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Indra Overland^a; Hilde Kutschera^a

^a Norwegian Institute of International Affairs,

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Pricing Pain: Social Discontent and Political Willpower in Russia's Gas Sector

INDRA OVERLAND & HILDE KUTSCHERA

Abstract

This article explores the influence of socio-economic discontent on the determination of decision makers to cut subsidies on natural gas for Russian households. The authors outline first the organisation of gas supplies and subsidies, and secondly the relationship between policymaking signals and public opinion concerning the minor price adjustments implemented so far. They then examine previous cases of discontent in other sectors, extrapolating implications for a major increase in gas prices. The conclusion is that Russian policymaking is characterised by a pattern of 'two steps forward, one step back': decision makers are concerned about discontent, but nonetheless they ultimately press on with reform.

BY KEEPING GAS PRICES ARTIFICIALLY LOW, the Russian government has provided few incentives for consumers to use gas efficiently. Combined with a badly maintained distribution network, subsidies cause Russia to consume more energy per unit of gross domestic product (GDP) than any of the world's 10 largest energy-consuming countries (World Bank 2008a, p. 28). According to World Bank estimates (2008b, p. 5), Russia could reduce its primary energy consumption by 45% through increased energy efficiency. Included in this figure is the potential saving of 240 billion cubic metres (bcm) of natural gas, equivalent to 51% of the country's total gas consumption in 2006 (EIA 2009). International organisations such as the World Bank (2008b, p. 5) and the OECD/IEA (2006, p. 16) reiterate the same message: whether it is with regard to the Eurasian gas balance, the Russian economy or climate change, Russia will have to make its natural gas sector more efficient. In order to boost efficiency, the government must reduce the subsidies for gas and allow prices to rise. The higher the price of gas, the more sense it will make for consumers to use it sparingly. The potential for higher gas prices is great: in November 2008, the average price of gas in Russia was slightly more than one tenth of what it was on the EU market.¹

Russian decision makers have on numerous occasions committed themselves to cutting subsidies and raising gas prices. The Russian government's 2003 *Energy*

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¹*Reuters*, 6 November 2008, available at: <http://www.reuters.com/article/rbssEnergyNews/idUSL628742520081106>, accessed 13 May 2009.

Strategy of Russia through 2020, which forms the backdrop for many of the events and developments discussed in this article, recognised the need to reform domestic pricing arrangements (Ministry of Energy 2003). The new *Energy Strategy of Russia through 2030*, adopted by the government on 13 November 2009, puts unprecedented emphasis on energy efficiency and repeatedly states that prices should gradually rise to market levels (Government of the Russian Federation 2009, pp. 2, 4, 16, 18, 21, 22, 33, 50, 52). At the G20 summit in Pittsburgh in September 2009, Russia signed the 'Leaders' Statement', pledging to phase out energy subsidies 'in the medium term'.²

As Ahrend and Tompson (2005, p. 810) have noted in this journal, however, higher gas prices are difficult to absorb, for industry and for households, due to their effect on prices for electricity and heating as well as on directly consumed gas. Also, according to Orttung (2009, p. 66), the Kremlin has long used energy subsidies for political purposes, to ensure 'continuing popularity and quiescence of the population'.³ Raising gas prices is seen as a particularly daunting task because of the deeply ingrained expectations of cheap energy inherited from the Soviet period. This may make the Russian population fundamentally averse to paying the full cost of the energy it consumes.

Ahn and Jones (2008, p. 133) note that, despite pressure from Gazprom, 'the Kremlin remains reluctant to raise prices for fear of provoking economic and social stresses'. Similarly, Hanson (2009, pp. 38–39) argues that, although the proposed price rises are significant, there might not be sufficient political determination to carry them through, as they would certainly prove unpopular with consumers.

When the global financial crisis hit in 2008, it resulted in rising unemployment and protests in several cities across Russia. Scholars suggested that such social unrest might result in the government's 'inability to control the discontent' (Baev 2009), in mass repression by the government (Kupchinsky 2008) or in a crisis 'the exit from which would not be possible within the framework of the current constitutional system' (Gontmakher 2008).

With such predictions of socio-economically driven upheaval as the backdrop, this article explores the ongoing interaction between Russian decision makers and public opinion over gas subsidies. The words 'pricing pain' in the title are meant as a *double entendre* and can be read either '*pricing* pain' or '*pricing* *pain*'. They refer to the socio-economic 'pain' and discontent that higher energy prices may cause among the populace, as well as to the political 'price' of that pain to the decision makers who might find themselves the targets of the discontent.

Our overall interest is thus in a set of variables that may influence each other in a circular manner:

$$a \rightarrow b \rightarrow c \rightarrow d \rightarrow a \dots \infty$$

where (a) is a reduction in subsidies; (b) is the resulting price rise for consumers; (c) is the socio-economic discontent that may result from the price rise; and (d) is the

²The Pittsburgh Summit 2009, 'Leaders' Statement: The Pittsburgh Summit', 25 September 2009, available at: <http://www.pittsburghsummit.gov/mediacenter/129639.htm>, accessed 9 July 2010.

³See also Heinrich (2008, p. 1563).

political will to carry out (further) subsidy cuts, which may be affected by the socio-economic discontent.

Repeated over time, this circular set of causal relationships can be thought of as a spiral or a feedback mechanism in which each variable is dependent on the previous one and independent in relation to the following one. We reduce this unwieldy complexity to a simpler causal relationship between one independent variable and one dependent variable, resulting in the following research question for this article:

How does socio-economic discontent (independent variable) impact on the political will of decision makers to press through with subsidy cuts (dependent variable)?

Even at this simplified level, operationalising the research question in terms of empirical data is not easy. One option might be to carry out a time series analysis of changes in gas pricing and correlate this with data on consumer views gathered through interviews, or with interviews with the heads of local gas supply companies across the country. Such an approach would have some strengths, but would require considerable financial resources and would still suffer from several flaws: the subjective element in such interviews; a risk that the interview setting might affect the opinions expressed by the interviewees if they understood that we are looking for the possibility of future discontent; difficulties with representative sampling of interviewees; and, finally, the possibility that consumers may react not only to actual price rises as registered in statistics, but also to signals from decision makers about planned price rises. (To avoid the last of these flaws, we include a section on public policy signals about future price rises below.)

