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Energy and Mineral Exports from the Former USSR: Philosopher's Stone or Fool's Gold

Leslie Dienes

*The Henry M. Jackson
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About this series

The *Donald W. Treadgold Papers* publication series was created to honor a great teacher and great scholar. Donald W. Treadgold was professor of history and international studies at the University of Washington from 1949 to 1993. During that time, he wrote seven books, one of which — *Twentieth Century Russia* — went into eight editions. He was twice editor of *Slavic Review*, the organ of the American Association for the Advancement of Slavic Studies, and received the AAASS Award for Distinguished Contributions to Slavic Studies, as well as the AAASS Award for Distinguished Service. Professor Treadgold molded several generations of Russian historians and contributed enormously to the field of Russian history. He was, in other ways as well, an inspiration to all who knew him.

The *Treadgold Papers* series was created in 1993 on the occasion of Professor Treadgold's retirement, on the initiative of Professor Daniel Waugh. Professor Treadgold passed away in December 1994. The series is dedicated to the memory of a great man, publishing papers in those areas which were close to his heart.

Sabrina P. Ramet
Editor

About the author of this issue

Leslie Dienes is Professor of Geography at the University of Kansas. He is the author of *Soviet Asia: Economic Developments and National Policy Choices* and co-author of both *Energy and Economic Reform in the Former Soviet Union* and *The Soviet Energy System: Resource Use and Policies*. His articles have appeared in *Soviet Geography*, *Post-Soviet Geography*, and *Soviet Economy*, etc., and have been published by the Joint Economic Committee for the Congress of the United States. He is also the author of "Corporate Russia: Privatization and Prospects in the Oil and Gas Sector," No. 5 in the *Donald W. Treadgold Papers in Russian, East European, and Central Asian Studies*.

On the aesthetic experience of humankind, the quest for the holy grail produced works which truly are triumphs of the spirit. In the conduct of the species, that quest produced not only triumphs, but also evil and monumental blunders. Scholars of economic development and of the present transition (from state ownership and planning to market) never laid claim to a holy grail. Yet the tenor of their writings has often suggested the discovery of the philosopher's stone. Most economists today regard the import substitution strategy of development to have been a failure, while its extreme manifestation, the cul-de-sac into which autarkic socialist planning led the countries of the former USSR and Eastern Europe, has become obvious to all. It is thus ironic that the success of export-led industrialization in a handful of states at a specific period of the post-World War II era (mostly in East Asia) is transformed into the philosopher's stone of economic transition from central planning to free markets. That stone of the philosophers is supposed to yield gold, be it in Poland or the Czech Republic, Uzbekistan or Yeltsin's Russia, irrespective of political culture and historical memory. Such textbook certainty is doubly ironic when we note that economic development is not synonymous with transition from central planning to market. In addition, in specific stages of development during the post-World War II decades, export-led development was linked in most countries to the simultaneous protection of the home or regional markets and to state involvement.¹

The transition strategy promoted for Russia by international financial institutions and the majority of Western advisors prescribed, among other things, the almost immediate lifting of price controls and the swift liberalization of trade. The strategy also advocated the boosting of exports through the inflow of foreign investment into whatever sector attracts international capital. In large measure that transition strategy is isomorphic with the export-based growth model, applied highly successfully in East and South-East Asia, but with far less happy results elsewhere.² In Russia's case, conflation of the transition and export-led developmental strategies has grave implications. That conflation has already produced social stress and policy conflicts which are fraught with more danger and unpredictability than is the case in Eastern Europe and China.

In Eastern Europe, the conflation of transition and export-base strategies has produced less glaring clashes among sectoral and branch interests and, by extension, among the political and economic elite in which group the former nomenklatura remains prominent. These states have no comparative advantage in natural resources, with the exception of agricultural ones, and even here only with certain qualifications. Here the strains manifest from the conflation of the two strategies are as much the result of West European subsidies and protectionism vis-à-vis Eastern Europe³ than from the inherent non-compatibility of the export-led model with the realities of the transition process.⁴ In China, the transition strategy has followed a different path with respect to the lifting of price controls, while the emphasis on boosting exports and attracting foreign investment has taken place in a very dissimilar milieu of facilitating agents and was not mirrored by import liberalization.

In Russia, however, natural resource endowment created a very different profile of comparative advantage and sectoral attraction for foreign finance capital. At the same time, significant investment in human resources in the socialist era had produced in society a spread of accumulated knowledge, skills, and expectations unapproached by the majority of population in those Third World countries for which comparative advantage lies in natural resources (and in most cases also of low-cost labor). The conflation of the transition strategy with the model of export-led development focusing on minerals, therefore, has produced tremendous social strain. It also produced momentous conflicts among sectors of the economy and members of the elite. Russia's mineral industries (particularly the oil and gas sector) was plunged into the midst of a fierce ongoing political struggle both domestically and internationally.

A growth path based on mineral exports is a more rational strategy for the newly independent states around the Caspian, provided the revenues are channeled into broad-based development and an increasing share of value added. While the historic experience from Latin America and Africa is not encouraging, the very favorable resource-population ratios in Kazakhstan, Azerbaijan and most of Central Asia should provide plenty of revenues for the development of some processing industries, agriculture and the social sphere. The shores of the Caspian Sea today represent the largest undeveloped and still only partially explored oil and gas reserves outside the Middle East. The region

is similarly rich in gold and non-ferrous metals. Distance from markets undoubtedly makes some non-ferrous metal deposits uncompetitive, but this is not the case with oil, gas, precious metals, and even antimony and a few other non-ferrous minerals. Against these riches, the combined population of all the newly independent states between Georgia and the Altay Mountains add up to less than that of Turkey or Iran.

Kazakhstan and the states of Central Asia, however, are landlocked. Presently, their exports to the world market depend on the Russian transport grid and distant Black Sea and Baltic ports, again in Russia, Ukraine, or the independent Baltic states. The long hauls, when added to port fees denominated in convertible currency, will decrease the comparative advantage of a number of bulky commodities. Russia, for which similar commodities provide the main export revenues, has no interest in fostering competition. It has little, if any, influence on gold mining projects by Western companies, since the high value to weight ratio basically eliminates transport costs as a factor. For other minerals, however, Russian control of transport corridors and the geopolitical complexities of alternate routes are decisive. Substantial mineral shipments from the new states of Central Asia and Kazakhstan to world markets serve Moscow's interests only if Russia can acquire large equity stakes in project development, receive significant transit revenues, and maintain control over export routes. This applies particularly to oil and gas with their fixed transport modes and investment needs.

This monograph analyzes the issues which have entangled Russia's mineral industries, particularly the oil and gas sector, in policy conflicts among government agencies and ministries, commodity producers, commercial structures, and the oil pipeline monopoly. These conflicts are enhanced because the mineral production and exports have been enveloped in corruption since Gorbachev's reforms and, together with banking, have proved to be the most egregious sectors for ill-gotten gains. The monograph also examines the manner in which the oil and gas sector is caught up in the struggle of economic and strategic policy making between Russia and some of the states around the Caspian Sea. As noted, large equity stakes in projects and benefits from controlling pipeline corridors will be Moscow's condition for acquiescence in large scale fuel exports from these states. Such benefits, however, will not accrue equally to the different participants in Russia (ministries, other government institutions, parastatals, and com-

mercial agents). The voices from Moscow speak with considerable variations, pursuing their own economic and political agendas.

The Mineral Industries in the Center of Russia's Policy Conflicts: Exports and Ownership

Primary commodities comprise the overwhelming portion of Russia's export earnings. In 1996, for example, fuels, metals, tonnage chemicals, and forest products contributed almost 70 per cent of all exports, an even higher share than the year before. A year later (1997), fuels and metals alone contributed 68.2 per cent.⁵ These exports, however, have been entangled in a ferocious political struggle unfolding in the wake of the largest asset transfer in history from state to corporate ownership. This struggle is unfolding in an economic and geopolitical environment of at least three interlocking dimensions. The first is the economic contraction and investment collapse exceeding that experienced by Western countries during the Great Depression. The second is the effects of inflation, exchange rates, and the rapidly rising production costs of Russian energy and raw materials. The third is the structural shift in the Russian economy, influenced by the sharply rising price of fuels and commodities in Russia and other states of the former USSR during the first half of the 1990s.

The rapid rise in energy and raw material prices has accelerated the collapse of Russian machinery and consumer industries and agricultural production. Supply constraints, especially on oil production, mounting domestic prices, and concurrently large volumes of exports have pitted producers and exporters against consumers within Russia. They have also generated conflicts within government agencies, ministries, and other institutions. Similarly, they helped to intensify criticism against the present course of reforms, fueling anti-Western suspicion among much of the Russian elite and the population at large. The age-old fear of being a backward fuel and raw material supplier to the West, raised to a canon in Marxist-Leninist theory, finds its justification again in the structural trends of the economy and the narrowly focused benefits of the transformation. The murky process of privatization itself, the poorly developed legal environment in general and the trading of securities in particular, have convinced many Russians that control over much of its resource riches are in danger of passing into foreign hands. Foreign direct investment, therefore, continues to

be hindered by political and legal obstacles. And yet this has not assuaged suspicion that, largely through third party portfolio investment, valuable resources have already fallen under foreign control.

