan has also started exporting natural gas to Turkey via Baku-Tbilisi-Erzurum pipeline as of 2007. These strengthened SOCAR financially while it remained to be active in negotiations with third parties along with the Ministry of Energy. The company invested heavily in Turkey, particularly in refinery sector, and plans to export Shah Deniz gas to southern Europe via multibillion projects like TANAP and TAP (Ediger & Durmaz, 2016; Ibrahimov, 2017). These investments make Azerbaijan an active player in a broader region. In this regard, it is not only an energy company, but became an important foreign policy tool for Azerbaijan.

In October 2013, Ministry of Industry and Energy renamed as Ministry of Energy, and Ministry of Economy and Industry established (Presidential Order 3 & 4, October 22, 2013). Natiq Aliyev preserved his position as the Minister of Energy, and his portfolio has become more focused on energy issues. The new ministry is responsible of preparation and implementation of energy policy, while SOCAR is the main actor in production and marketing of the produced oil and gas in the country in collaboration with its foreign partners. In this setup, SOCAR's interest from time to time might conflict with the government's interests. SOCAR negotiates with foreign actors both as the representative of the government and as a contractor in the consortium (Ciaretta & Nasirov, 2012: 290).

Looking at the new structure in Azerbaijan's energy sector, SOCAR became even more important in the last two decades. Similar to his father's practices, Ilham Aliyev chose to preserve state control on hydrocarbon sector of Azerbaijan. The presidency has a leverage on the management of the company as it decides about the executive team. Ilham Aliyev has continued to work with the team he knew rather than making frequent shifts in the elite network. In this regard, figures like Ramiz Mehdiyev from Nakhichevan clan or Beyler Eyyubov from Kurdish clan are still influential in the system. Moreover, Natiq Aliyev and Rovnaq Abdullayev are the prominent names of the energy sector. During his rule, Yeraz clan has lost its power, but his wife's family Pashayevs gained power in political and economic terms. The Pashayev family is shown the second influential group after the Nakhichevan clan, but they are mainly influential in non-energy sector.

5. CONCLUSION

This chapter takes Azerbaijan as a representative case in which the state preserved its ownership in the energy sector in the post-Soviet period. Strong political elite integration under the Aliyevs rule promoted state ownership as the elite managed to consolidate its power in the absence of a serious challenge. The political economy of the country played a crucial role in structure of the elite. In this chapter I showed that as a peripheral state, Azerbaijan's underdeveloped economy was based on agriculture and energy sector. This did not change under the 70-year administration of the Communists. The political and economic institutions had a reactive character and mostly manipulated by the RSFSR. The country was dependent on Moscow in many aspects. Its culture, economy and politics were shaped through the policies designed by the actors and institutions in the center. Local administration was mainly responsible for undertaking the orders and preservation of the status quo. Institutions in Azerbaijan had a local character and limited access to abroad. The elite was mainly concentrated around the party and its administrative units. Underdeveloped character of the economy and institutions were also influential on the elite capacity. There was hardly a well-developed human capital with capabilities or knowledge about foreign trade, liberal markets, or finance. Moreover, access to institutions in

Moscow to get necessary permissions or licenses to engage with big business was problematic. This also undermined the elite diversity in the country.

Gorbachev's reform process in essence had important impacts on the USSR in general. These reforms affected Azerbaijan mainly politically by triggering a counter elite movement to emerge just like in the Baltics and the Caucasus around nationalist ideas. Wave of nationalism dispersed rapidly with the emergence of Nagorno-Karabakh issue. This played a crucial role in elimination of Communist leaders one after another in the late 1980s. A similar trend hardly took place in the economic sphere due to several reasons. First, the lag effect caused a delay in the introduction of liberalization policies of perestroika in the society. Moreover, reforms of liberalization were hardly embraced by the administration. Second, even though petty business thrived in the country in the late 1980s, it was hard to talk about an economic elite (like the oligarchs in Russia) in Azerbaijan with accumulated capital and necessary tools in the early 1990s. Yet, Azerbaijan became independent in an environment that a new group emerged as an opposition to the Communist regime, the counter elite. These people had some ideas about the identity issues and demands of regime change, but lacking bureaucratic or political experience.

Abulfaz Elchibey and his friends found themselves on top of the state after the elimination of the former Communist figures. Nevertheless, they were lacking basic resources. Even though certain steps were taken, the very loose integration of the counter elite left it open to manipulation through certain channels and weakened its power of resistance against crises. Shortly after coming to the office, Elchibey faced with threat of a *coup d'état* and decided to leave the capital for his hometown. In fact, this caused elimination of the counter elite and prepared basis for return of the old guard under the leadership of Heydar Aliyev.

The former Secretary General of Azerbaijan Communist Party, Heydar Aliyev, was away from Baku in the dissolution process. At the beginning, he was sidelined by Gorbachev in Moscow, but decided to turn back to Nakhichevan as an active politician. As the speaker of the Nakhichevan Parliament and former leader of the country, he was invited by the President Elchibey to Baku to manage the crisis. Aliyev played his cards right and smoothly replaced Elchibey. He took the support of

the people (the nation) through referenda and elections, but his main advantage was the link between him and the elite. Most of the bureaucratic elite had been appointed during his Communist Party secretariat or under the rule of his protégé Kamran Bagirov. His successors hardly made any serious changes in the elite structure of Azerbaijan. Moreover, he had access to strong clans like the Yeraz and Nakhichevanis. During the Communist era, Aliyev had chosen to promote these groups within the system and these groups preserved their importance in Azerbaijani politics. After taking the control of the state mechanism he managed to sideline domestic resistance with the support of informal and formal networks. He even faced with armed opposition, but controlling the security institutions and the political elite, he successfully eliminated these attempts.