However, the main challenge that an approach involving a time series regression would fail to deal with is that of projecting past experiences into the future. Gas prices for Russian household consumption have been increased on several occasions, but, as we explain below, these raises have been relatively small. In examining the dynamics surrounding the decisions to implement more dramatic price increases in the future, we are thus talking about a qualitatively different level of potential conflict. Simply extending past responses to gas price rises into the future could produce a misleading picture of what would happen. In addition, because individual consumers in many cases cannot easily reduce their consumption in response to higher prices due to the lack of metering for individual households, this is not an economic relation where pricing, supply and demand are finely tuned. That also increases the risk that reactions to future and bigger price increases may not be proportional to former reactions to smaller price increases.

At the methodological level therefore, this article builds on the understanding that the outcome of gas-price reform is not only a function of stable economic facts and their interaction, but must also be understood as the next phase in a long term, path-dependent trajectory of relations between the population and decision makers over socio-economic issues.

At the empirical level, we have therefore chosen to conduct this study not as hypothesis-testing of the independent and dependent variables, but rather as an extrapolation in which we go back to previous cases of major socio-economic reform in other sectors to see what they indicate about the possible future behaviour of

Russian actors in the gas sector. This means that our analysis involves making inferences across sectors, which in turn may reduce the strength of our conclusions. We believe that the conclusions are still important because this topic is so central to Russian and international energy politics and, as the discussion here has shown, there are few other ways of going about analysing it. Before moving on to the cases from other sectors, we present some basic information needed for understanding the flow of gas and subsidies, and provide a brief overview of the interaction that has already taken place between policy signals and popular attitudes in Russia's gas sector.

The natural gas supply chain

Higher gas prices would affect household consumers through several channels: district heating, electricity generation, employment in the industrial sector, and gas for cooking. Of these, only the latter involves the direct use of gas by household consumers. In all the other channels, households use natural gas indirectly, which increases the complexity and unpredictability of the impact of changes in gas pricing—including consumer reactions (IEA/OECD 2006, pp. 40–41).

District heating

Households would feel the main effect of higher gas prices via district heating. District heating plants consume large amounts of gas, accounting for over 30% of Russian energy consumption. This consumption amounts to 150 bcm a year, only 30 bcm less than Russia's annual export of gas a few years ago (OECD/IEA 2004, p. 15). The residential sector could thus account for 37% of potential energy savings, according to some estimates (Robeck 2005).

Providing centralised heating at the district level is far more efficient than heating many small units separately, so the Soviet-built district heating systems should—in principle—be highly energy efficient. However, this efficiency potential is poorly exploited, due to the sub-optimal design of most Soviet-era systems, as well as their age and lack of maintenance. District heating can be particularly efficient when heat is co-generated with electricity in combined heat and power plants (CHPs), but such units account for only 30% of heat generation in Russia (ESCOBALT 2005, p. 6). Moreover, the temperature of most Russian space heating can be adjusted only at source (Nuorkivi 2005, p. 17). Many households cannot adjust their radiators, and often do not even have the option of switching them off. Such features make it difficult for Russian households to save energy.

The poor state of Russian district heating infrastructure results in significant heat loss from pipes. According to the World Bank (2008b, p. 5), heat distribution losses represent between 20% and 25% of total heat generation in Russian district heating systems. Similar to gas leaks and flaring further upstream in the system, these heat leaks represent inefficiencies beyond the reach of end consumers.

The district heating enterprises that burn much of the natural gas are separate from, but owned by, municipal administrations. Most households pay a nominal sum for heating as a part of the municipal utility fee. Tariff levels vary between regions, as do gas prices. Since a new federal law on local self-governance came into force in January

2006, the local authorities have been responsible for the provision of utility services for the population.⁴ Few municipalities have the capacity to meter the actual consumption of gas for individual households, or even for individual residential buildings; in most parts of the country, households are therefore charged a nominal fee. Since that fee is invariably too small to cover the full cost of heating, this leaves the municipalities with a deficit (Martusevich 2008, p. 7), which in turn is covered by transfers from the federal budget. The federal transfers are channelled through provinces or republics, further complicating these fiscal flows.

Electricity production and industry

Russia is the world's fourth largest electricity producer (IEA 2008, p. 13). The average share of gas in the thermal fuel mix is 66% (OECD/IEA 2006, p. 27; ESCOBALT 2005, p. 6). Gas prices therefore have a major impact on the cost of producing electricity, but the degree to which this is reflected in the bills of household consumers will depend upon the final outcome of the recent break-up of RAO-UES (*Rossiiskoe aktsionernoe obshchestvo*—Unified Energy System) and reform of the electricity sector. For household consumers, flat-fee payment schemes for electricity have been replaced by metering in some areas, but tariffs per kilowatt hour (KWh) for households are still set by the state.

Increased gas prices as a result of reduced subsidies could have a significant impact on Russia's industrial sector, much of which depends on heavily subsidised energy, especially in the aluminium and pulp industries. The European Union as well as several non-European member states of the World Trade Organization (WTO) have pressed for Russia to cease the differential pricing of gas for the domestic market and exports in order to reduce what they see as the unfair advantage of Russian exporters (Cooper 2006, p. 2; Stern 2005, p. 173). Russian negotiators have argued that WTO rules cover subsidies for specific industries only, not generally subsidised energy (Spanjer 2006, p. 2889; Ripinsky 2004, p. 463). Russia has not yet arrived at an understanding with its WTO interlocutors on this and other issues, and remains a non-member of the organisation.

For the purposes of this article, the important point is that higher gas prices for the industrial sector would have significant, albeit indirect, impacts on household economies, largely through greater unemployment. Because of the mispricing of production factors such as energy during the Soviet period, many industrial units are sub-optimally located and have high transportation costs, which are compensated for by cheap energy (Hill & Gaddy 2003, p. x). In some industrial areas, higher gas prices could therefore force companies to shut down.