Russia's oil, gas, and metal industries are among the very few branches in which the existing capital stock can produce commodities readily marketable internationally even with no improvement in quality or assortment. Such exports have been vital to the budget through revenue-, profit-, and export taxes, special excises, licenses and, up into 1995, direct sales of some commodities by government agencies themselves. Of all civilian industries, therefore, these are probably the most important strategically for the Russian government (as for those of all former republics). Despite serious decay of much of the sector's capital stock, and—in the case of oil—depletion and deterioration in the quality of reserves, oil, gas, and some metals still represent the most competitive branches of the Russian economy. Together with the banking, telecommunication, and certain non-ferrous metal branches, they comprise the sectors which could most attract foreign investment on a truly large scale.

At the same time, however, the transfer of a large part of mineral assets to private hands can confer immense and immediate wealth on their new owners the way assets in very few industries can. Such transfer also provides ample and easy opportunities for illegal enrichment. The oil, gas, and some of the metal industries are second only to banking in this respect. The combination of their strategic importance, critical budgetary role, and unmatched opportunities for self-aggrandizement has thrust the energy and mineral sectors into the whirlpool of all of Russia's "basic domestic conflicts: those between [itself], the military-industrial complex, the agricultural sector; those between the center and the regions; and those between political forces favoring [various degrees of] protectionism and those supporting an open economy."⁶ Even when not directly involved in making policy, the oil and metal companies, Gazprom, and the pipeline monopoly, Transneft', play a substantial role in such policy through different allies and "patrons" among Russia's central ministries and government committees. They have also been caught up in the struggle of economic and strategic policy making towards the other successor states of the defunct USSR.

The emerging economic system is being formed in a cauldron of struggle for economic and political power. Despite serious ob-

solescence and decay, the oil and gas industries and parts of the mineral sector still concentrate the finest assets of the Russian Federation. Assets in the ferrous metallurgical and petrochemical industries are among the most worn out. Yet, here too, the collapse of military and heavy industrial demand, combined with low labor costs and below world level energy prices in the first years of the transformation provided managers with golden opportunities for self aggrandizement through export openings to Western markets. Those connected with the oil, gas, and mineral sectors, therefore, have had the most to gain from overt and covert appropriation of assets. Indeed, the headlong, haphazard process of privatization was undertaken with neither economic efficiency and rationality, nor social or geographic harmony in mind. Its purpose was to bury, once and for all, the centralized command system. Former Deputy Minister Anatoly Chubais, in charge of privatization, was explicit on this point, even characterizing it as "economically worthless."⁷

All evidence suggests that top managers in the oil, gas, and mineral industries, and banks closest to the government, were the chief beneficiaries of the privatization process. The transfer from state to corporate ownership took place without a corporate law in place. As a result, no authority has been regulating the functions of the various management organs or limiting the extent and the manner of shifting power and wealth from one such organ to another. Enormous unearned wealth has shifted into the hands of the "oil and gas generals" and "mineral barons", and to their corporate backers in the banking sector.⁸ "Threatened by rapid and dramatic economic changes, and confused by the maze of new regulations and procedures governing this new economy, workers have become not less but more dependent on their managers to represent their interests."⁹

It is also through these features of low asset valuation and the frequency of closed auctions following voucher privatization that nationalists, conservatives, and liberals alike can link managerial-nomenklatura acquisition of property rights with the threat of foreign and criminal takeovers of Russia's resources. Portentous for the country's economic future and its relation with the developed world is the growing conviction on the part of many Russians that Western financial corporations are trying to dominate their most profitable industries through third parties at bargain basement prices and in a few cases have already succeeded in that endeavor. Particular alarm was expressed by Vladimir Piterskiy, Vice Presi-

dent of the Russian Academy of Natural Sciences (and also an officer of the Security Council), who claimed that three British businessmen have acquired shares for more than two-thirds of the aluminum production capacity in Russia and listed their controlling shares in the Saisansk, Bratsk, Krasnoiarsk, and Novokuznetsk Aluminum Combines. He stated forcefully that Russian banks had bought up the shares of Russia's enterprises on behalf the off-shore company, "Trans-CIS-Commodities Ltd.," which itself acts in coordination with the British company, Trans-world metal, that is the largest trader in Russian aluminum.¹⁰ Only the Krasnoiarsk plant remains overwhelmingly in Russian hands through the repurchase of shares. Yet in 1996, this plant lost \$20 million in a fictitious foreign deal.¹¹

The oil industry provides a relevant contrast to such alleged acquisition of factories in the non-ferrous metal industries. In the latter, plants have been able to put large quantities of metals onto the world market with very little investment, given large idle capacities and accumulated inventories, resulting from the collapse of demand in military related and other industries. In the former, nearly all of the efforts by the major oil companies has focused on as yet undeveloped fields. A recent work of mine showed that the amount of extra oil recoverable by investment in older producing fields (through well workover, restoration, and repair of facilities) is relatively small. New oil must come from explored but yet undeveloped fields.¹² Major petroleum companies, therefore, would like equity in such new fields and are basically interested only in large ones (except in parts of the Volga-Ural province where the infrastructure is well developed). They also want production sharing guarantees to protect their investment against the vagaries of shifting tax laws.

The Russian oil generals, however, are very sensitive about such arrangements, arguing forcefully that prospecting, exploration, and delimitation work was done by them. They are also wary of the valuation of past work, given the development in ruble-dollar exchange rates since 1990. Russian oil generals have taken account of the soaring demand for hydrocarbons in the developing world, especially Asia (at least until the recent financial crisis), and the instability and long-term uncertainty that continue to affect the Middle East. They reckon that over the longer term oil and gas reserves (at least west of the River Yenisey) would appreciate in value and retain their attraction, in contrast to aluminum capacity and most metal producing centers deep in the Eurasian

interior (see below for the latter). The interpenetration of "corporate Russia" with the political sphere on both the national and regional levels was instrumental in the scuttling of two huge oil developmental projects (one with Exxon the other with Amoco) in August and September 1997, in the European North and West Siberia respectively.¹³ Nor is "Corporate Russia," for the most part, willing to accept the accounting oversight which such joint projects would bring, limiting its almost unrestricted freedom of action with the nation's wealth.

A perceived threat of foreign leverage over key industries is a sensitive political issue everywhere. It cannot be assuaged by abstract arguments of economic rationality, especially in a turbulent period of transition when asset values are patently distorted by a host of legal and socio-political uncertainties and by rampant corruption. In the Russian case it also cannot be divorced from the disorientation and frustration experienced by the population through the loss of economic security, widespread pauperization, and the radical diminishment of international status. It is almost certain that the case of the aluminum industry was instrumental in the stinging blow to foreign oil investors by the audit chamber of the Duma. On 31 October, the chamber recommended the rejection of the bill which would have permitted product-sharing in about 250 oil fields holding 38 percent of Russia's proved reserves.¹⁴ Without a watertight product sharing law, the needed large-scale inflow of foreign financial capital into the Russian oil industry will not happen. Even with such a law, however, the process of big financial inflow will be slow and torturous. That law will merely provide a framework for individual negotiations which will have to be tailored to the highly differentiated geological, technical, and geographical conditions of each major deposit. Nor will the joint ownership of natural resources between the federal government, republics and regions, currently enshrined in the Law of Underground Resources and the Constitution itself, promise smooth sailing for field development even with a product sharing law passed. On the other side of the bargaining table, Western investors are also showing more caution, given the prospect of depressed oil prices for a number of years to come.

Corporate Restructuring: Integration or Competition in the Russian Oil Industry

As early as 1993, Valery Kyukov and Arild Moe have identified the fundamental cleavages for domestic policy conflicts in the oil industry as geographical and conceptual. The first cleavage concerns the degree of regulatory and revenue sharing rights of the federal versus the republic/regional governments, the second the degree of integration (and monopolization) versus competition.¹⁵ I have dealt elsewhere with the first, as exemplified by the battle between Moscow and the 89 subjects of the Federation over resource ownership in the Laws on Underground Resources, the aborted Law of Oil and Gas, and the ongoing struggle over the Law on Production Sharing.¹⁶ The second cleavage concerns not only control and influence on the company level, with corresponding financial rewards, but on the level of government organs as well, and is directly relevant here. Privatization, more accurately, corporate restructuring, has not measurably improved the efficiency of Russia's energy and mineral industries. Nor has it muted the fierce struggle for resource allocation, merely shifted the conflict onto a wider and more open arena.

That second cleavage relates to the issue of effective competition and institutional/government control over the oil and gas industries and its revenues, particularly from export. Struggle for influence and financial gains manifest themselves at almost each level of organization, from exploration to distribution, to pipeline access, and export. The Russian production organizations do not merely engage in extraction, refining, and export but encompass most support activities, and control and manage the bulk of the infrastructure in the area in which they operate. This remains true of the big so called integrated companies, such as Lukoil and Yukost', into which large numbers of production associations have been amalgamated. These parent companies also strive to retain a maximum of control over the daughter companies, the former production associations, and whatever downstream and peripheral facilities they have (and will have) acquired. Oil generals tend to regard the industry's problems as chiefly technical, with performance hinging mostly on investment and equipment allocations. The solution lies in the proper integration of the whole technological cycle and increased capital allocation.