As a well-equipped politician, Aliyev was a credible figure in the society. Other figures failed to leave a legacy in the transition period and were discredited by the society. In terms of institutional and structural integration, his long lasted-rule in Azerbaijan and his KGB past gave him certain advantages in the state building process. Establishing a network based on loyalty, he hardly faced an organized opposition in the absence of an institutionalized party politics in Azerbaijan. Rather his political party, YAP, became the dominant political in Azerbaijani politics. Moreover, in the absence of a value-based fragmentation among the political elite, he was hardly challenged in the political sphere. The nationalist trends and search for the stability in the society further served to his popularity. In this regard, there was a strong political elite integration, and low elite capacity in Azerbaijan under Heydar Aliyev's rule.

Energy sector became one of the main areas of interests of Aliyev. He personally orchestrated policies in the hydrocarbon sector just after taking the presidential office. He appointed his son, Ilham Aliyev, as the deputy president of SOCAR. SOCAR was redesigned after the collapse of the Soviet Union, and under Aliyev's rule its vertically integrated structure further consolidated. In the privatization process, energy sector was kept out of the program. Even though certain figures within cooperation with foreign actors sought to privatize SOCAR, they failed. The attempt to privatize SOCAR is a blurred case in Azerbaijan politics. It seems that certain bureaucratic figures, and maybe some elements from the presidential office

took role in this case. In the last analysis, Aliyev decided to keep SOCAR under the control of the state. In my interviews, most of the respondents said that he had the control on the state and SOCAR was a strategic asset. Thus, the rational thing for Aliyev was to preserve state's ownership in the energy sector.

Looking at Heydar Aliyev's period, SOCAR became an important economic and political asset. Agreements with international oil companies provided significant financial resources during the transition period. Moreover, Aliyev established diplomatic links based on mutual interests with European and Russian governments.

Flow of petro-dollars gained momentum in the 2000s, when Ilham Aliyev came to power. The consolidation of the state's control on the energy company continued in the 2000s. SOCAR became an international actor with its investments abroad. Azerbaijan shows characteristics of a rentier state as the oil sector dominates the economy. Certain flaws of Dutch disease can be seen in the economy. The other economic sectors hardly thrived in the last three decades. Moreover, dependence on oil rents creates fragilities in the economy in times declining oil prices in the international markets.

The privatization of SOCAR is not a part of the political agenda. The state control continued to consolidate under Ilham Aliyev's rule. The strong political elite integration in the country continues. The country's peripheral characters prevail and state dominates the economy. Elite capacity hardly developed in the last three decades. The crony-capitalist system and family ties serve to the strong elite integration in Azerbaijan. Even though clan-based politics weakened with the Yeraz clan's charismatic figures were eliminated from the mainstream, still Nakhichevanis are influential in the system. Moreover, families like Pashayevs became part of the political elite in the 2000s. Aliyev with the dominant political elite group orchestrates the distribution of wealth and power in the country. Thus, it is hard to talk about a possible emergence of privately-owned national energy company to control the majority of the sector in the near future.

CHAPTER 5

CONCLUSION

1. Summary of the Argument in a Comparative Manner

This dissertation explores the political economy of energy sector restructuring in the post-Soviet space and the role of elite integration in this process. The energy sector has attracted much interest in the literature on post-Soviet studies due to outstanding hydrocarbon resources in the region. In fact, energy resources played a crucial role in the transition process in all countries in the newly independent states as manifested in different domestic socio-political developments. Although this space is comprised of countries with exceptionally rich hydrocarbon resources, the socio-political experiences these countries went under are far from unique, reflecting each country's own nationally-specific features.

One of the key nationally-specific features, in this region, is diverse processes of emergence of different ownership structures. This dissertation shows that there is a clear difference among the Russian Federation and all other cases in the post-Soviet space. All countries in the post-Soviet countries, other than the Russian Federation, preserved their state monopolies in the energy sector and cooperated with international oil companies to varying degrees. Russia, on the other hand, is a unique case with the emergence of privately-owned national energy companies that almost exclusively controlled the majority of energy sector. Looking at this fact, I address the following three interrelated questions in this dissertation: “How does energy sector ownership change after exogenous shocks (such as regime breakdowns) in a hydrocarbon-rich country?”. In particular, “Under what conditions the restructuring of the energy sector ended up with the state's relinquishing control of the most strategic sector in Russia, but not in other post-Soviet countries?”, and “Under what conditions the state sustained and regained control on the energy sector in the post-Soviet space?”.

In addressing these questions, I argue that differences in the elite structure affects the ownership structure in the energy sector. To build my argument that the elite structure has an effect on the restructuring of the energy sector, I use comparative historical analysis methods. Using a causal narrative method, I compare and analyze two periods in Russia and compare these two cases with the Azerbaijani experience in the post-Soviet period. I choose Azerbaijan as the representative case as being the most similar case to the Russian Federation. I exclude Turkmenistan and Kazakhstan, the other hydrocarbon-rich countries in the post-Soviet space, for reasons of parsimony.