Increased unemployment in the industrial sector would have a negative impact on any community, but would be particularly devastating for Russia's 'mono-towns'—

⁴Federal Law No. 131-FZ of 1 October 2003, 'Ob obshchikh printsipakh organizatsii mestnogo samoupravleniya v Rossiiskoi Federatsii'. The law was passed by the State *Duma* on 16 September 2003 and approved by the Federation Council on 24 September 2003, it was published on 8 October 2003 in *Rossiiskaya gazeta*, and was effective from 1 January 2006 (available at: <http://www.rg.ru/2003/10/08/zakonsamouprav.html>, accessed 5 December 2010).

settlements almost totally dependent on one company or a few companies within the same sector. Moreover, such areas are likely to suffer losses of electrical power and heating if the local industry is shut down, as such services are often provided by local factories.

Implications for households

According to Gazprom, the gasification of the Russian Federation reached 62% in 2007, meaning that more than 40 million Russian dwellings had access to gas.⁵ District heating makes up 70% of the residential heating market (OECD/IEA 2004, p. 41), and over 60% of fuel consumption by district heating systems is natural gas (OECD/IEA 2004, p. 45). More than 70% of electricity production in European Russia, where most of the country's population is concentrated, is based on gas (OECD/IEA 2006, p. 27). That means that if a reduction of subsidies for gas leads to higher electricity and utility tariffs, it will affect the vast majority of Russian households. The fact that these households also tend to be located in the more central and wealthier regions of the country—and thus that price increases may paradoxically have a positive effect on regional economic inequalities within the country—does not necessarily mean that price increases will be any more welcome. On the contrary, the regions that are connected to the gas grid are likely to have greater political clout and to be more demanding than remote rural ones that are off-grid.

As Martusevich (2008, p. 2) points out, the government has already encouraged the regions to achieve full recovery of utility costs by raising tariffs. As a result, utility services have already become unaffordable for a large and growing part of the population, while the full costs are still not covered. According to the OECD (2003), the cost of water supply and sanitation (which are part of the utility payments) is a burden if it exceeds between 3% and 5% of a household's income. Applying a threshold of 3.5%, Martusevich (2008, p. 3) finds that in 2001 water and sanitation were very expensive for the poorest 10% of Russian households. By 2006, water and sanitation represented a similar economic strain for 70% of Russian households. This example indicates the dramatic impact likely from any further increase in utility tariffs driven by higher gas prices. Only a relatively small minority of Russian households, it seems, have sufficient income not to be affected by rising utility tariffs.⁶ Stefan Buzar (2007, p. 9) has defined 'energy poverty' as 'the inability to heat the home up to a socially- and materially-necessitated level'. If gas prices continue rising, increasing numbers of Russian homes will come under that definition.

Might such negative effects on household economies be circumvented by realising the efficiency potential further upstream in the system in the district heating plants and other infrastructure, without raising consumption tariffs for end users, and thus avoiding socio-economic discontent? Certainly, part of the efficiency potential could

⁵Gazprom, 'Gazprom v voprosakh i otvetakh', undated, available at: <http://www.gazpromquestions.ru/?id=35#c449>, accessed 26 May 2009.

⁶In 2001, household expenditure on all utilities services represented 10.1% of the average disposable income of the poorest 10% of households in Russia. District heating made up 1.8% of this expenditure, while water supply and sanitation stood for 3.5% (Martusevich 2008, p. 4).

be realised this way, as some changes that could be made to equipment and installations by district heating plants could be recouped relatively quickly at current price levels—at least in theory. In practice, however, most of the investment that could have been feasible at current prices has not been made anyway, so the incentives are clearly not strong enough. That may be due to the high degree of risk and nervousness related to many investments in Russia, because of the lack of a sense of long-term security for private property. For many investors, it is not sufficient for a Russian investment to be profitable in principle: it must be highly profitable in the short term to justify the perceived risks.

Moreover, the current payment scheme omits the linkage between consumption and cost in many parts of the country, and therefore leads to a lack of efficiency incentives for end users. If price changes are to yield increased energy savings, the infrastructure will have to be improved at the same time, especially metering for individual households and apartment buildings. Reforming the gas payment scheme is mutually dependent on broader energy-sector reform and will have a significant impact on household consumers. In the remainder of this article we examine from two different angles how those consumers may react to the price increases that will follow from the implementation of pricing reform.

Policy signals about gas prices

This section examines public policy signals from Russian decision makers about reducing subsidies and thus raising prices for natural gas. This material is relevant for several reasons. Firstly, it shows that policymakers have already repeatedly expressed the intention of raising prices. Secondly, the wavering between signals about raising prices and about not doing so indicates that policymakers are sensitive to public opinion on this issue. Thirdly, consumers may react not only to actual price rises, but also to official signals about planned price rises. Consumer reactions to such signals may in turn stop decision makers from actually carrying out a signalled price rise. Thus it is not sufficient to look at statistics on price rises alone: it is also necessary to examine the dialogue between decision makers and the population.

Table 1 summarises the data in this section. Some of this material comes from mass media sources. Although in certain contexts it may be inadvisable to rely on the mass media, in this case it is necessary, since our focus is on the communicative interaction between decision makers and the population. In modern, large-scale societies with millions of citizens, such interaction takes place mainly through the media.

Table 1 shows that, although gas pricing policy signals in Russia over the past six years can be confusing, some trends stand out. Firstly, there is a pattern of two steps forward, one step back. Russian officials have repeatedly announced ambitious plans to reduce subsidies. The main watershed in the series of policy signals indicating that prices will rise was the government's decision in late 2006 that domestic prices would be equalised with those Gazprom receives for its exports, minus export duties and transportation costs (referred to as 'netback'). Subsequently, however, they have oscillated between moderating the scope of the subsidy cuts, extending the deadline for implementation and reimposing the cuts.