Reformers, by contrast, realize that the integration of companies does not necessarily foster efficiency and can in fact serve to

preserve the essential features of the administrative principles that prevailed under the Soviet regime. "For vertically integrated companies to become efficient, they need an environment of independent companies that can provide competition as well as serving as buffers for supply and deliveries of oil. They also need a competitive system of suppliers of services and equipment."¹⁷ At present there is scant indication that such an environment will be created in the near future. It was probably quite unrealistic of reformers to envisage the delegation of important strategic decisions to daughter companies, while the soft infrastructure of legal, financial, informational, distribution and export oriented services remain so weakly developed and are anything but transparent. In most cases, the parent companies insist on retaining control over the development of new fields, financing, credit, stocks, and investment policy, foreign trade, and the pricing of many services.¹⁸

As of late 1995, the evidence seems strong that the restructuring of the oil industry has not improved the efficiency of resource allocation. Eight integrated corporations were created to rationalize investment combination and sequencing from geological prospecting to the filling station. The flexibility that such vertical and horizontal integration provide, however, has been misused. Lukoil, Yukost', and the other joint stock companies have instead turned into conglomerates, sprouting an overgrowth of commercial banks, insurance companies and similar commercial baggage that have nothing to do with their core business (Lukoil in 1992-93 spinned itself around with 72 joint ventures). For such conglomerates, the exploration and development of reserves, especially at new deposits, have become encumbrances. According to a senior researcher of the Russian Academy of Sciences, the idea of effective vertical integration "from wellhead to pump" has not been realized in Russia.¹⁹

In mid- August 1995, however, a journalist claimed that in the tug of war between industrial, commercial, and regional interests, those thriving for more efficient vertical integration may be gaining the upper hand. The oil giant Lukoil has outmaneuvered Permoil, acquiring its refinery assets, and later the whole company, after undercutting its attempt at regional independence.²⁰ In addition to Permneft', Lukoil acquired through direct transfer by the Chernomyrdin government eight more regional oil firms, augmenting Lukoil's reserves by one-third and pushing that company's production share to 17 percent of Russia's total. They also gave Lukoil a virtual regional monopoly from the upper Kama

River to the Caspian Sea on exploration, development, processing, and transit routes (excepting, of course, the territories of Tatarstan and Bashkortostan, two of the strongest Republics). These transfers, along with a number of others, are linked to the "loan-for-share" scheme devised by the government to plug up budgetary holes. The scheme shifted vast amount of energy and mineral wealth through insiders auction to a few well connected private banks just prior to Yeltsin's reelection campaign. An *Izvestiia* reporter expressed the conviction of most Russians: "The fight for the fuel and energy complex is a fight for power."²¹

The Energy and Mineral Sectors and the Economy

Nor has restructuring muted the conflict on a still higher level involving ministries. Indeed, the conflicts of the past two years recall the struggle for resources which in the era of central planning used to take place within Gosplan. Today, the struggle over activities that produce revenues has taken the place of lobbying in Gosplan for more investment and a larger wage bill. In the oil and gas sector this means above all the right to control (or at least influence) the volume of exports, access to pipelines and conditions for transferring the right of access, transport tariffs, licensing and exploration fees, and the like. Yeltsin's decree in late November 1995 to create a Federal Energy Commission (headed for a while by former First Deputy Minister, Anatoly Chubais), was a heavy blow to the Ministry of Fuel and Energy, its chief and closely associated deputy at that time, Yuri Shafranik and Anatoly Fomin, being forced out a year later. The Commission received full prerogative over the lucrative activities of production, transport, and export in the oil and gas sector, in addition to overseeing prices and participating in construction and development decisions.

The energy and mineral sectors also seem to be caught up in a basic split over broad economic policy within the Russian government and with international lending agencies. In late 1996, *Nezavisimaia gazeta* reported that ministers in the Russian government were split into two opposing camps, with fierce bureaucratic infighting between them. The first is the "finance" group which wants to concentrate on reducing interest rates (in part to permit more foreign borrowing), combating tax arrears, and break up monopolies. The second is a "sectoral" group that wants to halt the slide in industrial production, pursuing a policy that concen-

trates on the real economy. Western monetarist advisors, the IMF and the World Bank, have focused chiefly on stabilization, price and trade liberalization, encouraged energy and mineral exports while pressing for the abolition of export duties. Yeltsin's radical reshuffling of the government in the early summer of 1997 has strengthened that wing and even former Prime Minister Viktor Chernomyrdin appeared largely committed to this view. However, the fall 1997 struggle between the government and Parliament over the budget and Yeltsin's long-manifest practice of checking and balancing among his subordinates seemed to have shifted Chernomyrdin's position again back towards the "sectoral" group. The bitter split among Russia's financial tycoons in the wake of the mid 1997 "bankers' war," and Yeltsin's firing of the entire cabinet in March 1998 will doubtless have consequences on the conflicting goals of the "finance" and "sectoral" groups and the direction of government's policy. Critics against the neglect of the real economy and the lack of any industrial policy have become especially vocal in the Duma and among non-governmental economists.²²

With respect to energy and mineral exports, the impact on the economy as a whole and the population at large should not be ignored. Oil and gas, as most other minerals, have played a highly equivocal role in economic development in other countries.²³ Their role in the far shorter transition experience will not be clear for some time. Gains from export earnings versus domestic energy needs had long been an issue in Soviet times, when prices in the country diverged drastically from those on the world market. The subsidization of other Communist economies by the USSR through deliveries of oil, gas, and other commodities below world prices was another issue to be settled on an inter-governmental level. The full decontrol of prices and trade should, in theory, resolve such conflicts because prices are supposed to vary only by their transport costs both at home and on the world market. Price and trade liberalization, however, is not yet complete, but it has already produced wrenching consequences everywhere in the former Soviet Union.

The extraordinary trade surplus Russia has achieved thanks to its exports of energy, metals, other raw materials is more a sign of great sickness than a foundation for a healthy economy. The country reached a \$40 billion positive trade balance in 1996, and more than \$32 billion in 1997, despite the significant worsening terms of trade. Relative to its aggregate trade turnover in 1996, Russia

achieved a trade surplus of 39 percent with countries beyond the borders of the former Soviet Union, a virtually unheard of ratio. In none of the industrial countries did the trade surplus come even close to 20 per cent that year. Japan's much publicized surplus in 1995 reached 18 per cent of total trade, but was reduced to 14 per cent a year later, according to preliminary data. The earning from export and import duties represents a significant portion of government revenues, amounting to 11 per cent in 1995.²⁴ It is clear, however, that exports are not bringing in investment goods to promote future growth. The share of foreign investment in total capital outlays in 1996 amounted to a mere 2.4 per cent.²⁵ Exports also do not result in the corresponding importation of consumer goods for the general population. Unorganized trade, which consists entirely of consumer goods, reduces the trade surplus considerably and does furnish consumer products for ordinary Russians. Such trade, however, has no role in investment—hence the restructuring of production capacity.

In addition, oil extraction in Russia has dropped sharply, with the cost of delivery soaring. This is true of other minerals as well. Even gas output decreased, though that decline was essentially demand-related and, with 30 per cent of global reserves and a massive infrastructure, Russia's comparative advantage is probably greater in this fuel than in any other commodity. Supply elasticities thus worsened significantly both in the short and the longer run. The oil industry especially will need very large investments for rebuilding and developing new reserves even to maintain the present level of extraction. Such capital can come only from the West and will require investment guarantees and sufficient profit. The volume of oil and gas exports versus domestic consumption, therefore, continues to be a highly political issue in Russia today. It becomes still more so for the longer term, since it is intertwined with the issue of foreign participation.

Russian oil output in 1996 fell to 301 million tons, even with the inclusion of gas condensate, i.e., by 47 per cent against that in 1988 and by more than one-third even compared to 1991. Crude oil production alone was only 295 million tons. With 197.5 million tons of crude oil produced during the first 7 months of 1997, the annual extraction level promising to be essentially flat for a number of years.²⁶ The continued decline in extraction *since* early 1994 is largely demand related. It is linked to price hikes in the pursuit of aligning domestic crude oil prices to those on the world mar-

ket, the full attainment of which still remained beyond reach at the end of 1996.²⁷ However, the overall downward trend in Russia's oil production to somewhere between 300 and 350 million tons per year has been a function of geological and engineering constraints, the decay of oil field and transport facilities, and the sharp fall in investment in the past six years. Even immediate massive foreign investment could now lift output back to the level of 1992 (400 million tons) only late in the next decade.²⁸ A program drawn up by Russian experts in 1995-96 estimates only a possible 330-350 million tons of extraction by that date, but contingent on the immediate passage of a product sharing law and a substantial lightening of the tax burden on the oil industry. With the present tax regime, one source claims that Russian petroleum output will fall to 230 million tons by 2005.²⁹ Very few undrilled fields will yield oil otherwise, and none will do so in frontier regions or offshore. The gas industry, too, needs renovation and vast amount of new capital after 2000.³⁰ But internal constraints on demand, revenues, and foreign participation will tie expansion mostly to export growth. Until the year 2004-2005, the latter will be modest.