In explaining diverse historical political economic outcomes, I develop a synthetic approach that I call *comparative elite structure model*. The rationale behind this theoretical model is to open a new perspective on the state-centered approach in the literature on political economy of hydrocarbon resources. I bring together two traditional approaches to explain the dynamics behind the differentiation in elite structures in different cases in a comparative manner: work on elite theory (Burton, Higley and Gunther, 1992; Giddens, 1971; Putnam, 1976; Michels, 1915; Mills 2000; Mosca, 1939; Pareto, 1991) and studies on the center-periphery divide (Shils, 1975). In my model, I focus on the *elite structure* in the post-Soviet space where I examine *political elite integration* and *elite capacity*. I operationalize political elite integration through exploring three components: (i) structural integration, (ii) institutional context and (iii) value consensus. Bringing in center-periphery divide into this debate I further argue that the historical context has implications on a country's elite structure in *the transition process*. The dissertation builds on the claim that the more centralized the political economy in a country, the higher the elite capacity and the weaker the political elite integration. Or the more peripheralized the political economy, the lower the elite capacity and the stronger the political elite integration. Considering the ownership in the hydrocarbon sector as the *dependent variable*, this dissertation takes the elite structure as the *independent variable* by looking at its dimensions of political elite integration and elite capacity and takes the context of political economic development as *conditional variable*.

The state in Azerbaijan and that in the Russian Federation have restructured and recast their key economic sector in entirely different ways. The state in Azerbaijan

preserved its monopoly in the energy sector throughout the 1990s and further consolidated its ownership under a state monopoly, SOCAR, throughout the 2000s and 2010s. The Russian experience of the 1990s contrasts with that in Azerbaijan. Russia of the 1990s built its privately-owned national companies that gained more than 50 percent share of the energy sector under Yeltsin's rule. The Russian state of the 2000s, however, reclaimed the sector's control once again and became the dominant actor under Putin. Although some privately-owned national companies remained as crucial players in the sector, they remained under a tight leash of the Kremlin. Thus, I examine the Russian Federation in two periods representing two cases. I rely on elite structure by exploring the nature of elite integration and elite capacity.

In terms of *political elite integration*, I characterize the first period under Yeltsin as *weak integration*. *Structural integration* and *value consensus* among the political elite was *weak*. Political elite network around Yeltsin was constituted of different factions coming from different backgrounds and had different perspectives about "what is to be done" and "how is to be done". Furthermore, there was a fragmented *institutional context* that fed the *weak* elite integration due to omnipresence of old political elite with conservative tendencies in legislative processes and a lack of a strong political party supporting Yeltsin.

In terms of *elite capacity*, I characterize this period as *high capacity* under the influence of the legacy of the past. Looking at the historical context, the RSFSR was the *center* of the USSR and it had the most developed institutions and human capital. The Russian elite were trained to be competent in designing and organizing policies from the capital and had access to the international system. These actors gained a broad maneuvering space even before the dissolution with Gorbachev's perestroika reforms. Implementation of these reforms were faster and easier in the center than in the periphery. Actors had better training and access to institutions in the center to exploit the advantages of the reform process. Following a period of liberalization under Gorbachev, members of the economic elite (oligarchs) and the political elite (nomenklatura) found themselves in a favorable atmosphere with more developed tools to pursue their own interests as the Soviet Union dissolved in 1992.

After the dissolution, state authority weakened in Russia just like in the other post-Soviet states. *The political elite integration* was *weak* due to high elite diversity. The new political elite was concerned of a revival of the old communist regime. Facing limited institutional constraints, economic (oligarchs) and political elite (nomenklatura), with both will and capability, gained a favorable maneuverable space to maximize their interests. They easily manipulated or shaped the privatization process to capture lucrative energy assets in Russia. Furthermore, the liberal wing within the political elite was orchestrating the privatization policies. They promoted policies of irreversible privatization and promoted emergence of new actors. The rationale behind this motive was preventing a setback in the transition process, which would end up with the return of the Communists to the power. As a result, privately owned national energy companies emerged under Yeltsin. In the end, a hybrid structure emerged in the energy sector. *Privately-owned national energy companies dominated the sector* in oil production and resource ownership. The new owners of these vertically integrated energy companies were infamous oligarchs and members of the nomenklatura who had access to the Kremlin. This opened the gates of political decision-making processes to the rising oligarchs and weakened the existing political elite. The gas sector had a different character where the state monopoly prevailed. In time, however, state's control on its administration grew weakened. The managerial team exploited Gazprom's resources through different channels like subcontractors, whereas the Kremlin had problems of having full control on the company.

In the second case under Putin, we observe a *re-statization* of the *Russian energy sector*. In terms of *the political elite integration*, I characterize this period as *strong integration*. The political elite around Putin was constituted of mainly technocrats from St. Petersburg (*pitirsky*) municipality and the *siloviki*. Putin worked with these actors throughout his former career as a KGB agent and as the deputy of a former St. Petersburg's mayor. Therefore, members of Putin's elite network were coming from similar professional backgrounds and thus had similar approaches to "what is to be done". These actors were not happy with the intricate privatization processes of the 1990s. Instead, they vied rebuilding the strong Russian state once again. Even though there were some differences about "how to reach to these goals" among these actors, the differences did not prevent them from acting together when necessary. This

shows a markedly *stronger structural integration* and *value consensus* among the political elite under Putin's rule than that under Yeltsin. *The political elite integration* was *strong* at the *institutional context*, too. When he became Yeltsin's successor, Putin had already reshuffled the cadres of the FSB and the prime ministry with the siloviki and technocrats from his network as former head of the FSB and Yeltsin's prime minister. In this way he re-gained control on key institutions in the country. Additionally, Putin's policies of recentralization and the omnipresence of a pro-Putin party in the Duma, United Russia, backing him further consolidated elite integration at the institutional level.