TABLE 1
POLICY SIGNAL

Statement	Comment	Source	Date
<p>'For intensification of energy saving we need: well-grounded increases in domestic prices for energy carriers ... effective price regulation is a quite necessary, but insufficient condition of energy saving intensification'.</p> <p>'Last year, OAO Gazprom did not make any profit in the domestic market. ... The Company is planning to make some small profit (0.8%) from its sales in 2004'.</p> <p>'... by 2011 ... domestic sales of gas will be equally profitable to sales in foreign markets'.</p> <p>'The Federal Tariff Service approved a 25% increase of Gazprom's wholesale prices in 2008... the average price of 1000 cm gas for industrial consumers from 1. Jan. 2008 will be 1690 rubles, and for the population 1290 rubles'.</p> <p>'... it would agree to a 40% increase in domestic gas prices in 2011, up from the 30% ceiling it had earlier proposed'.</p> <p>'If the principle of equal profitability were to be applied immediately, it would be necessary to raise the price of gas in Russia by 95–100%... A compromise was reached. We keep the emphasis on netback ... but at the same time, in essence, the transition period is extended for several years. In practice we will go over to netback in 2014–2015'.</p> <p>'... in May 2008 the Russian Federation Government approved the following limits for wholesale price increases until 2011: 25% in 2008–2009, 30% in 2010, and 40% in 2011'.</p>	<p>Early but vague commitment.</p> <p>Contrast with Gazprom statement from 29 July 2009 below, the target proved elusive.</p> <p>Ambitious and concrete plans, all for well after the upcoming parliamentary elections in 2007 and the presidential election in 2008.</p> <p>This announced final approval of a long planned but repeatedly postponed price rise, two days after <i>Edinaya Rossiya</i> won a super-majority in parliamentary elections.</p> <p>A planned price rise was increased the month after the presidential election. This overturned a previously promised delay of five years before domestic prices would be increased.</p> <p>The financial crisis is about to hit Russia.</p> <p>In spite of the financial crisis now being felt in Russia, Gazprom maintains its position and pushes for major price rises.</p>	<p>Ministry of Energy (2003, p. 13)</p> <p>Gazprom (2004, p. 64)</p> <p>Prime Minister Fradkov (Grivach 2006)</p> <p>Federal Tariff Service (L'vov 2007)</p> <p>Ministry of Economic Development and Trade^a</p> <p>Deputy Minister of Economy Klepach (Grivach 2008)</p> <p>Gazprom (2008)</p>	<p>28 August 2003</p> <p>25 May 2004</p> <p>30 November 2006</p> <p>4 December 2007</p> <p>14 April 2008</p> <p>30 May 2008</p> <p>3 December 2008</p>

(continued)

TABLE 1
(Continued)

Statement	Comment	Source	Date
'The Federal Tariffs Service has cleared an almost 20% rise in domestic gas prices next year in another step to bring the state-capped prices up to market levels in a few years'.	Vagueness about gas prices as the effects of the financial crisis are felt.	Federal Tariff Service ^b	6 November 2008
'Wholesale prices for natural gas for the population will rise by 25% in 2009, 30% in 2010 and 40% in 2011'.	No elections on the horizon; ambitious and relatively swift price rises announced.	Federal Tariff Service (2009)	13 February 2009
'But we have spoken about the need to adopt European pricing in our country, for example, on gas. This is necessary for our own economy ... the regions have the right to reduce the percentage of family income that goes to pay the utility rates from 22% to 15% or 10%, the cut-off line from which people are entitled to subsidies'.	Prime Minister Putin prefers to emphasise the soft part of the message when he has to deliver it himself.	Putin (2009)	6 April 2009
'In 2009 Gazprom is planning to profit from domestic gas sales for the first time ever'.	Contrast with similar Gazprom statement from 25 May 2004 above. <i>Déjà vu?</i>	Gazprom Board of Directors (2009).	21 July 2009
'The Ministry of Energy is not prepared to cancel state regulated prices until 2012 at the earliest ... Gazprom in "some cases" abuses its dominant position, therefore liberalisation of domestic prices on gas ... is "extremely risky ..."	A statement detrimental to Gazprom and in favour of the oligarchs—a rare indication of lobbying and counter-lobbying on gas prices.	Ministry of Energy (Praim-tass 2009)	
'After 2011, gradual transition to the application of market principles for price formation for gas will be implemented by expanding the unregulated segment of the market and the formation of market prices for gas'.	After so much to and fro, the same basic message keeps resurfacing.	Government of the Russian Federation (2009, p. 52)	13 November 2009
'From 2011 onwards, the price of gas should be based on the equal profitability of supplying external and internal markets. Prices should, however, not be raised by more than 40%'.	After so much to and fro, the same basic message keeps resurfacing. Perhaps the financial crisis is beginning to seem less of a worry too.	Gazprom Mezhhregiongaz ^c	15 June 2010

Notes: ^aBusiness in brief, *Moscow Times*, 14 April 2008, available at: <http://www.moscowtimes.ru/article/1009/42/361904.htm>, accessed 31 May 2009.

^bReuters, 6 November 2008, available at: <http://www.reuters.com/article/rbssEnergyNews/idUSL628742520081106>, accessed 13 May 2009.

^cGazprom Mezhhregiongaz, 'Postavki gaza rossiskim potrebitelyam', undated, available at: <http://www.mrg.ru/node/34>, accessed 7 July 2010.

Secondly, behind the scenes there is lobbying by Gazprom for higher prices in order to halt its financial haemorrhaging in the domestic market (Ahn & Jones 2008, p. 133), and counter-lobbying by the Russian oligarchs who use cheap energy to secure their export profits. Gazprom was spurred on in its lobbying efforts by the sharp rises in oil prices from 2002 onwards. Under the contracts that regulate Russian gas exports to Western Europe, the price of gas is linked to that of crude oil with a time lag of a few months.⁷ The higher the price of oil increased, and in the context of Gazprom's earnings from exports to Western Europe, the more unreasonable seemed the price that Gazprom was receiving for its gas at home.

Thirdly, however, gas pricing is not solely the result of lobbying and counter-lobbying by powerful actors: decision makers do seem to take public opinion into consideration in setting price increase rates. This is shown by the reluctance to initiate significant price rises before the 2007–2008 election cycle, by the attempts to limit price increases in connection with the 2008–2009 financial crisis and by the fact that subsidy cuts are usually planned not for immediate implementation, but well into the future. This behaviour confirms earlier research on tariff changes in the Russian utilities sector, which also found that politicians tended to defer difficult changes until after politically sensitive events like elections (Andrianov *et al.* 2003, p. 8).