Russia's financial stability achieved by 1996 remains fragile and deceptive. The government essentially exhausted all domestic sources of borrowing, because the sum of all bank deposits and money in circulation equaled the size of domestic government debt market (GKO). At the same time, foreign investors, who hold 30 per cent of government bonds, have withdrawn huge amounts from that market, at least temporarily, in November-December 1997.³¹ That stability also seems impotent to generate investment in the real economy³² and so far has failed to lift the country out of the deep depression.³³ Money has been increasingly removed from inter-enterprise relations, where only 15 percent of transactions were paid with real money in early 1997, according to *Nezavisimaia gazeta*.³⁴ And simply there seems to be an insufficient quantity of money in the economy as a whole to spur any investment-led upturn. The total quantity of M2 (i.e., cash and bank deposits) in Russia as a whole roughly equaled that in Finland and amounted to a mere 13.4 per cent of the GDP in the second quarter of 1997, increasing by less than 2 per cent during the previous year and a half. Aggregate lending by Russian banks to the private sector amounted to a mere 7 per cent of the GDP in 1996, and bank credits and loans as a source of enterprise finance plunged by almost half to less than 11 per cent of the total between the end of 1994

and early 1997.³⁵

Not surprisingly, investment in the Russian economy since 1990 fell each year and in 1996 was less than 30 per cent of that six years earlier, with a further 8.2 percent drop in the first eight months of 1997, compared to the same period a year before. While GDP declined 6 per cent in 1996, the value of fixed capital decreased by 18 per cent, against only 10 percent in 1995.³⁶ A mere 5 per cent of aggregate investment in 1995 came in from abroad. Since the beginning of the decade, Russia has accumulated only some \$9 billion in direct foreign investment by July 1997, and Moscow City alone was the beneficiary of an astounding 57 per cent of this capital, according to the country's main economic weekly.³⁷

The fall of inflation to below 20 per cent in 1996, the obvious success story of the past three years, is also illusory in part, because that dragon was simply transformed into gigantic wage arrears and inter-industry debt. Non-payment, in fact, soared as a share of the GDP from 10 to 27 per cent between May and August of 1997 and as much as 70 per cent of all industrial sales are barter.³⁸ Russia "is not the low-inflation, high-growth economy that [investors] are looking for," according to a Western analyst. Former Prime Minister Chernomyrdin noted that a 5 percent annual growth in the GDP would require investment of 600 trillion to 900 trillion rubles (\$110-\$170 billion), but did not venture to say where the money would come from.³⁹

International financial institutions, with the IMF at the lead, apparently believe that holding the Russian government to objective standards and requirements as a condition for the disbursement of funds will provide the needed pressure for continuing the reforms and transforming the economy. However, when the state is fractured along both institutional and regional fissures, with fragmented but overlapping authorities and competing but shifting alliances, the efficacy of this policy remains doubtful. At any rate, while the economy will indeed be transformed, the result is unlikely to be what was expected. Thus, the institution of government itself bears little resemblance to that in Western states and has almost no collective responsibility. It is composed of competing yet interpenetrating elite cartels, effectualizing their interest through institutional intrigue and with no clear accountability. In the starkest terms, "institutional warlordism" reigns.⁴⁰ The privatized energy and mineral companies, with their "patrons" in ministries and government commissions are very much part of that scene.⁴¹

During 1995 and early 1996, for example, the major oil corporations supported the IMF demand of lowering then lifting export duties, which would also greatly benefit joint ventures. The Ministry of Finance, on the other hand, strongly objected to the proposal, pitting itself against the Ministry of Economics as well. At issue was the question whether growing oil exports would compensate the Ministry of Finance for the lost revenues from export duties. The Ministry of Economics, which seems to have lost influence, was apparently wooing the new giant corporations in the oil and gas sector, which wanted lower export taxes for obvious reasons.⁴² The IMF has insisted on the lifting of all export duties, but also of special exemptions and privileged access to pipelines, as a precondition for disbursing tranches of the new 9 billion ECU stabilization fund. Under IMF pressure, most such distortions and privileges were canceled by 1 January 1996 and all abolished by 1 July, but pipeline fees and border duties were raised significantly to compensate for lost revenues. In addition, as late as August 1996, *Delovoi mir* claimed that one quarter of all oil shipments were under some special regime. Export access allocations for the fourth quarter of 1997 averaged 27 per cent of production for about 18 companies, but ranged as high as 60 and even 100 per cent for a select few.⁴³ And in early 1997, the Russian government put a \$17 per ton excise duty on oil exporting firms that buy at domestic prices, in fact resurrecting the abolished export duty under a different name.⁴⁴

Passions have flared and debate has raged over these demands since the fall of 1995, indeed even before, when the first \$6.25 billion stabilization fund was disbursed. When quotas were in force, the government allocated to itself the largest export quota (amounting to \$1.5 billion in 1994). The loss of that direct income and that from export taxes would need to be compensated by new excise taxes on oil and gas and increased exports. At the same time, it was widely feared that a renewed surge of domestic energy prices, fueled by the excises and the export surge which was expected to follow the abolition of export taxes, would bludgeon industries which are large energy users. This would lead to increased wage arrears, swell unemployment, and increase poverty in many regions.⁴⁵ Events seem to have confirmed these fears. Through half a decade of dramatic dislocations, Russia has not managed to close the gap between the domestic and world energy prices. By the spring of 1996, the gap was nearly gone, given the VAT and an excise tax on crude oil just raised from 39,400 to

55,000 rubles per ton.⁴⁶ However, the renewed US-Iraqi confrontation in September 1996 and the continued sanction on all Iraqi sales again jacked up the world price, and once again put it out of reach for the Russian economy for a while.

The higher excise taxes and the 1996 upward shift of world prices, however, further widened the rift between domestic energy consumers and exporters. After much wrangling and contradictory decrees, the Russian government yielded to IMF pressure and lifted export duties on both crude oil and refinery products (except fuel oil) on 1 July 1996. To make up for budgetary losses, the lost export revenues were compensated by increasing the excise tax from 55,000 to 70,000 rubles per ton, which is claimed to compensate oil producers as well.⁴⁷ The rise in excise taxes on the other hand added an average of \$6 per ton to the domestic price of crude oil and raised the price of gasoline to close to \$0.80 per US gallon at the refinery and to \$1.30 at the pump.⁴⁸ Enterprises throughout the country were facing the fall and winter of 1996 with stockpiles of furnace fuels 38 per cent below their normal needs. Large number of Russian regions and major power plants apparently operated without any reserve cushion.⁴⁹

Given the increased arrears from domestic consumers, however, the health of the oil industry has not improved and its physical assets continue to decay, and almost 40,000 wells, 35 per cent of the entire well stock, stood idle by 1998. Well commissioning has fallen steadily, by 14 and 17 per cent respectively in 1995 and the first 8 months of 1997 (I have no data for the intervening year of 1996).⁵⁰ The average production costs at well head continues to rise. Transport costs, excises, and tariffs, raised the domestic purchase price for refineries to 64 per cent and the export cost close to three-quarters of the world price in late 1996. Domestic prices of gasoline and diesel fuel exceed the international mean by 59 and 36 per cent respectively already by the end of 1996.⁵¹ The ongoing revaluation of fixed assets will raise amortization and boost production costs by 20-30 per cent. The anticipated rise in extraction costs in the face of the 25 percent drop in the world crude oil price in the first quarter of 1997 was expected to shave off most of the profit margin even for exporters by the latter part of that year.⁵²

Although clearly not a neutral observer, the president of Sugutneftegaz claims that with the increased excise tax of 70,000 rubles per ton, the price of crude oil would need to rise up to 720,000 rubles per ton, else West Siberian companies will not make enough profit for any expansion of capacity. At such a price, how-

ever, "Russian oil will not be bought by anyone."⁵³ This is certainly true within Russia and the CIS. Beyond the former USSR, however, the price jump in early autumn, 1996, provided Russian producers with a \$3 margin above the 720,000 ruble equivalent that Sugutnef' president finds satisfactory. Russian companies were exporting from Novorossiisk at between 390,000 and 432,000 rubles per ton without profit tax and under 415,000 rubles even from Ventpils, Latvia.⁵⁴

The price hikes of 1996, therefore, were a boon to those who could export beyond the borders of the former USSR, even though the rise in the value of the ruble relative to the dollar was squeezing profits throughout the year. Oil traders and producers able to export earned an extra \$7 on every ton sold to the West. In the first 11 months of 1996, about one-third of all oil produced in Russia was exported. These windfalls, however, could not resurrect the Russian economy as a whole, which in 1995 was 6-7 times larger than all the energy industries combined. They did not even help much to rebuild the fuel-energy sector itself, which must depend on the domestic economy for the bulk of its markets and the ability of domestic consumers to pay their bill. Most inputs for the oil and gas industry also come from Russian and, to a much lesser extent than in the past, Ukrainian suppliers. In the first quarter of 1996, for example, 72 per cent of the pipes and 85 per cent of the ferrous metals of all kinds imported by Russia were shipped in from former republics.⁵⁵

The windfall revenues oil exporters gained from the price hikes during 1996 also proved to be temporary, and prices began to decline sharply in early 1997 already. The close of that year also saw the end of the "Asian boom," and the flight of international capital from emerging markets in general. Wrenching economic woes in East Asia will inevitably translate into a slowdown in their galloping demand for petroleum products, which in turn will depress the world price of oil. By early February world crude oil prices have plunged again and Urals crude was trading at around \$13.60 per barrel. Such a price, if lasts, will be disastrous for Russia's oil industry and its economy as a whole. Even a \$15.50 per barrel price is reckoned to cost Moscow \$1 billion in tax revenues.⁵⁶ And if the embargo against Iraq were to lift, even partially, within the next 12-20 months, oil prices could collapse further still.

