

## Analysis

# Gazprom's Role in Regional Politics: The Case of the Yamalo-Nenets Autonomous Okrug

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## Summary

The Yamalo-Nenets Autonomous Okrug in northwestern Siberia is Gazprom's most important prospecting region, representing more than 80 per cent of the corporation's total extraction. Gazprom therefore has considerable influence in the region. Its tax payments now amount to 70 per cent of the region's budget revenues. The company has also become involved politically. Gazprom's representatives hold 36 per cent of the votes in the regional parliament. Over the past years, the company has increasingly tried to assert control over regional politics.

## Introduction

The Yamalo-Nenets Autonomous Okrug in northwestern Siberia is Gazprom's most important prospecting region, representing more than 80 per cent of the corporation's total extraction. Tax revenues from local natural gas and oil companies cover 90 per cent of the region's budget. Approximately 60 per cent of the tax revenue is derived from Gazprom subsidiaries, while another 10 per cent comes from the oil company Sibneft, which is now also part of Gazprom.

Gazprom is also represented in regional politics. On the one hand, the company is closely linked to the municipal administrations where gas is extracted; on the other hand, Gazprom is directly represented through its own deputies in the regional parliament, who held 28.8 per cent of the seats during the 2000-2005 election period. Gazprom (including Sibneft) has managed to increase its representation in the new regional parliament to 36.4 per cent; as a rule, the company is represented in parliament by executive managers of its regional subsidiaries.

## Gazprom's entry into regional politics

Gazprom's engagement in Russian regional politics began with the Russian parliamentary elections in 1993, in which the candidate supported by Gazprom in the Yamalo-Nenets Autonomous Okrug failed to win a seat. His opponent won the constituency by sharply criticizing Gazprom after the gas company had defaulted on payment of wages and social contributions. This defeat at the national polls was widely regarded as a poke in the eye for Gazprom from the regional electorate. The Gazprom management reacted by engaging more actively in regional politics.

The replacement of the regional governor at the

behest of President Boris Yeltsin was regarded as the point of departure for this new engagement. Gazprom supported the new governor, Yuri Neelov, and he was voted onto the company's executive board. Neelov was also backed by Gazprom and the local politicians associated with the company in the gubernatorial elections of 1996. He won the ballot with 69 per cent of votes cast.

The regional government and Gazprom also cooperated effectively in the economic sphere. The two parties concluded their first general partnership agreement in February 1995. Furthermore, from January 1997 onwards, their financial relations (particularly Gazprom's tax payments) were governed by annual agreements. Deliveries of natural resources were accepted in lieu of payment. This procedure gave rise to a whole range of dubious deals. For example, the Itera company was integrated in the 1997 agreement. Gazprom supplied the region with natural gas, which was offset against the corporation's accrued taxes at wholesale rates and not at the market price. The regional administration sold the gas to Itera at the same price, albeit in contravention of Russian law.

Despite this preferential treatment, Itera accrued tax arrears. Instead of collecting this tax claim, the regional administration assigned the debt to Mezhhregiongas, a Gazprom subsidiary. Mezhhregiongas, in turn, settled the debt with gas deliveries that were again resold to Itera at preferential rates. As a result, Gazprom accumulated a sizeable back tax that amounted to approximately 11 billion rubles (at the time, about US\$500 million) by the end of the 1990s.

At the same time, a change in legislation allowed Gazprom to credit the assets of its subsidiaries to the company's headquarters in Moscow. This meant that

taxes on the assets of subsidiaries in the Yamalo-Nenets Autonomous Okrug no longer contributed to the local budget, but went straight to the municipal budget of Moscow. The noticeable reduction of Gazprom's payments to the regional budget caused a falling-out between the company and the local administration. Additionally, Gazprom's decision-making processes were centralized as part of a corporate reorganization, leaving the managers of subsidiary companies with less room for maneuver in their relations with the regional administration.

### Regional politics without Gazprom?

In order to pressure Gazprom, the regional governor stated publicly that licenses for natural gas fields would only be awarded as part of public tenders, since "there are other companies besides Gazprom that would like to work actively in the region".<sup>1</sup> As a result of this conflict, Neelov failed to be reelected to the Gazprom board in 1999.

The regional administration responded to the falling-out with Gazprom by cooperating with oil companies and small independent natural gas companies in the region. In this way, it was hoped, a counterbalance to Gazprom could emerge that would reduce the region's economic dependency and help it win back political maneuverability.

Vice governor Iosif Levinson played a key role in developing regional economic concepts to support independent gas producers. Before entering politics in 1996, Levinson was the head of regional geological company Purneftegazgeologia, which was in charge of exploration work and therefore was in possession of information on the gas deposits in the region. Later, the company was able to secure licenses for several natural gas fields with the help of Levinson, who as vice governor was in charge of licensing. Levinson was the biggest shareholder in the company, and in 2001, after it merged with Novatek, he became a major shareholder in the new corporation. The regional administration then began to nurture Novatek by giving it licenses and tax breaks, for example an exemption from tax on assets. As a result, the share of independent producers

in regional extraction rose from 2 per cent at the end of the 1990s to 13 per cent in 2001.