Elite capacity was *high* in the Putin period. Members of the nomenklatura managed to survive within the system and the economic elite had prospered throughout the 1980 and 1990s. This was the case despite a series of deep political and economic shocks. Russia remained in the leading position in the entire post-Soviet space. Although some features of the *center* showed signs of weakening with Russia's integration into the international system, the center mostly preserved its *high elite capacity* and *strong institutional infrastructure*. In spite of its high capacity, the economic elite faced difficulties in preserving and maximizing their interests under Putin. This was obvious when the Kremlin decided to strengthen the central power and take the energy sector under control by imposing new rules such as a new tax reform. Energy was undoubtedly the most important sector for Putin. Even in his doctoral thesis, he emphasized the vitality of this sector for Russia's future. Key members of Putin's elite network, like Igor Sechin and Aleksey Kudrin, also had similar aspirations for controlling Russia's energy sector.

Russian privatization of the energy sector in the 1990s falls into a period when the oil prices hit rock bottom. The new owners (nomenklatura and oligarchs) hardly opted for paying taxes, but made millions of dollars investments into increasing production from the hitherto under-invested oilfields under the Soviet rule. When the prices started to increase in the 2000s, production recovered with the introduction of new technology and administration. On the one hand, there was an industry with high revenue rates, but hardly paying taxes. On the other hand, there was a new government with members from the ranks of security institutions believing in re-establishing order, but inherited a broken system. Thus, hikes in prices definitely

made the sector even more attractive for re-statization along with other political dynamics.

The fact that the political elite under Putin's rule had a *strong integration* contrasts with the economic elite being far from integrated since the late 1990s. Putin opted for strengthening state power through centralization policies. Using law enforcement measures and controlling federal power, the Kremlin eliminated or co-opted oligarchs in the energy sector starting from early 2000s. The economic elite failed to withstand pressures from the strongly integrated political elite under Putin. They either chose to surrender and obey to the new rules of the game, or lost their ownership in the sector after rounds of futile resistance. As of 2005, the balance between the privately-owned national energy companies and state-owned companies reversed. The share of the *privately-owned national companies* in the oil sector *shrunk* whereas the *state-owned companies expanded*. The state-owned companies, Rosneft and Gazprom, became the key actors and members of Putin's elite network became top managers. The privately-owned national companies like Lukoil and Surgutneftegaz survived the re-statization process, but their share in the Russian energy sector hardly expanded under Putin.

Putin and the siloviki seem to have a conservative stance about the limits of autonomy of non-state actors in Russia. The energy industry became a key economic base for channeling funds to the state budget. The share of oil and gas revenues in the federal budget peaked at 51.3 percent in 2014. Even after the plunge in oil prices, revenues of hydrocarbon resources constituted 39.6 percent of the budget in 2017. There are similarities with respect to the share of hydrocarbon rents in the exports and those in the federal budget. Excluding production cost and refined products, the share of oil and gas rents in exports was 37.8 percent in 2016. Apart from its fiscal benefits, the sector serves as a key mechanism for wealth re-distribution. The Kremlin has an advantage of giving licenses and contracts to the new economic elite through state-owned companies. Thus, the Russian economy revolves around a crony capitalist system in which the energy sector plays a critical role. Furthermore, the energy companies equipped Russian foreign policy with access to and leverage in different geographies like Europe, the Middle East, Central Asia and Eastern Mediterranean.

In the case of Azerbaijan, following an ephemeral period of rule of by counter elite, Heydar Aliyev came to power who was then succeeded by his son, Ilham Aliyev. In terms of *political elite integration*, I characterize the Azerbaijan case with *strong integration*. As a *peripheral state*, *elite capacity* and *elite diversity* were both *low* in Azerbaijan. Other than Heydar Aliyev, no serious groupings or actors emerged after the collapse of the Soviet Union that managed to stay on power and make dramatic shuffling in the elite structure. Thus, *structural integration* was *strong* under the Aliyevs. Heydar Aliyev, like Vladimir Putin, was a former KGB agent and ruled the country for more than a decade under the Communist regime. Under his administration, certain clans (Nakhichevan and Yeraz) were favored in Azerbaijan and these cadres remained mostly untouched even after Aliyev's departure for Moscow in 1982. Gorbachev's liberalization policies hardly made any changes in the peripheral state's economy, but triggered a nationalist movement with an anti-Communist stance. The subsequent regime change eliminated the Communist Party from the scene in Azerbaijan. Having a loose structure, the counter elite movement (the Popular Front) failed to fill the power vacuum in the country. As expected, this movement hardly made dramatic changes in the cadres. Coming back to power, Aliyev re-established order and reclaimed his legacy. Investing once again in clan-based politics in his elite network, he further consolidated elite integration in the political sphere. In the absence of an institutionalized political party culture, political groups gathered around charismatic figures, and the strongest figure was Aliyev. The Aliyevs' political party, YAP, dominated Azerbaijani politics, by taking advantage of the presidential administration. Other political parties had problems of access to political power and lacked the necessary human capital. Naturally, these parties became irrelevant in power politics in time. Thus, the Aliyevs established a strong control at both the executive and legislative level. Under these circumstances it is hard to talk about an institutional divide – a *strong elite integration* persisted under the aegis of the presidential palace. The absence of any serious fragmentation in Azerbaijan's elite structures about "what is to be done" and "how is to be done" contributed further on Aliyev's power. The main concern had become political *stability* in times of ethnic conflict which further amalgamated Aliyev's rule. Therefore, the Aliyevs hardly faced any ideological challenges and enjoyed a *value consensus* among the ruling elite on maintaining stability in Azerbaijan following an