Since 1991 (but also through 1993-1995 alone), the oil export boom beyond the CIS was accomplished entirely from diversion from former republics (since the breakup of the USSR, total net oil

and product exports actually declined, i.e., more crude oil and products were diverted from former republics than increased beyond the CIS). Such diversion can be accomplished only once. Deliveries to the CIS were down to 12, 238,000 tons of crude and 392,100 million tons of products during the six month of 1996, little more than a fifth that of the first half of 1991.⁵⁷ CIS debts for Russian fuels also began to decrease in the second half of 1995, with debt for natural gas comprising 85-88 per cent of the total. Russia cannot divert gas from the CIS to the world market, as she can divert oil and, at any rate, current deliveries of fuels are now more or less regularly paid for.⁵⁸ In addition, prices to former republics are essentially at world levels now, even though such imports are mostly settled under clearing agreement or in barter. Since early 1995, domestic enterprises have accounted for the overwhelming share of Gazprom's unpaid bills.

Within Russia, the mounting cost of fuel had a devastating impact on energy intensive industries. More than a quarter of all industrial firms were unprofitable in 1995, but almost 48 per cent in 1997 (first ten months). Particularly sharp jumps in the share of unprofitable firms took place in the oil refining, chemical-petrochemical, and ferrous metallurgy branches.⁵⁹ By September 1997, two-fifths of all firms were loss making in 74 of Russia's 88 regions, covering the whole country, apart from Chechnya.⁶⁰ Rising energy costs have hit regions burdened with long transport hauls particularly hard, so that east of the Urals the share of unprofitable firms well exceeded the country's average by the mid-1990s already, with rapidly worsening conditions since.⁶¹ An excise tax on crude oil alone raises the price by a further 8 percent, undermining the viability of even more firms.

The financial balance achieved at the price of continued economic depression worries energy producers and corresponding government institutions. In early October 1996, Pyotr Rodionov, Energy Minister for less than a year, unequivocally declared that domestic energy prices for industry should be decreased to stimulate economic growth and former Prime Minister Chenumyrdin himself came out in favor of a price freeze. Indeed, on 10 October the Federal Energy Commission announced a freeze for gas and a 10 per cent cut in electricity rates for industrial users.⁶² This was clearly contrary to hitherto dominant Western counsels, with their monetarist emphasis, and the wishes of international financial institutions.⁶³ Similarly, giant Gazprom, claimed in early summer 1997 that its customers owed it 3.3 times as much in unpaid bills as

that monopoly owed to the government.⁶⁴ During 1993-1995 Gazprom apparently received no payment for 53-59 per cent of all gas delivered, with that share growing each year.⁶⁵ By October 1996, a number of sharp price increases in the previous 20 months put the average domestic price of gas for Russian industrial consumers only 8.5 cents behind the European export price.⁶⁶ Adding transportation costs from the main consuming centers of European Russia to West Europe means that for industrial consumers the posted wholesale price in Russia may now exceed the average in Europe.⁶⁷ The real price is much lower, of course, since more than half of that which is delivered is not paid for.

Residential customers are another matter. While the residential-communal sector still used only 13.6 per cent of aggregate gas supply in 1995⁶⁸ (more like 15 per cent if self consumption by pipelines transport is excluded), it paid only one-tenth of the price charged to industries in the second quarter of 1995. Compared to household and commercial users in Western Europe, the price of gas was as low as 4-6 per cent in 1995.⁶⁹ Advocates of lower energy prices made it clear that a freeze or reduction of energy prices would apply only for industries, and the residential-communal sector must pay more.⁷⁰ Indeed, the government already announced the raising of household electricity prices from 1 October 1996 and put consumers using more than 200 kwh per month on notice that their bills will eventually double.⁷¹ Yet it will be politically impossible to hike residential energy prices anywhere near the level for industry. The lack of metering and thermostatic control of gas use by many millions of residents and by district heating plans (which represent the bulk of communal demand) also presents a long-standing technical barrier to disconnect non-paying residential customers. Given the relatively small share of this sector in aggregate consumption and the politically sensitive issues involved, neither market pricing nor the wholesale shedding of residential users will be possible for yet a number of years.

The push to reach international price levels too quickly appears to have been counterproductive. It has greatly contributed to the recurrence of the 1992 non-payment crisis, which prevents any sorting out of economically viable from non-viable enterprises by the price system. Through a perverse counter-incentive, it also seems to deter those firms which have been paying their bills from continuing to do so. And while energy consumption in the former USSR was extremely wasteful and much higher than justified by economic welfare criteria, current levels of demand have plunged

to the level of Third World countries. By the mid-1990s, per capita liquid fuel consumption in Russia had fallen to the level of Venezuela and Jordan and was barely above that in Mexico. Less motor gasoline was consumed in the Russian Federation per capita than in Jamaica, and much less than in Mexico.⁷² The economic transition which created a small oligarchy of financial and mineral barons essentially destroyed the middle income group which had begun to enjoy higher living standards and personal energy use.

In this context, Gazprom, too, has emphatically argued that it provides an indispensable social service for millions of employees and households without payment, and is in fact a creditor for the entire economy. With 8 per cent of the Russian GNP, it claims to provide a full quarter of all budgetary revenues, and by June 1997 the government's debt to Gazprom exceeded its own arrears by 14 per cent. It has accused the government of wanting to "destroy it in its present form" under IMF pressure and break it up into half a dozen smaller companies.⁷³ The confrontation with First Deputy Prime Minister and Fuel-Energy Minister Boris Nemtsov was resolved in a compromise for now, but more in Gazprom's favor. By the end of August 1997, the monopoly managed to "pull 14.5 billion rubles out of its pipelines, mainly through effectively threatening its own debtors. The larger half of its debt (representing only fines and interest on late payments) may in fact be canceled. On the other hand, all talk about breaking the monopoly up into fully independent companies have ceased for now, Nemtsov himself declaring that "only a madman would destroy Gazprom."⁷⁴

The monopoly also continues to manage the government's 35 per cent share in the giant company. A trust agreement makes Gazprom chairman, Rem Viakhirev, trust manager of the state's share through 1 March 1999, though with restricted powers.⁷⁵ Finally, in December 1997 Nemtsov himself and two allies had to leave the government supervisory board that the First Deputy Premier had established in the spring of that year to oversee Gazprom. While the management of the gas monopoly will lose a few of its biggest perks, the ouster, by presidential decree, represents a substantial defeat for Nemtsov, who has been the most energetic crusader for clipping Gazprom's wings.⁷⁶

Energy and Mineral Exports: Decreasing Competitiveness

Energy and raw materials have long dominated exports in the defunct USSR. They comprised the overwhelming share of exports to the West, but comprised the bulk of those to the CMEA as well. The latter were conducted on concessionary terms, which, however, hardened significantly during the 1980s. After the Soviet breakup and the beginning of Russian reforms, the idealized model of transition, urged by international lending institutions and most Western advisors, called for rapid liberalization of foreign trade. The latter would be "restructured towards the country's comparative advantages and demands." In the words of Anders Åslund, this means that "If the change in the economic system is carried out properly, ...exports should start "skyrocketing by 25 to 35 per cent in the first year of systemic change..." And there will be a shift in the structure of total exports towards "raw materials...[which, together with] intermediate goods will dominate for years to come."⁷⁷

Energy, metals, other raw and intermediate materials indeed dominate Russia exports. Fuels and metals alone commanded about three-fifths of all exports during 1997, a share which reached almost 69 per cent during the first half of 1997.⁷⁸ To countries beyond the former USSR, the share of raw and semi-finished materials rose to a full 90 per cent by the end of 1996 and remained almost the same in the first half of 1997. Exports comprise an astonishingly high portion for most of them. Nearly 43 per cent of crude oil extracted, more than one-third of refinery products, 36 per cent of all gas, more than 72 per cent of all fertilizers, four-fifths of all nickel and 84 per cent of all cellulose produced was exported in 1997.⁷⁹

The aggressive push into Western markets, however, was accomplished entirely through diversion from former republics (Russia, in fact, cut exports to the successor states *more* than it was able to augment it beyond the former Soviet borders).⁸⁰ During the first half of the 1990s, aggregate energy exports actually declined in physical volume, though they continue to account for well over two-fifths of all exports earnings. Because prices to CIS states have not fully reached world levels even in 1995, that diversion, together with the price hikes of 1996, gave Russia a substantial boost in revenues reaped from energy exports. In the final analysis, it was the UN embargo on Iraq which enabled Moscow to boost oil exports to the West to the extent achieved. Yet the ex-

port offensive has not expedited the modernization of Russia's capital stock. As of 1997, even the energy sector experienced negligible modernization. Nor has Russia witnessed any real upgrading in the assortment and quality of energy, raw, and, semi-finished materials shipped abroad.