Fourthly and finally, despite these tendencies, Russian decision makers seem intent on maintaining the long-term goal of reducing subsidies, and they keep returning to ambitious plans for subsidy cuts. Although the reform of gas billing in Russia is moving slowly and there are many setbacks, it is not at a standstill. During the Soviet period, gas was dramatically underpriced. In 1995, only 7% of the gas used by Russian consumers was paid for in cash, another 42% was paid for with barter goods and bills of exchange, and 51% was not paid for at all—in spite of continuing low prices during the 1990s (Mitrova 2009, p. 13). Compared to that situation, gas pricing and billing in the 2000s seems to be headed in the right direction. Cuts might be modified and deadlines postponed, but the overall objective remains clear.

Although gas prices have been raised for Russia's households several times, and we can discern some important patterns of behaviour in these developments, the increases have so far been relatively small. As inflation has remained between 10% and 13% during the period 2000–2010, it has eaten up much of the price rises too. In order to make prices correspond to the real value of the gas (as benchmarked in Russia's exports to its main export market in Western Europe) and to realise the potential incentive for energy efficiency, far more drastic price increases will be needed. This also means that future price increases will have to be on a qualitatively new level—therefore one cannot simply project past gas-price increases into the future. This is why, rather than extending past trends of gas pricing and public reaction into the future, we now inquire into the reactions to similarly drastic socio-economic changes in other areas of Russian society.

⁷The current trend is towards a partial delinking of natural gas contracts from oil prices, although it is not clear how far this process will go.

Recent public protest in Russia

This section examines previous cases of public protest linked to major changes in government policy or the national economy. Based on the lessons learned from these cases in other sectors, we try to say something about likely reactions to major reductions in subsidies for natural gas. Protests have been relatively rare in Russia during the last decade, so the reactions of decision makers to the few major protests that have actually taken place become important in setting a precedent for similar cases in the future, even if they are in disparate social sectors. Given the methodological weakness of a regression on time series data discussed above, this inferential approach is the least unsatisfactory option for an understanding of this important area of study.

Three cases are covered here: the protests against the ‘Law on Monetisation’ in 2005, demonstrations against high petrol prices in 2008, and the wave of rallies in connection with the financial crisis in 2008 and 2009. The great complexity of reform in these areas and the delays in its implementation, highlighted in early research on these issues by, among others, Andrianov *et al.* (2003, p. 13), make them particularly relevant for understanding the prospects for price reform in the natural gas sector. In addition, it would also have been pertinent to cover the municipal services reform, including the privatisation of utilities, which has led to similar public protests (IKD 2009). We have, however, chosen not to deal with this case here, due to space limitations and because that reform is still in its early stages.

The Law on Monetisation

In January 2005, thousands of Russians took to the streets to protest against the implementation of Federal Law 122 F-3, also known as the ‘Law on Monetisation’. In order to understand this law and the protests it generated, the concept of *l’goty* must be explained.⁸

Rasell and Wengle (2008, p. 6) define *l’goty* as ‘special benefits or privileges that entitle eligible recipients to the free or discounted use of various public services’. ‘Eligible recipients’ include such diverse groups as military veterans, disabled people, pensioners and residents of the Far North. They are entitled by the *l’goty* system to benefits such as free or reduced payment for public transport, housing, utilities, medicines and stays in sanatoria (Wengle & Rasell 2008, p. 740; Alexandrova *et al.* 2005, p. 117).

In the 1990s, as a measure against runaway inflation, the Soviet era system of *l’goty* was expanded by broadening the ranges of the in-kind benefits and their recipients.

⁸О внесении изменений в законодательные акты российской федерации и признании утратившими силу некоторых законодательных актов российской федерации в связи с принятием федеральных законов “О внесении изменений и дополнений в федеральный закон об общих принципах организации законодательных и исполнительных органов государственной власти субъектов российской федерации” и “Об общих принципах организации местного самоуправления в российской федерации”. The law was passed by the State *Duma* on 8 August 2004 and approved by the Federation Council on 8 August 2004. It was published on 31 August 2004 in *Rossiiskaya gazeta* and was effective from 1 January 2005 (available at <http://www.rg.ru/2004/08/31/samoupravleniye-dok.html>, accessed 5 December 2010).

With their wages eaten up by inflation, many households became increasingly dependent on *l'goty*. Wengle and Rasell (2008, p. 741) refer to estimates that between 10% and 15% of the budgets of poor households consisted of *l'goty* in 2003. Though data are not available, the figure was probably even higher in the 1990s. However, it was becoming clear that the *l'goty* system was ill suited for handling the social challenges of post-Soviet Russia: the system was under-financed and the focus on in-kind benefits rather than money disempowered the beneficiaries and led to wastage.

On 22 August 2004, the *Duma* passed law 122-F3, replacing *l'goty* with cash. When the law came into force in January 2005, major protests broke out. Those who had been receiving *l'goty*, the so-called *l'gotniki*, held that the financial compensation would not even pay for the services previously provided free of charge. In addition, many feared a situation similar to that of the 1990s, when inflation dramatically diminished the real value of wages and pensions.

Protests took place in most major Russian cities, as demonstrators blockaded roads and, in some instances, government buildings (Wengle 2005, p. 7). Though initially provoked by the 'Law on Monetisation', the rallies included both *l'gotniki* and other sections of the population and evolved into a display of general dissatisfaction with the decision makers. The protests had a grassroots quality, although some were organised by parties and organisations (Wengle & Rasell 2008, p. 745). Certain opposition politicians, among them Oleg Shein of *Spravedlivaya Rossiya* and Galina Khovanskaya of *Yabloko*, used the monetisation issue to rally political support against the government. The protesters had solid popular support among the population; according to a survey carried out by the Levada Center, 81% of the population either supported the protests or said that they understood them and could relate to them (Wengle 2005, p. 7).