ethnic conflict. In this case, therefore, elite integration was strong in structural and institutional terms and there were no strict factions in value consensus.

Unlike strong political elite integration, *elite capacity* was low in Azerbaijan.

Azerbaijan was a peripheral country under the Communist system. Governed from Moscow, institutions had a reactive and a simpler character rather than being innovative and sophisticated. There was no direct access to the international system and the elite in Azerbaijan was less competent than that in Russia. The reform process under Gorbachev's rule had no serious impact on transformation of basics of political economy and did not lead to emergence of an economic class with capital accumulation. Subsequently, the privatization process was mainly shaped by the political elite and the extractive industry was kept out of the privatization process.

Similar to Russia, steps for establishing a vertically integrated energy company were taken in 1990s. *State ownership prevailed and was consolidated* under the Aliyevs. After coming to power, Heydar Aliyev took over the administrative control of the energy sector and appointed his son to the top management of the state monopoly. Even though certain figures sought to privatize SOCAR in the second half 1990s, all these attempts failed. The policy decision to keep the energy sector out of the privatization process by the political elite and lack of capable elite networks within political and economic circles were main factors behind this failure. Petrodollars mainly came through royalties taken from foreign companies under Heydar Aliyev's rule, but his son, Ilham, enjoyed oil windfalls particularly in the second half of 2000s. SOCAR remained as the key player that dominated economic development in the country. Even in the early 2000 SOCAR was providing more than 50 percent of financial funds for the budget. Excluding production cost and refined products, the share of hydrocarbon rents was 43.6 percent of exports in 2016. The share of mineral fuels, mineral oils and product of their distillation constituted 91 percent of exports in the same year. SOCAR became one of the main gas exporters in the region. Just like in Russian energy companies, the state monopoly became an important actor both in gas and oil industry both for domestic and foreign markets. This activism along with multibillion-dollar investment portfolio in neighboring countries gave Azerbaijani government certain leverages in foreign policy. The clan-based relations

have lost momentum under Ilham Aliyev, but a crony capitalist relation system based on redistribution of oil wealth through contracts or licenses evolved in the country.

Let us re-visit the empirical data on the impact of nature of elite structure on energy sector restructuring across the three cases under study: Yeltsin's Russia where privately-owned national companies dominated the energy sector, and Putin's Russia and Aliyevs' Azerbaijan where the energy sector was dominated by the state.

In terms of the outcomes this dissertation is addressing, Yeltsin's Russia markedly differs from Putin's Russia and Aliyev's Azerbaijan. Yeltsin's Russia is characterized by *weak political elite integration* with *high elite capacity*. It is this combination of the two dimensions of elite structure that resulted in energy sector restructuring in Yeltsin's Russia in transition with the emergence of privately-owned national companies. As the successor of the RSFSR, the Russian Federation had a more developed institutional infrastructure and human capital. In the transition period, elite integration was weak, because in the center different elite groups emerged thanks to high elite capacity and diversity. Actors tended to pursue their own interests and gained leverage to manipulate and shape policies with the presence of weak political elite integration. The combination of weak political elite integration with high capacity of the elites in Russia led to a hybrid structure in the energy sector. On the one hand, privately-owned national energy companies emerged in the oil sector. On the other hand, the gas industry was kept intact under the control of the state by Yeltsin's longest served prime minister, Viktor Chernomyrdin. The hybrid structure in the sector shows the primacy of agency of the elite and their preferences for driving energy sector restructuring.

The two other cases, Putin's Russia and Aliyevs' Azerbaijan, the energy sector remained under the dominance of the state. These two cases display striking similarities with respect to political elite integration. I categorized both of these cases as *strong integration* cases. Elite capacity differed markedly across these two cases due to differences in political economic context in Russia and Azerbaijan. It was strong elite integration, therefore, that led to re-consolidation of state control in the energy sector. From a comparative perspective, these cases show that, *the stronger the political elite integration, the stronger the control of the state remaining in the*

energy sector. In countries with strong elite integration, therefore, the political elite seeks to maximize state's control over the energy sector. Elite capacity, the case studies show, is of no consequence. In these cases, the strongly integrated political elite uses the judiciary, executive and legislative mechanisms and over-power the economic elite who seeks to control the energy sector themselves. Control of the energy sector through state owned companies as such advantages the political elite in the redistribution of resources (hydrocarbon rents). These advantages, in turn, results in less dependence on taxes from citizens thanks to fiscal revenues accruing from petrodollars. Yet, in neither of these cases, states' sharing control with foreign actors in the energy sector is ruled out. My interview data shows that sharing of control may be allowed since international oil companies bring necessary capital and technology to exploit rich hydrocarbon resources.