The high earnings from oil exports, however, have fizzled, as world prices plunged anew. In late January 1998, the price of Brent blend (the benchmark crude quoted on the International Petroleum Exchange in London) dove to less than \$15 a barrel. By March of that year, Russian oil was selling at \$12.22 per barrel in Europe, in contrast to \$20-22 a year before. The UN Security Council's decision to permit Iraq exports for \$5.2 billion in the next six months (instead of the \$2 billion previously allowed for a half a year period) and reduced Asian demand have exerted tremendous downward pressure on the world price. Experts claim a global excess supply of 500,000-800,000 barrels per day, and Asia's economic troubles will continue to depress consumption there for a while. It is believed that Iraq would need to stop producing for an entire year for prices to return into the \$18-\$22 range.⁸¹

Metals compose the second largest group of Russia exports, tonnage chemicals, wood plus cellulose the third and the fourth. Since 1992, these non-fuel tonnage commodities hugely increased their share in Russian exports beyond the old USSR, jumping from 18 percent that year to 34 per cent during 1995.⁸² Much of metal and chemical exports were also diverted from former republics, but it was the collapse and insolvency of Russia's own military-industrial complex which, in these branches, freed the bulk of production capacity (and, in the first year or two, even inventory in stock) for shipment abroad. Metals, chemicals, and wood products comprise diverse clusters and vary even within each group. They have disparate "transition experiences," but also many common characteristics and problems. Exports comprise an astonishingly high share for most of them: 78 percent of all primary aluminum, 71 per cent of copper, 82 percent of nickel, 63 percent of ferrous metals, almost half of synthetic rubber, and 78 percent of all fertilizers.⁸³ All but a small portion of these exports go to countries beyond the former USSR.

Severe ecological pressures, rising production costs, and decaying capital stock characterize all these commodities within Russia. On the world market, their export encounters a long-term secular price decline and intense price competition, recurring charges of dumping, and in some cases market restrictions for en-

vironmental reasons. Nitrogenous fertilizers, for example, are essentially an indirect export of natural gas since, aside from capital equipment, methane provides the overwhelming part of all their inputs. Cheap imports from Russia have captured nearly a fifth of the market for ammonium nitrate in the European Union by late 1997 and "have been a running sore for EU manufacturers." Fraud has proved to be a massive problem, since imports have been declared at the official minimum price but then sold for substantially less. To combat such fraud, EU member states have agreed to slap a \$30.5 duty on imports from Russia to replace the regularly violated minimum price.⁸⁴

As to metals, the past three decades (from 1965 through 1995) have seen the composite price index (for 35 metals) decline two times in real terms, the downward trend barely affected by short term perturbations. The prices of 33 out of the 35 fell during the 1980s.⁸⁵ Then the dramatic shift of Russian (and other CIS) metals production from domestic to export markets have had very substantial additional impact on the world price, contributing to instability and inviting retaliation. A Russian source claims, for example, that in their feverish attempts to dump their products, Russian steel plants shifted 8 million tons of "surplus" metals to already saturated outside markets during 1997, depressing prices even further.⁸⁶

The case of aluminum is perhaps the best publicized, but the experience of other commodities (such as refined copper, platinum, nickel, cellulose etc.) are essentially similar. The collapse of military orders and the crisis in the aerospace and aviation industries led to the swelling of inventories and unused capacity. By 1996, Russian internal consumption of aluminum per capita fell to a mere 3 kg, while its factories produced 20 kg per capita, 85 per cent of the total for export. From 1989 through 1993, Russian shipments to world markets soared from 500,000 to some 1,600,000 tons. World prices collapsed and, under international pressure, Russia was forced to agree to bear a full third of all global reduction in aluminum exports. In 1994, the shipment of primary aluminum and refined copper rose sharply again.⁸⁷ Largely because of shipments out of Russia during 1995, world aluminum supplies grew by 2.5 percent despite a 4.5 per cent drop in demand. The world price collapsed again by almost one-third. The oscillation is expected to continue, with supply increases of 5.8 percent during 1996, but with healthy growth again in demand and prices towards the end of the decade.⁸⁸

For Russian producers, however, costs in this highly power-intensive industry are rising even faster with the sharp increases of electricity prices. Production costs climbed by 50-70 per cent in the first half of 1996 alone. As the profitability of exports declines, Russian firms would need a radical reconstruction of their factories, for which they have no funds. During 1993-1996, only 2-4 percent of revenues in the industry were spent on modernization, while that figure ranges between 10 and 15 percent in the West.⁸⁹ In addition, Russia has long struggled with a severe deficit of domestic bauxite. Its factories work overwhelmingly on a tolling basis, the share of which at Krasnoirsksk and Bratsk reached 74 and 83 per cent respectively. All raw materials are brought in and the products remain in the ownership of foreign companies, who also control a large share of the industry and own a majority of shares in a number of factories. Tolling, which provides four-fifth of all Russian aluminium exports, has enabled the industry to survive. However, given the accordion-like movement of prices, it has not earned enough to enabled large-scale modernization so far.⁹⁰ At the same time, rising production costs have put the metal out of reach for domestic consumers, while actual and perceived foreign control of capacity has fed growing xenophobia.

As in the case of aluminium, tolling has proved vital to the survival of the ferrous metal industry as well, even though only half of the monstrously overbuilt and, on the whole, value-subtracting steel capacity is producing at present. In this industry, too, increased exports are responsible for keeping the industry in business. However, tolling arrangements here are different and foreign control is not an issue. Sager notes that much of the growth in the volume of ferrous metal exports has occurred under so-called 'internal tolling.' "Under this scheme, foreign companies [usually trading entities] buy iron ore and coal from Russian producers, ship it to Russian iron and steel plans, paying all transport and smelting costs, and then claim the end products for sale exclusively outside Russia."⁹¹ This arrangement contributes far more employment because Russian raw and auxiliary materials are purchased and used. Since mid-1995, however, the introduction of the "currency corridor" (i.e., permitting only a slow depreciation of the ruble against the dollar within strictly limited boundaries), combined with sharply rising prices for energy and transport, has drastically reduced profit margins for ferrous metal exports.

"Internal tolling," however, has not contributed to the modernization of existing capacity any more than tolling in the alumi-

num industry has. Investment in the iron and steel industry collapsed by almost 60 percent from 1991 through 1995, leading to further decay of the already obsolete, energy wasting capital stock.⁹² Not to lose exports, the Russian government was forced to reduce drastically, then wholly eliminate, export taxes on ferrous metals (except scrap steel to protect that input for domestic metal producers) well ahead of lifting such taxes for oil and gas, and without any pressure from the IMF.⁹³ These measures, however, could not arrest the rapid worsening of the Russian steel industry's competitive position on the world market. The industry still earned \$16 billion from exports in 1996 (more than half of the value of its total output), but by the end of the year exports became unprofitable for most factories. Profitability dropped more than threefold within that twelve months, and some 70 per cent of firms in Russia's ferrous metallurgy can be considered bankrupt.⁹⁴ The economic crisis in South-East Asia will further damage prospects for Russian ferrous metal exports for the rest of the 1990s. This region accounted for two-fifths of Russian exports, but demand here has plunged and prices fell by 20 per cent.⁹⁵

In these circumstances, the severe anti-dumping measures prepared by the EU Commission against Russian steel pipes will be a very heavy blow, since the almost 33 percent anti-dumping duty is more than three times that imposed on Romanian and Slovak steel, in fact negating the benefits gained from the abolition of the export tax earlier.⁹⁶

In contrast to aluminum exports which depend overwhelmingly on tolling (with supply adjustments presumably dependent on foreign companies) platinum, palladium exports, as that of nickel, copper, lead, zinc, and fertilizers originate entirely from Russian mines and factories. Foreign trade, therefore, creates more extensive backward linkages and is instrumental in protecting employment more broadly. The crisis of non-payment, which has again enveloped the country's economy, has hit these industries as well. And just as with aluminum, the large volume of Russian exports exerts a downward pressure on the world prices of these metals. Prospects on the world market will depend on whether Russia will reign in its exports or not.⁹⁷ The influence of Russian supplies on world copper prices is much weaker, but not negligible. Any growth in Russian (and Kazakh) exports will increase the existing surplus, estimated to be 50,000 tons in the first half of 1997, but from two to five times as much as from July to December of that year.⁹⁸ Similarly, while the share of exports in the output of the

Russian chemical industry rose from 5.3 to percent in 1991 to almost 22 percent three years later, by 1994 nitrogenous fertilizers had to be dumped a full quarter below the world price.⁹⁹ As in the case of aluminum, such tactics to find markets invite retaliation.

Some of Russian commodity exports will also be restricted by increasingly stringent environmental standards for the products in Europe. At the same time, the raw material and commodity orientation of the Russian economy prolongs the severe ecological damage of the Soviet era. While aggregate production declined, notwithstanding increased exports, the ecological damage has not decreased correspondingly. Investment collapsed in these branches as well and was expected to fall to one-fourth that of the 1990 level by the end of 1996.¹⁰⁰ Mineral and commodity producers, therefore, could invest almost nothing to make their plants environmentally more benign. Non-fuel products with significant ecological burdens hugely increased their share in Russia's export structure since the beginning of transition, surpassing the contribution of oil and gas in 1995, though the oil price jump in 1996 may have put the former slightly ahead again.¹⁰¹ In some cases, tightening environmental standards in Europe with respect to imports have begun to restrict Russian exporters. From October 1996 on, for example, the EU has barred the import of diesel fuel with higher than 0.05 percent sulfur content for the transport sector. The Russian market consumes diesel with 0.2 and 0.5 percent sulfur and most of its refinery equipment is geared to these standards. In 1996, Russia was obliged to sell its diesel to heat and power stations, which paid \$6 less per ton.¹⁰²