The reaction of the decision makers to these protests was multifaceted. Initially, the government maintained that the reform was a success and largely ignored the protests, while the state media portrayed the protests as being driven by marginal groups. Protesters were detained by the police, and several were reportedly beaten (Corwin 2005). In February, the decision makers seemed to change tactics, however, and gave an official response to the protests. President Putin publicly criticised the government and regional governors for inadequately implementing the Law on Monetisation, and acknowledged that the reform had not been properly prepared (Wengle 2005, p. 7). Concessions were made to reduce the loss of privileges of the *l'gotniki*; pensions and salaries for some groups were increased ahead of schedule, and other social reforms were delayed. However, implementation of the reform continued.

Price increases on petrol

Russia does not have the same tradition of subsidising petrol as it has for natural gas. Andresen (2008, p. 13) suggests that this can be partly explained with reference to Soviet tradition.⁹ Gas, the main source of heat and electricity production in Russia, has traditionally been provided by the state, whereas petrol is for those who own cars—which were luxury items until recently.

⁹Lenin had proclaimed that 'communism = soviet power + electrification' (Lenin 1977, p. 280).

Without directly subsidising petrol prices, Russian decision makers have occasionally put pressure on petrol retailers to keep prices down. This happened during the second half of 2006, after prices had increased by 11% in the previous months.¹⁰ German Gref, the Minister of Economics, called on oil firms to avoid price increases. Subsequently, prices stayed flat, despite a 15% rise in wholesale prices in April 2007.

A year later, the situation was quite different. World oil prices were rapidly approaching an all-time high, and between February and July 2008 petrol prices rose by almost 40% (Ministry of Economic Development and Trade of Russian Federation 2008). This price increase resulted in a nationwide outburst of protests on 24 May. These protests were not unique to Russia, as this was a time when decision makers in many countries were facing similar reactions to high petrol prices. The Russian Motorists Association organised protests in cities across the country. Its main argument was that, as citizens of one of the world's major oil-exporting countries, Russian car owners should have to pay less for petrol than they were currently doing. Police reactions were severe, but the decision makers showed no other public reaction to the protests, and did not put the same pressure on oil companies as in 2006. Quite the contrary: when oil prices decreased and petrol prices across the world started falling in late 2008, Russian oil firms were not pressured by the government to follow suit.¹¹

The global financial crisis

Russia was hit hard by the financial crisis. By April 2009, the unemployment rate was growing rapidly, and the exchange rate with the Euro rose to €1 to R44, up from €1 to R36 in October 2008.¹² At a meeting on 23 April 2009, First Deputy Interior Minister Mikhail Sukhodolskii reported that more than 2,500 protests related to the socio-economic conditions had taken place in Russia since the beginning of the year. He described most of these protests as 'targeted at the escalation of social tensions and the achievement of dubious political goals of certain public movements rather than for the protection of people's interests'.¹³

One area where protests had been building up was the car import business. The government raised tariffs in order to protect the domestic car manufacturing industry during the financial crisis, and in December 2008 Russia saw the first wave of protests related to the higher import tariffs on cars. The increase was highly unpopular in broad sections of society, particularly in the Far East, where many jobs are connected to the import of second-hand cars from Japan.

¹⁰Reuters, 2 May 2007, available at: <http://uk.reuters.com/article/oilRpt/idUKL2866042720070502>, accessed 5 January 2009.

¹¹Russia Today, 2 December 2008, available at: http://www.russiatoday.com/Business/2008-12-02/Fuming_drivers_set_to_drive_petrol_price_scrutiny.html, accessed 31 May 2009.

¹²Currency rates as of 1 October 2008 and 15 April 2009 according to www.xe.com, accessed 22 May 2009.

¹³Mark A. Smith, 30 June 2009, available at: [http://www.da.mod.uk/colleges/arag/.../09\(05\)MAS%20mod%20style.pdf](http://www.da.mod.uk/colleges/arag/.../09(05)MAS%20mod%20style.pdf), accessed 12 January 2011.

The first significant protests against increasing car import tariffs occurred on 13 and 14 December. There were demonstrations in several Russian cities, but the initial rallies were in Vladivostok. These protests received additional attention because of the way decision makers reacted to them: riot police were flown from Moscow to Vladivostok to confront the demonstrators, treating them harshly and detaining over 100 people (Chernyshev 2008). This crackdown was widely interpreted as reflecting distrust in the local police and authorities in Vladivostok, over 9,000 km from Moscow. Despite this firm reaction by the federal authorities, the protests continued to spread. On 21 December came new demonstrations in Vladivostok, in which the riot police reportedly beat and detained several participants. Parallel protests occurred in Moscow, where hundreds of people denounced the higher tariffs. Despite this wave of protests, the government implemented the tariff hike in full.

December 2008 also saw protests related to other economic issues. In the city of Izhevsk, thousands rallied against rising housing and utilities fees (Coalson 2008). By January 2009, the protests seemed to channel a more general dissatisfaction with the economic and political situation in the country, and with the way the decision makers were handling it. On 30 and 31 January, thousands of people across Russia protested against the government's economic policies. Among these were about 2,000 communists protesting in Moscow, and an estimated 2,500 protestors in Vladivostok, where vehicle import tariffs were again among the main issues. Also these protests were reportedly broken up by the police (Parfitt 2009).

Another category of protests occurred in the mono-industrial centres, the so-called 'mono-towns'. The closing of a factory in such a town can be catastrophic for the local community, which depends on it not only for employment, but often also for electricity, district heating and various cultural activities. The impact is further exacerbated by the fact that such industrial sites are located near the natural resources on which they are based, often far from other population centres. Finding a new job and commuting to the neighbouring town is seldom an option for unemployed mono-town residents.¹⁴

Approximately 12% of Russia's population live in mono-towns, and several of these towns saw protests and civil unrest during the spring of 2009 (Whitmore 2008). The most noted of these took place in Pikalevo, where over half the workforce had lost their jobs by the beginning of May.¹⁵ In reaction to unemployment and underpayment, thousands took to the streets, protesting against what they saw as the shutting down of the whole community. Prime Minister Putin then visited the town and ordered the owners of factories to resume production. The owner of the main factory, and formerly the richest man in the country, Oleg Deripaska, was humiliated

¹⁴Other mono-towns are based around the former Soviet automotive industry, most famously the AvtoVaz plant in the city of Togliatti. There were recurrent protests in such towns from 2006 onwards. Although they were sometimes combined with demands for government intervention and subsidies to maintain jobs, such protests have mainly been triggered by downsizing aimed at improving the profitability of specific factories, rather than broader socio-economic policy. We have therefore chosen not to focus on them here, although they became a significant part of the wave of protests in connection with the financial crisis.