2. The Dissertation's Contributions to the Literature

This dissertation analyzes the conditions under which privately-owned national energy companies emerged in the post-Soviet space and others which led to consolidation of state control of the energy sector. The literature on political economy of hydrocarbon resources generally overlooks the emergence of privately-owned national energy companies. The literature largely focuses on the impact of hydrocarbon resources on political and economic institutions and takes energy sector as given. This literature is mainly developed around the debates on the rentier state or the resource curse (Beblawi & Luciani, 1987; Humphreys et.al., 2007; Luong and Weinthal, 2010; Mahdavy, 1970; Ross, 1999; Robinson et. al., 2006), in which the state is taken as a black box. In these studies, the role of agency of the elite in energy sector restructuring is underexplored (Sarbu, 2014). The literature on nationalization and expropriation opens a window of understanding about the ownership structure in energy sector in a limited fashion. These studies look at state's domination in the sector in relation with the foreign oil companies (Duncan, 2006; Guriev, Kolotilin, Sonin, 2011; Mahdavi, 2014; Warshaw, 2012). What is generally overlooked in the literature is the emergence of privately-owned national energy companies in domestic settings and the dynamics behind these processes. Even though there are some studies with a regional or country focus looking at the expropriation or privatization experiences (Grace, 2005; Gustafson, 2013; Hoffman, 2011; Li Chen,

2008; Stern 2005), these do not aim at gaining comparative leverage for theoretical explanation. This dissertation relies on a comparative research design in building a theoretical model explaining diverse cases of energy sector restructuring. It looks at the rise and fall of privately-owned national energy companies with a comparative approach in the post-Soviet space. It shows that state ownership in the energy sector is not a static phenomenon. Instead, it shows how ownership may change after a regime breakdown under certain conditions.

In the literature it is argued that “[i]nstitutions constrain elites quite strongly. However, in times of basic reform and transformation – such as the post socialist countries experienced during the 1990s – institutions are in flux and consequently, elites have wider latitudes of choice and action” (Higley & Lengyel, 2000: 1-2). Thus, the literature argues that there is a negative correlation between system’s resistance and maneuverability of the agency of the elite. This argument, this dissertation shows, is only partly true: it helps explain the restructuring of the energy sector in post-Soviet Russia. Similar exogenous shocks emerged in the same geography, in Azerbaijan, Turkmenistan and Kazakhstan, yet *without* the same consequences. Therefore, this literature falls short of explaining the long status quo structure in post-Soviet states (other than Russia) after the collapse of the Soviet Union. Thus, energy sector restructuring must have an alternative explanation. This is what this dissertation aims to show.

First, elites need to have certain capabilities to challenge certain mechanisms or shaping policy making processes. These capabilities limit or determine the capacity of affecting the system even in a transition period. I conceptualize these capabilities as the elite capacity in this study. In the case of Russia, political and economic elite with high capacity successfully took over the political system at a time of transition. This resulted in the domination of privately-owned national companies of the key sector in the Russian economy. In Azerbaijan, however, such a dramatic change in ownership did not emerge due to low elite capacity in the transition period.

Second, political elite integration is a crucial factor conditioning the restructuring processes of the energy sector beyond the capacity of the elite. Strongly integrated political elite structures have certain leverages. They have the advantage of using law

enforcement units and fiscal mechanisms to shape the political and economic sphere. The economic elite failed to preserve their interests in the energy sector under Putin's rule, even if they proved to be capable enough to maximize their interests with their capital, links, media power under Yeltsin's rule with weak elite integration. Only through opening the black box of the state, through the model I outline in this dissertation, can we see how actors make decisions. This model depicting actors' behavior brings the agency of the elite to the fore. Elites have power to drive policy making mechanisms, but their capability to affect depends on the elite structure in a given political setting. Elite capacity and political elite integration, therefore, are important factors conditioning the outcomes in energy sector in transition periods of energy rich countries.

Centering on elite integration as a concept offers an important insight here. Although there have been many studies on the elite, the concept has not been adequately operationalized to explore different cases in a comparative perspective. I offer a parsimonious model with *comparative elite structure* model by looking at three key components to understand the level of political elite integration in a country. These are *institutional context*, *structural integration*, and *value consensus*.

This theoretical model also establishes a link between the level of development of a given political economy and its dominant elite structure. The two Russian and the single Azerbaijani cases show that there is a close relationship between elite structure and the level of development of a political economy. Russia, as the center of the USSR, was the most developed country in the post-Soviet space. Azerbaijan, however, displays characteristic features of a peripheral state. In the transition processes, the differentiation in their levels of political economic development led to different outcomes. The diversity within the elite and their high capacity *in the center* led to the formation of different factions to emerge with different goals in Yeltsin's Russia. The lack of diversity within the elite and their low capacity *in the periphery* led to monolithic elite structure with common goals in Azerbaijan. These two cases reveal that even when two political economies share the same regime legacy preceding a transition period, their level of economic development will define the nature of elite structure and hence the outcomes in energy sector.