The Chimera of Structural Change

The Russian experience to date seems to show that the shock wave nature of market pressure made it harder, not easier, to lay the long-term foundations of a normal, law-governed, market economy. Recent studies note that the more such pressure increased, "the more 'irrational' (in terms of neoclassical economics) firm behavior became...There is a danger that negative selection may be at work. It may be the 'mafia species' which do best—those who break the rules, bribe politicians, avoid taxes, cheat customers, and stash their earnings in foreign bank accounts." In addition, fierce competition from imports will not allow the generation of profits on a scale to effect investment in new equipment and products. "Thus, too much competition too early in the tran-

sition will kill off firms that could have adapted and become mainstays of a new market economy."¹⁰³ The evolving structure of the Russian economy, six years into the transformation gives little reason for satisfaction with the process. The share of material production did contract in favor of the service sector (long neglected in the Soviet era). Yet as a Japanese scholar has clearly shown, "the relative expansion in the output of services, mainly caused by the expansion in the trade and financial sector, represented nothing more than the expansion of profit and mixed income accumulated in these sectors."¹⁰⁴ In addition, in Goskomstat's Russian Federation Report on National Account, the contribution of the banking sector to the Russian Growth National Income (GNI in current prices) is entered as steadily rising negative percentages. The share changes from -0.5 percent in 1990 to -10.6 percent of the total in 1994, thus casting doubt on the reliability of the whole methodology of national income computation, at least in the service sector (Table 1).¹⁰⁵

Table 1:

GDP of the Russian Federation by Sectors of Origin. Per cent of Total (in current prices)

	1990	1991	1992	1993	1994
Industry	35.4	37.6	34.6	38.0	28.7
Agriculture	15.5	13.8	7.2	8.3	6.4
Construction	8.9	9.3	6.4	7.3	7.7
Others	1.2	1.2	1.3	0.6	0.5
Service	32.6	36.7	52.8	44.4	59.1
Commercial	16.4	23.1	42.4	30.7	42.7
Non-Commercial	3.0	2.9	2.4	2.8	4.1
Mixed	13.2	10.7	8.1	10.6	12.3
Banking	-0.5	-2.2	-4.0	-5.6	-10.6
Net taxes	6.9	3.7	1.7	7.1	8.1

Source: Worldbank, Goskomstat, Russian Federation: Report on National Accounts, October 1995, A-1.

Taken from M. Troschke, A. Sekarev, H. Clement and V. Vincent, *op.cit.*, p.9.

Within the industrial sector, which registered an overall output decline of more than 50 per cent between 1990 and 1996, the machinery, timber and wood product, construction materials, and light industries (i.e., textiles, apparels, and footwear) experienced far more catastrophic drops. In 1996, these branches produced only 14 to 36 per cent as much as six years earlier, with substantial decreases even after 1994, when other branches have begun to show signs of stabilization (Table 2). The combined percentages of electric power, fuels, ferrous and non-ferrous metallurgy rose to more than half of aggregate industrial production by the end of 1996 even in constant 1992 prices (i.e., the year in which the lion's share of price realignment took place). Five years earlier, these branches contributed less than two-fifths of total industrial output. The structure of Russia's economy has become even more raw material and energy-dominated, notwithstanding the fact that, with the exception of natural gas industry, these primary branches also registered substantial declines in physical output (Tables 2 and 3).¹⁰⁶

Table 2:
Changes in the Industrial Output in 1991-1997 (in per cent to 1990=100)

Industry	1992	1993	1994	1995	1996	Memorandum
						Item*
Industry	75	65	51	50	48	101.5
of which:						
Electricity	96	91	83	80	80	96.5
Fuel	87	77	69	69	67	100.0
Ferrous metallurgy	77	65	53	57	56	101.3
Non-ferrous metallurgy	68	59	53	55	53	103.8
Chemical Industry	73	58	44	47	47	101.9
Machine-building	77	65	45	41	36	103.0
Timber, wood-working	78	63	44	44	34	101.0
Construction materials	78	65	47	44	33	95.0
Light	64	49	26	18	14	96.5
Food	76	69	57	52	48	98.3

*Percentage growth claimed October 1996 - January 1997 (October 1996 = 100)

Source: Goskomstat RF

Table 3:
Industrial Output Structure in 1991-1997 (in per cent, fixed 1992 prices)

	1991	1992	1993	1994	1995
Industry	100	100	100	100	100
of which:					
Electricity	5.5	6.4	7.1	8.2	8.4
Fuel	16.3	18.5	19.1	21.7	22.2
Ferrous metallurgy	7.9	8.2	7.9	8.3	9.4
Non-ferrous metallurgy	9.4	8.6	8.6	9.9	10.5
Chemical Industry	8.7	8.3	7.6	7.3	8.1
Machine-building	19.7	20.5	20.1	17.6	16.5
Timber, wood-working	4.5	4.8	4.5	4.0	4.1
Construction materials	3.3	3.3	3.2	2.9	2.8
Light	8.3	7.1	6.4	4.3	3.1
Food	10.0	10.3	10.9	11.4	10.8
Other	6.4	4.0	4.6	4.4	4.1

Source: Goskomstat RF

As a result of such perverse structural development, the energy and material intensity of the Russian economy has actually increased (by 47 per cent, according to Russian statistics).¹⁰⁷ With due allowances for huge uncertainties and imprecisions in the data, Table 3 presents Goskomstat's calculations in constant prices. The irrational bloating of material and energy intensity of the Russian economy since reforms began cannot, therefore, be attributed only to price changes. Attempts to prove on the basis of a far more modest drop in electric power consumption that Russian GDP declined only half as much as official statistics suggest also appear quite illogical.¹⁰⁸ Power demand belongs, in part, to fixed costs, which can be adjusted only slowly. This is particularly true in the post-Soviet states, in which the household and municipal sector accounts for only a meager share of total consumption (in 1987, household-municipal sector accounted for less than 13 per cent of Russia's aggregate electric power demand).¹⁰⁹ With investment in the economy, including the industrial sector, falling each year (to below one-third of the 1990 level by 1996- see above) energy waste must have risen substantially. One source claims that a full 40 per cent of electricity produced is squandered.¹¹⁰ The service sectors and the shadow economy (most of which also comprises services) are not power intensive. In addition, as shown by Tabata, the

increased share of services in the Russian GDP was simply caused by the enormous growth in profit in these sectors, at least until the mid-1990s.¹¹¹

Russia and the Newly Independent States of the Caspian Basin: Old and New Players: 1993-1998

The defunct USSR, as Imperial Russia before it, "overlooked the back door to the other civilizations of Eurasia," to use Toynbee's words.¹¹² In fact, it not only overlooked the door but controlled a number of the back rooms of other civilizations as well: from the Catholic/Protestant Western world, to a large chunk of the land of Islam, and bits of Buddhist and Lamaist Asia. Empires vanish, but the land, its resources and people, and the infrastructure built up through the decades remain, though the latter may be largely unsuited to the requirements of the new era. The traumatic social and economic transformation is occurring on that concrete geographic template, on which the new Russia must redefine its interests. However, given the chaotic nature of the socio-economic transformation today, the definition of *national interest*, even of *national economic interest*, remain murky. Zero sum games are the rule among the principal actors. Harmonizing the short run with the longer time horizon, difficult even in a properly functioning society, is hardly possible.

With the breakup of the USSR, Azerbaijan, Kazakhstan, and the republics of Central Asia removed themselves from Moscow's control. However, independence has also removed them from a budgetary watering hole, where they had a large and frequently visited stand. Yet the breakup has not eased Russia's concern with Asia; on the contrary, it has increased it! Nor could Russia free itself entirely from all budgetary costs related to the former republics on its southern flank. The Imperial (Byzantine) eagle, prominently and frequently displayed again, remains double-headed. Ukrainians and Byelorussians certainly do not consider the Tajik-Afghan or the Georgian-Turkish borders as the frontiers of their nations, but for Russians the answer is not so clear cut. Two-fifths of Russia's new *Sudeten minorities* (co-nationals in the new successor states) are in these six newly independent states. When not actually seeing any sign of tribal turmoil, and/or Muslim religious backlash along these frontiers, it takes little effort to conjure them up. Once the strategic border from the old Soviet one shifts northward, it is difficult to see it securely planted anywhere else. No

strategic line of defense is imaginable across the Kazakh desert, even if this were possible politically. In Central Asia, the heavily populated Fergana Basin, with its 12 million people and gerrymandered, irrational boundaries, represents a particular concern. If it experiences a civil/tribal war, like the recent and still ongoing turmoil in Tajikistan, all of Central Asia and southern Kazakhstan would be exposed to severe turbulence.

On the northern flanks of the Caucasus, most of the 20 odd indigenous nationalities *inside* the Russian Federation and numbering 5 million have a history of animosity to Moscow. The brutal Chechen war of 1994/95 came on the 150 years anniversary of the launching of Imperial Russia's Caucasian Wars (which dragged on for three decades)¹¹³ and forty years after Stalin's wholesale deportation of four of the region's peoples. In addition, two major nationalities (Ossetians and Lezgins) bestride the new Russian border, a status to be exploited by both Russian and outside forces. The North Caucasus is next door to Russia's breadbasket (the Kuban', Stavropol' Krai, and the Lower Don region), which produce 23-24 percent of the country's grain, with almost twice the yield of the national average.¹¹⁴ All three are inundated by refugees.