¹⁵*Rossiya* television channel, 'Izbezhat' uvol'nenii pikalevtsam ne udastsya', 3 June 2009, available at: <http://www.vesti.ru/doc.html?id=290032>, accessed 12 July 2010.

on television—at the same time as he was discretely provided with credits worth billions of dollars by the Russian state to save his indebted business empire from bankruptcy. Putin's appearance in Pikalevo may have been a smokescreen for the state aid to the Putin-friendly Deripaska, as some commentators have insinuated (Latynina 2009), but the fact that Putin made the effort to travel there and stage an elaborate television performance shows nonetheless that such protests matter for the government.

Comparison of protests

If we begin by comparing the protests about *l'goty* and petrol prices, we find that both were expressions of popular discontent with the Russian decision makers, but they differ in several ways. Whereas the issue of *l'goty* and monetisation involved protests against a specific government reform, the issue of petrol pricing concerned protests urging the government to take action.

The two movements also differ with regard to their participants. The anti-monetisation demonstrations saw participants from a broad range of social groups, as well as those specifically affected by the reform. The petrol-price protests, by contrast, involved almost exclusively young, male car owners. Thus, general societal involvement in the rallies was far more significant in the monetisation protests, which were most likely boosted by feelings of solidarity with the *l'gotniki*. Moreover, higher petrol prices naturally concern those who already own cars and have certain economic resources. These differences may partly explain why the monetisation protests drew in a larger segment of the population than did the petrol-price protests.

As for outcomes, there are both similarities and differences between the two movements. The demonstrations against monetisation did yield some results, including increased pensions and wages. The petrol-price rallies, on the other hand, saw no change of policy as a direct result; petrol prices did eventually decrease as the oil price fell, but the effect came later in Russia than in many other countries. However, both examples show situations where government policy in general has appeared little affected by popular protests.

Some of the protests related to our third case, the financial crisis, are more similar to the petrol price example than to the *l'goty* example, as they reflect frustration with lack of policy engagement rather than negative reactions to an implemented policy. The protests against the tariff increase on car imports, which seem to have been the most large-scale protests related to the financial crisis, were directed precisely at a specific government policy. Thus even in connection with a crisis that permeated Russia and put stress on all parts of society, socio-economic discontent still revolved around sectoral issues.

These three cases show that protests may have influenced the speed and degree of policy implementation, without stopping it. Policymakers ultimately moved ahead with their plans regardless of public opinion. Finally, the tendencies described here fit with the findings in the section above on policy signals concerning the minor price increases in the gas sector so far. There we saw that decision making on gas prices involves a two-pronged approach in which sensitivity towards popular reactions is

combined with the will to continue pragmatically with reform despite these reactions.

Implications for gas pricing

These cases of earlier socio-economic protest indicate patterns along which popular reaction to gas-price reform might develop. Monetisation and the global financial crisis are what Andresen (2008, p. 8) refers to as 'hot-button issues'. These two examples also share several features with the issue of gas pricing: they are related to governmental economic reform (or to the lack thereof); they concern a large part of the population; they are all likely to have greatest impact on the lowest-income groups; and they fundamentally challenge the psychological inheritance from the Soviet period.

We have seen that decision makers have often responded by trying to stop or limit protests (for example by detaining people protesting against increased petrol prices, or dispatching special police forces from Moscow to Vladivostok to handle protests against import tariffs on cars), and have branded the protesters as 'marginal groups' (as with the monetisation protesters) or 'opportunists' (as with the financial crisis protests during the first part of 2009). At the same time, they have palliated protesters by offering partial concessions, slowing down reforms and putting pressure on local and regional authorities to alleviate problems. It is also worth noting that protests have not been banned altogether—perhaps in order to ensure a minimum safety valve to reduce the pressure of protests on socio-economic issues.

In all the cases studied here, the decision makers seem to have achieved their objectives—in the sense that their policy was ultimately implemented. It therefore seems likely that any protests against increased gas prices might be met with similar tactics. As for the role of potential protests in the planning of gas-price reform, earlier cases have shown decision makers that, although protests may be unpleasant, they are not synonymous with policy failure. Reforms can be implemented even if the population shows its discontent.

The dog that did not bark

The cases of previous protests in other sectors covered in this article were selected for their relevance, but also because there have been relatively few protests to choose from in Russia. Although the government was relatively ineffective in its reform efforts during Putin's second presidency and achieved little in terms of reducing Russia's dependence on commodity exports or addressing corruption, the Russian economy and society still saw dramatic changes during this period. Since December 1999, when Vladimir Putin became acting president, Russia has undergone significant federal reforms (Hyde 2001), judicial reforms (Solomon 2002), foreign policy changes (Lo 2003) and tax reforms (Åslund 2004). In this context, considering the extensive and often painful changes Russian society has experienced, the number of protests during this period has been relatively small. Therefore, understanding this lack of protest is perhaps just as relevant for the strategy of decision makers as analysing the protests that did take place.

The limited public expression of popular discontent could be linked to the idea of a special social contract between the Russian population and the policy makers in which a lack of democratic regulation of decision makers is made acceptable as long as the government ensures political stability and economic welfare. During 2009, the mass media referred frequently to this contract theory, with journalists and academics alike speculating on whether the financial crisis might invalidate the contract, finally causing Russians to turn against their rulers in earnest. As mentioned at the beginning of the article, commentators Baev (2009), Gontmakher (2008) and Kupchinsky (2008) are among those who have seen such protests as the beginning of a possible revolution. Could demonstrations against a rise in the price of natural gas become another driver for such a revolution?

Previous examples have supported the notion that gas prices have the potential to generate discontent and public protest, and the developments during the financial crisis showed that concerns related to the overall economic situation could be linked to sector-specific dissatisfaction with, for example, import tariffs on cars. However, two points should be borne in mind here: despite the severity of the financial crisis and its consequences for the population, most Russians still did not protest, and the most prominent decision makers remained relatively popular.