3. Findings that Support the Conventional Literature

Some of the findings of this study support the insights from two debates in the conventional literature. First, the rentier state debate, in a nutshell, claims that, in energy rich countries, petrodollars hinder economic development. Oil rents are mainly seen as resource curse or Dutch disease in the literature (Ross, 1999; Robinson et. al., 2006; Humphreys et.al., 2007; Krugman, 1987; Corden, 1984; Torvik 2001). Increase in the flow of petrodollars with the windfalls in the oil markets lead to domination of energy sector products in the export baskets of Azerbaijan and Russia. This has become, as the literature expects, a structural problem in these countries. These problems are further aggravated by economic fragilities stemming from the under-development of non-hydrocarbon sectors and the economic slowdowns in times of fluctuations in the world oil markets.

The literature also draws our attention to institutional features like nepotism and crony-capitalism in energy rich countries as the state-owned companies dominate the sector (Goldman, 2007; Dawisha, 2014). This gives certain advantages to the political elite to favor their clientelist networks via the resources under their control. My findings support the literature which claims that state ownership in the energy sector provides further advantages for the political elite both in Azerbaijan and Russia. The political elite has the capability of distributing oil wealth in accordance with their interests. This provides legitimacy for the regime and also helps to reproduce the regime through clientelist networks. Moreover, I also show, in line with Balmaceda (2008: 5), that the political elite's access to decision making mechanism in the energy sector makes state-owned companies instruments of domestic and foreign policy agenda. Moreover, the literature argued that foreign direct investment in the energy sector consolidates the regime and increases authoritarian tendencies (Bayulgen, 2010). My study has a similar finding that elite structure in Azerbaijan has an unchanging character with strong entry barriers into the political system thanks to financial funds received via foreign direct investment.

Second, the debate on privatization and nationalization/expropriation (Guriev et.al., 2011; Duncan, 2006; Warshaw, 2012) argues that in time of low prices, privatization is the general strategy. The literature also argues that an opposite strategy dominates

when oil prices rise in global markets. My study supports this claim for the post-Soviet space, but it goes beyond what the literature points to. In the post-Soviet period, foreign oil companies gained access to the energy sector in Russia, Azerbaijan, and Kazakhstan. But the Russian elite opted for privatization to domestic firms rather than promoting foreign investment both in the Yeltsin and the Putin periods. The infamous “loans for shares” program under Yeltsin is a striking case in point. Rather than raising potentially larger funds through competitive privatization by opening the market to foreign oil companies, the Kremlin outright favored the Russian oligarchs. Thus, the privatization process depended not only on world commodity (i.e., oil) prices, but also the elite structure and their capacity to shape decisions on energy sector restructuring.

This study, therefore, supports the conventional literature in two ways. First, dependence on hydrocarbon rents hinders economic and political development by creating more fragile systems in economic terms and promoting non-democratic regime types. Second, oil price is an important determinant in privatization decision of the political elite. Yet, the elite structure also matters in shaping decisions of privatization in the energy sector.

4. Summary and Discussion

This study shows that, after a regime breakdown, ownership in the energy sector may change in an energy-rich economy with the condition of having a high elite capacity and weak elite integration. Elites gain a larger room for maneuvering in times of transition periods. Having necessary will and capability, elites can override or manipulate weakened institutional limitations. However, their will and capability may face certain resistance in case of strongly integrated elite structures. Elites, under these circumstances, may fail to challenge the status quo in maximizing or preserving their interests. This study, therefore, brings new insights into *the structure-agency* debate in the social sciences by introducing the concepts of elite integration and elite capacity.

The literature on the state has developed immensely in the late 1970s and early 1980s which corresponds to the period when the literature on political economy of oil

flourished. The literature on hydrocarbon resources has been looking at the impact of oil revenues in energy rich countries. It hardly explored the changes in the ownership structure in a comparative manner. Even though there are studies on nationalization, expropriation and privatization, scholars categorically overlook the dynamics behind the emergence of privately-owned national energy companies. This study integrates the elite dynamics for exploring processes of restructuring of the energy sector after a regime breakdown. I present a theoretical model in this study by integrating two bodies of literature –the elite theory and Edward Shil’s theory on center-periphery divide – to explore the political dynamics of restructuring in the post-Soviet space. I call this model the *comparative elite structure*. Using comparative political methodology and causal narrative method, I view the state not as a black box; rather I focus on the outcomes as products of elites in a given political economy. Thus, this study looks beyond the conventional perspectives on the state to explore changing political economies. I argue that we need to focus on the nature of elite structure in the post-Soviet space in order to explain the emergence of privately-owned national energy companies therein.

In this dissertation, I looked at Azerbaijan and Russia in a comparative manner as the most similar cases in the post-Soviet space. Even though these two countries have so many similarities, they followed different paths in restructuring their energy sector. In this regard, I argue that having similar historical backgrounds, countries with different elite structures will end up with different ownership models in the transition period.

Comparing the two periods in Russia across themselves, and with Azerbaijan, I conclude that the stronger the political elite integration, the less likely the emergence of privately-owned energy companies in the post-Soviet space. On the one hand, as political elite integration gets stronger, political elite tend to preserve and consolidate state ownership in energy sector further. On the other hand, the weaker the political elite integration and the higher the elite capacity, the likelihood of domestic actors to gain control in the energy sector increases as elites take advantage of political fluctuations in a country to maximize their own interests. In neither of these cases do we observe the exclusion of foreign actors. The need for advanced technology and

capital, in particular, paves the way for foreign oil companies to penetrate into the sector to varying degrees.

Looking at the findings of this dissertation, I argue that it is not possible to expect emergence of privately-owned national energy companies that control the majority of the sector in Azerbaijan, Turkmenistan, or Kazakhstan in the near future.