In 1999, the regional administration concluded initial partnership agreements with the oil companies operating in the region, namely Rosneft and Sibneft. The most significant provisions on the part of the administration concerned guaranteed tax relief and preferential treatment in the allocation of extraction licenses, while the companies agreed to take on economic and social responsibilities in the region. The agreements were concluded for a four-year period and subsequently extended. The oil companies' parliamentary representatives actively participated in codifying these agreements into regional legislation.

Rosneft in particular benefited from this cooperation. The company was able to vastly expand its oil extraction in the region and to make inroads into the gas production business. In return, the company paid its taxes on time and invested in the social infrastructure of the region. Thus, in 2003, approximately 60 per cent of Rosneft's investments went to the Yamalo-Nenets Autonomous Okrug. The regional administration also managed to persuade other oil companies to increase their engagement in the region, for example Lukoil, TNK, and Yukos, all of which in 2001 stated their interest in acquiring licenses for new gas fields.

Neelov's victory at the 2000 gubernatorial elections, with 88 per cent of the ballot, proved that he had managed to secure a power base that was independent of Gazprom. His election campaign was supported by the independent gas producers and oil companies in the region. There were only two nominally independent candidates to challenge Neelov, both of whom were de facto associated with him. In the following years, however, the federal center and Gazprom incrementally raised the pressure on the regional administration.

### Pressure on the regional administration

In the same year, Gazprom began to expand its share of regional production through company takeovers. The upshot of this was that Novatek remained the only independent gas producer in the region. The position of oil companies in the region was also weakened. Rosneft, controlled by the federal government, was not able to establish a permanent independent position in the region. Gazprom took over Sibneft in 2005, thus neutralizing the second largest oil company in the region. As a result, the regional economy and therefore also the regional budget were once again completely dependent on Gazprom. This was also seen in the fact that the share of tax payments coming directly or indirectly from Gazprom to the regional bud-

<sup>1</sup> Under a federal decree of June 1992, the federal government and the administration of the Yamalo-Nenets Autonomous Okrug transferred the right to develop reserves of gas and gas condensate in the Nadym-Pur-Tazovski and Yamal regions to Gazprom. This decision was made without any prior auction or call for tenders, and gave the company not only the rights for exploring fields that it already owned, but also the development rights for as-yet untapped fields with very great potential. This was a major obstacle to future competition, despite the federal legislation „On Natural Resources“, which supposedly facilitated competitive access to the Russian gas fields.

get increased to over 70 per cent.

Simultaneously, the federal center weakened the regional administration's position by backing the merger of the autonomous okrugs with Tyumen Oblast. This meant that the okrug regional administrations were forced to cede part of their authority to the government of Tyumen Oblast. Furthermore, the regional administration of the Yamalo-Nenets Autonomous Okrug was weakened by the general restrictions that President Putin imposed on the regions. Thus, the reorganization of corporate taxation and of licensing rules deprived the regional government of important instruments in its negotiations with the oil and natural gas corporations.

Neelov came under further pressure after the president reserved the right to nominate governors himself in September 2004, since his gubernatorial term was due to expire in early 2005. In order to secure Putin's support for his nomination, Neelov had to make significant concessions. Specifically, he was forced to dismiss several members of his administration, including vice governor Levinson. In the subsequent elections to the regional parliament, Gazprom's representatives were able to increase their share of votes from 13 per cent to 36 per cent.

### Conclusion

The interaction of political and economic players in the region is thus determined by the relationship between the governor and Gazprom. Between 1994 and 1999, the governor cooperated with Gazprom. The company supported the election campaign of governor Neelov, who was elected as a Gazprom board member. In return, Gazprom was formally granted significant tax breaks, but only fulfilled a fraction of its remaining payment obligations to the regional budget and in the social sphere. Additionally, the gas company pooled its decision-making processes in

Moscow, thus reducing its readiness to negotiate with the regional political elites. This conflict came to a head at the end of the 1990s.

In the next phase, from 2000 to 2005, Neelov tried to cooperate with other companies in order to create a counterbalance to Gazprom and regain political and economic maneuverability. The regional administration started issuing licenses for natural gas fields via open calls for tenders, thus fostering the independent gas producers. Although governor Neelov lost his seat on Gazprom's supervisory board, his deputy joined the boards of several production companies that were competing with Gazprom. Additionally, the administration concluded partnership agreements with the oil companies in the region that offered tax breaks as an incentive for increased output.

The result was an increase in the importance of independent gas and oil companies for the region, which thus managed to reduce its dependency on Gazprom. Unlike Gazprom, however, the other corporations generally met their commitments in terms of paying taxes and investing in social programs. In this way, governor Neelov managed to be reelected even without the support of Gazprom.

Gazprom's cooperation with the federal center against the regional political elites did, however, eventually lead to a significant weakening of the latter. The loss of authority in the areas of taxation and licensing, and especially the planned merger with Tyumen Oblast, increasingly reduced the freedom of action of the regional political elites. Since the nomination of governors by the Russian president was introduced in 2004, Neelov has been forced to dismiss several close advisors in order to secure his own position. Conversely, Gazprom, which has expanded its control of the regional economy over the past years, can be expected to regain influence.

*Translation from the German: Christopher Findlay*

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