Surveys conducted by the Levada Center in March 2009 show that 26% of Russians considered it likely that they would take part in protests against current price levels and the general standard of living if such protests were to occur in their home town. That was only 2% more than in March 2008, and 1% less than in March 2005, the year of the uproar against monetisation. Of those questioned, more than half had not even heard of any recent protests over deteriorating standards of living (Levada Center 2009a). Also, the limited support for public demonstrations is reflected in the relatively strong popular support for Russia's rulers. In April 2009, surveys indicated that 68% of the Russian population approved of President Medvedev's work, and 76% approved of that of Prime Minister Putin (Levada Center 2009b). These surveys, made after the financial crisis hit Russia, indicate that it did not cause the country to teeter on the brink of revolution.

This is not to imply that the Russian population is not concerned about issues like the financial crisis or higher gas prices. In another survey conducted by the Levada Centre between 26 and 29 March 2009, Moscow residents were asked what they worried about. Rising municipal utility bills was the most common concern mentioned by the respondents. As many as 55% said they worried about utility bills (up from 19% in 1999), whereas only 27% said they worried about unemployment (Levada Center 2009c). In sum, issues such as utility bills and the price of natural gas are major concerns for the population—but they are unlikely to provoke a revolution.

The financial crisis may not have generated a revolution, but it did have significant impact on how decision makers and consumers alike think about socio-economic matters such as gas-price increases. The declared goal of the Russian government has been to bring domestic gas prices up to West European levels, excluding transport costs and export taxes. Under most current contracts, gas prices are currently indexed to the oil price with a lag of approximately six months. For gas, however, because there is no world price, it makes sense for Russia to use West European prices as its

benchmark instead, since that is where it exports most of its gas and receives the highest price.¹⁶ The financial crisis, shale gas and liquefied natural gas (LNG) have brought West European price levels for natural gas closer to Russian prices—at least temporarily.

However, the fact that the target came closer does not necessarily mean that it has become easier to attain. Gas is priced in US dollars, and with a Russian ruble that is weaker than the dollar, closing the gap between Russian and European prices might become more difficult. As revenues from the European market decrease due to falling demand and falling prices, potential income on the domestic market will become increasingly important to the finances of Gazprom, and thereby also those of the Russian state.¹⁷ On the other hand, further economic pressure on household consumers raises the likelihood of negative reactions against decision makers, as shown by the recent protests concerning other issues. The general economic situation in Russia also makes it more difficult to increase prices, and also raises the potential political cost of gas-price increases—the ‘price of the pain’, to put in the jargon of this article’s title. Thus, from a decision maker’s point of view, both the potential gains and costs of increasing gas prices are raised by the economic downturn in Russia under the financial crisis. The overall result of the financial crisis for the prospects for removing subsidies for natural gas is therefore one of raising the stakes, rather than increasing or decreasing the probability of successful implementation.

For a Russian gas pricing reform to be effective, it will have to be carried out in conjunction with structural reform. The current economic downturn may have a negative impact on the ability and willingness of decision makers to make the investments necessary for such parallel reform. Prime Minister Putin’s speech to the *Duma* on 6 April 2009 demonstrated the intention to cushion the effect of higher utility prices through more generous benefit schemes (Putin 2009). However, with the impact of the financial crisis, there might not be sufficient funds for both financial cushioning and structural reform. Taking recent popular discontent and protest into consideration, Russian decision makers may therefore be forced, at least in the short term, to choose between assuaging the population and implementing their gas pricing reform in full.

Conclusions

Our discussion of policy signals showed that decision makers have demonstrated some sensitivity towards the possibility of socio-economic discontent in their policymaking on gas prices so far. Nevertheless, they have retained their ultimate goal of reducing subsidies.

The section on previous cases of public protest in other sectors showed that policy issues similar to that of gas pricing have led to public protest. Such protest has been

¹⁶In Vladivostok, which according to plan is to receive gas from 2012, the import of West European gas will be less appropriate than for the western part of the country, where the vast majority of the population lives and most of the gas is consumed.

¹⁷Gazprom contributed \$40 billion to the state in 2008, a figure some sources argued would fall to around \$22.5 billion in 2009 (Kramer 2009).

most severe in cases where a significant part of the population felt affected by the new policy, and where compensating for the consequences of the policy has been difficult. This would probably apply to a gas-price increase as well. However, we should recall that protests have still been the exception rather than the rule. The numerous occasions on which protests have not occurred are also an important part of the reaction pattern of the Russian population.

Overall, the material examined in this article indicates that there is reason to expect significant interaction between decision makers and household consumers on the issue of gas pricing. If decision makers decide to raise gas prices rapidly, that might well trigger major protests. Similarly, discontent and the prospect of public protest may affect the choices made by decision makers, even though previous protests do not seem to have changed policy drastically, only modified or delayed it.

Interestingly, the possibility of protests seems to have a more significant impact on the strategies of decision makers than those protests that actually do occur. This is to a certain degree mirrored in the empirical material of this article: we have seen that, once protests occur, they have not led to major policy changes. When protests actually take place, it seems that decision makers cannot allow themselves to be too greatly influenced. Perhaps this is because they believe that would be considered a weakness, or because they fear that giving in to one protest would encourage protests on other issues as well. On the other hand, they are certainly aware of the negative influence each protest has on their popularity and on the democratic image of the political system. That makes it more important to the decision makers to avoid protests in the first place, than to bow to them once they occur. This is a possible pattern of interaction that would benefit from further research.

Finally, this article indicates that there is sufficient will and ability among Russia's decision makers to carry through reforms, despite their sensitivity to protests. Protests are not a factor that paralyses the government's capacity for reform: rather, they are one element that contributes to shaping reform and the schedule of its implementation. The financial crisis and its immediate aftermath are hardly optimal times for a series of gas-price increases, so the schedule of pricing reform may be delayed by a few years. Nevertheless, these decision makers know from past experience that painful socio-economic changes can be implemented despite popular discontent, even if expressed publicly. And thus, they are likely to continue to implement their reforms, and gas prices for the domestic residential market in Russia seem set to rise in the years to come.

Norwegian Institute of International Affairs

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