Considering the prevailing peripheral characteristics that lead to the absence of elite diversity and low elite capacity in the post-Soviet period, these factors will limit the possibility of emergence of privately-owned national energy companies even after a potential regime break down in the future. Russia on the other hand is still a contrasting case. There are still elites with high capacity in Russian elite structure, and this makes the re-gaining of control of the majority of the sector by privately-owned national energy companies in the sector still possible. Yet, this is currently unlikely considering the regime stability and strong elite integration. In fact, the history under Putin's rule shows that as the political elite integration continues to consolidate at the expense of elite capacity and diversity, the autonomy of privately-owned national companies weakens while the state-owned energy companies expand their share in the energy sector.

The comparative elite structure model offers a parsimonious framework for exploring the prospects for energy sector restructuring in the post-Soviet space. This model can be adopted in case studies that analyze other significant political dynamics. As based on small-n comparative case studies and having certain assumptions, there are limitations of this study. Nevertheless, it may still offer insights on energy-rich countries outside of the post-Soviet space. Looking at their elite structures and political economy certain predictions can be made about possibilities of change in ownership to test the given theoretical framework in the future. Considering the findings, further studies can be conducted on differences in ownership models and their implications on foreign policy, regime type and regime stability for energy rich countries. Moreover, this model can be tested further to have a better insight about large scale privatizations or public procurements in transitory countries.

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APPENDIX

Guidelines for Interviews

1. The Russian Federation:

Transformation of Elite Structure

- 1) How can you describe the elite structure (political, economic etc.) in Russia during 1990s? Was it monolithic or pluralist?
 - How can you categorize different political groups in the post-Soviet period?
 - Was there a consensus or dispute regarding the policies to be pursued in the transition process?
- 2) How did the pluralist elite take form in the post-Soviet era?
 - What was the role of Gorbachev's perestroika politics?
 - How did the privatization policies affect the formation of business elite?
 - Didn't the elite in the local level get the privilege of foreign trade during the Gorbachev period? (For Azerbaijan)

Political Bargaining with Interest Groups

- 3) Keeping in mind the structure of the elite in the 1990s what can you say about the Yeltsin administration's power in politics? Could Yeltsin consolidate his power just after the August 1991 coup?
 - Were any compromises given by the Yeltsin administration to different interest groups for sustaining its political power during the transition period?
 - Did Yeltsin need the support of business elite at any point of his administration to preserve his political power? Why and How?

Restructuring Energy Sector

- 4) How can you describe the structuring of the energy sector (i.e. gas and oil) in the aftermath of the dissolution of the USSR?
 - Was there a peculiar characteristic of privatization of the energy sector in 1990s?
 - What were the differences between emerge of Lukoil, Yukos, and Surgutneftegaz during the privatization of 1992 by the Presidential decree and the privatization during the Loans for Share program?
 - Why did the privatization of the oil sector and gas sector was differentiated? While the energy sector was divided into pieces the gas sector restructured under the monopoly of Gazprom?

- Was there a competition among the business elite to get the control of energy assets?
- 5) Why did some companies allowed to be private whereas the others remained at the control of the state?
 - 6) How did the private energy enterprises emerge in Russia, but not in other former Soviet Union countries? What was the peculiar characteristic of the Russian Federation?

Putin Period

- 7) Comparing Putin's era with Yeltsin were there any differences in terms of political elite-interest group relations?
 - Could Putin sustain a consensus among different groups and consolidate his power? If so, how?
- 8) Why did the state control increased on energy sector by strengthening Gazprom and Rosneft during the Putin administration?
 - Was it something political or economic?
 - Considering Yeltsin's constraint how did Putin succeeded to challenge the economic elite? What was the source of his power?
 - Were there any differentiations in policies conducted towards non-state national energy companies and foreign energy companies?

2. Azerbaijan:

Transformation of Elite Structure

- 1) How can you describe the elite structure (political, economic etc.) in Azerbaijan during 1990s? Was it monolithic or pluralist?
 - How can you categorize different groups in the post-Soviet period?
 - Was there a consensus or dispute regarding the policies to be pursued in the transition process?
 - What was the role of Gorbachev's perestroika politics on the formation of political elite in Azerbaijan?
 - Did the elite in Azerbaijan get the privilege of foreign trade during the Gorbachev period?
- 2) Comparing Ilham Aliyev period with Heydar Aliyev's were there any differences in terms of elite structure?

Political Bargaining with Interest Groups

- 3) Keeping in mind the structure of the elite in the 1990s what can you say about Heydar Aliyev's power in politics? Could Aliyev consolidate his power just after the fall of the Popular Front (Elchibey)?

- 4) Were any compromises given by the Aliyev administration to different interest groups for sustaining its political power during the transition period?
- 5) Did Heydar Aliyev need the support of business elite at any point of his administration to preserve his political power? Why and How?

Restructuring Energy Sector

- 6) How can you describe the structuring of Azerbaijan's energy sector (i.e. gas and oil) in the aftermath of the dissolution of the USSR?
 - Was there an attempt of privatization of the energy assets?
 - What were the reasons behind keeping state monopoly (SOCAR) in the energy sector?
- 7) Why did some state assets privatized whereas the others remained at the control of the state?
- 8) How did the private energy enterprises emerge in Russia, but not in other former Soviet Union countries? What was the peculiar characteristic of the Russian Federation?