There is no free lunch, however, even for a Great Power or, perhaps, *especially* for a Great Power. Russian subsidization of the former republics unquestionably continued through 1992-1994. What is most interesting for the present study though is the following: in 1993 the new states of Central Asia became the chief recipients of technical credits from Russia's Central Bank and government credits in general. A year before, Ukraine and Belarus' received some 60 percent of the total.¹¹⁵ Aid to Kazakhstan probably included nuclear cleanup costs, ancillary expenses for the space station Baikanur and the like. Kazakhstan used up a full third of all credits from Russia's Central Bank in the first quarter of 1993 but received no further government credit for the rest of the year. As of September 1995, almost half of all CIS debts on government credits was owned by Tajikistan and Uzbekistan. Central Asia plus Kazakhstan accounted for 66 percent of the total.¹¹⁶

The privatization *blitz* of the most recent years injected new actors into the geostrategic relations of Russia with its former republics in Central Asia and the Caucasus. Even before that *blitz*, Russia's various ministries and other government institutions found it difficult to speak with a coherent voice. Defining national interest and developing a consensus concerning them was proving pain-

fully difficult. The creation of huge corporate entities, some of which rival in size the largest in the West, has added further complexity to the issue. The political, financial, and personal relationship of corporate structures to government institutions raise sensitive questions everywhere. Such relationships become especially germane in Russia and the CIS today, given the chaotic and turbulent nature of economic transformation and the unsettled political environment. The emerging contours of geopolitical relations of Corporate Russia with the new states around the Caspian are molded by the latter's relative strength towards Moscow, and by the alliance of interest and evolving patronage connections between the corporate entities and Moscow ministries, government commissions, and other bodies. As noted, the privatization *blitz* in Russia itself increased the cast of characters with divergent economic and political interests. Such divergence manifests itself in Russia's relations with the petroleum-rich and strategically important states of the Caucasus and Central Asia.

The diverging developments can be discerned, in my view, as follows. Uzbekistan and its Karimov-led *ex-nomenclatura* elite have mostly freed themselves from Moscow's pressure. They have acquired considerable elbow room to pursue a basically independent economic and political strategy both internally and with respect to the world at large. Success in agricultural and mineral development (thanks to natural endowment, astute policy, up to a point, and favorable price development for several years on the world market) has almost eliminated Uzbek dependence on imported food and oil. For the first time in recent history, the area sown to grain actually overtook that sown to cotton,¹¹⁷ although the poor 1996 grain harvest prevented the country from reducing its dependence on imported food to the extent it had planned. In contrast to Uzbekistan, Azerbaijan, Kazakhstan, and Turkmenistan enjoy far less maneuvering room and suffer from a weaker bargaining position *vis-à-vis* Russia, though with some differences among them.

Azerbaijan and Kazakhstan

Azerbaijan is more buffeted than any of the other resource-rich Muslim states. That country is on the front line of the conflict concerning the transport routes for Caspian oil. So far the maneuvering and negotiations involved only the "early oil," i. e., oil which recently began to flow to export markets and thus help finance

facilities for extraction and transport of much larger quantities after 2000. Agreement on pipelines to pump that "big oil" to markets later will be far more difficult. Azerbaijan is appreciably closer to open seas than Kazakhstan and Turkmenistan and its sweet oil requires no expensive investment for desulfurization, which the generally very sour crudes from east of the Caspian do. In 1992, Azerbaijan barely produced enough for its own needs and refinery capacity well exceeds Azeri output. Traditionally, the Baku refinery (one of the two in the country) piped in West Siberian oil through Chechnya, also receiving oil via tankers from Turkmenistan and Kazakhstan, and had swap deals with Iran.¹¹⁸

By contrast, Kazakhstan cannot bypass Russia geographically at all for its "early oil," which in fact is already flowing for export through existing Russian pipelines. What constrained shipments so far was plant capacity to remove most of the 18 per cent H₂S and mercaptan contaminants, demanded by the pipeline monopoly, Transneft', before permitting shipment. By the end of 1996, two plants for desulfurizing 11 million tons were to have reached full capacity and Kazakhstan could ship almost that much to loading terminals.¹¹⁹ Yet far from raising the volumes, Russia actually reduced the quota of Kazakh oil it allows for export through Russian pipelines. Less than one-third of the potential that existing desulfurization plants are capable of processing is actually exported, with another million perhaps, moving by tankers to Baku and Iran. The Russian pipelines monopoly and/or refineries have even refused to take the oil for their own use, as it was specified in the intergovernment agreement for 1993-1994 between the two states. Instead, Kazakh shipment of crude oil, already down from 18.8 million tons in 1990 fell to 5-6 million per year during 1994-1995 and to between 4 and 5 million tons through Transneft's facilities in 1996.¹²⁰

One Western scholar claims that the Russian governmental commission which controls scarce access to pipeline and loading terminals actually gives Kazakhstan preferential treatment as compared to Russia's own West Siberian producers. What constrains Kazakh exports in his opinion is not "Russian obstructionism" but the 220,000 barrels-per-day capacity of the Atyrau-Samara pipeline.¹²¹ Yet, in addition to the Samara pipeline, another one from north-west Kazakhstan leads to Orsk in the Urals, and in the Soviet era, Russia refined most of Kazakhstan's appreciably larger output. While Russian pipelines are indeed in deplorable physical shape, their overall carrying capacity can hardly constrain ship-

ments from Kazakhstan, given the fact that oil extraction in the Federation has dropped by almost one half since 1988. As noted, Kazakh exports through the network of Transneft', the Russian pipeline monopoly, in 1996 was less than half of the capacity of the Atyrau-Samara pipeline, and also less than half of the desulfurization capacity already on line for the supergiant Tengiz deposit. Whether it is Moscow itself or the pipeline monopoly which has been responsible for thwarting the flow of more crude oil from north-west Kazakhstan, the reality of that obstruction was vehemently stressed by Kazakh participants at an international conference in the fall of 1995.¹²²

To export modest quantities circumventing the Russian transport hold, Kazakhstan signed a swap deal with Iran and ships small quantities through rail across Azerbaijan and Georgia. These routes that avoid Russia may have provided up to 3 million tons of export volumes for Almaty during 1997.¹²³ Kazakhstan's "early oil" concern is, therefore, entirely a *political issue* between Almaty and Moscow. As of early 1997, there were no physical or economic obstacles for the shipment of 10-11 million tons beyond the former USSR through Russia alone. As with oil, Kazakhstan also cannot break Russia's transport hold for its giant Karachaganak gas and condensate field. Just as Tengiz oil, that gas also cannot be piped to Russian or Ukrainian consumers before desulfurization, which is presently done in Russia's Orenburg processing plant not far from the Kazakh border.

For both Azerbaijan and Kazakhstan, the exploitation and marketing of oil is also entangled in Moscow's own internal power struggle. Russia's Foreign Ministry can expect no institutional or financial gain from the development of Caspian reserves. The Energy and Economic Ministries, on the other hand, can anticipate such gains, certainly indirectly through the participation of Russian oil corporations and through the Transneft' pipeline monopoly, provided substantial portion of the new oil is shipped *via* Russian territory. Even factories of the military-industrial complex may perhaps benefit, since today they manufacture 30 per cent of all equipment for Russia's own oil and gas sector.¹²⁴ Not all Russian oil companies, however, have the inside track politically to gain the right of such participation. Giant Lukoil seems to be Russia's designated representative in the Azeri Caspian consortium, a privilege resented by less well connected firms.¹²⁵ By January 1997, Lukoil managed to acquire big stakes in the largest Caspian projects through determined, aggressive policy and substantial political

backing from the Russian government. The company is also fighting its exclusion from Azerbaijan's Inam deposit in which it was originally pressing for a full half of the stakes.¹²⁶

An unpublished World Bank Report noted in April 1994 that at that time Kazakh President Nursultan Nazarbayev ruled out equity stakes for Russia in his country's oil and gas development. Russian pressure and stranglehold on transport routes apparently has forced a shift in Nazarbayev's position rather quickly. By 18 August 1995, Lukoil's president was conveying a message of "gratitude" from Russian Prime Minister Viktor Chernomyrdin himself for Kazakhstan's confidence in Lukoil, which was now entrusted with taking part in a number of large scale projects for developing Kazakhstan's fuel sector (i. e., exploring the Caspian shelf, developing the Kenbai oil fields, modernizing the refinery at Atyrau, acquiring part of the Chimkent refinery etc.). However, even Lukoil may not have sufficient interest to see a competitor like Chevron engage in massive oil exports from Kazakhstan until it gains a higher share of equity in the supergiant Tengiz field (Lukoil had originally demanded a 20 percent equity in that project).

While Russia's Fuel and Energy Ministry and the country's oil and gas corporations would benefit from the development of Caspian reserves, the Ministry of Foreign Affairs has nothing to gain from such international participation. It has resolutely opposed the division and development of offshore resources by riparian states.¹²⁷ So has, evidently, the Europa Institute of the Russian Academy of Sciences. Its director contrasted the short time horizon of those forces in the country that play for immediate gains with the principled position of the Foreign Ministry which has Russia's long term interests in mind. In 1995 he criticized Lukoil and the Fuel-Energy Ministry for scrambling to join the international consortium with the right of mere junior partners. In his view, only a strategic vision and tough line, such as "happily" taken by the Foreign Ministry, can guarantee that Russia will remain a key player in Transcaucasia and, indeed, the Middle East, in the future.¹²⁸ Most interesting, however, was the position of the Ministry for Cooperation with CIS Countries (Minsotrudnichestvo. The Ministry was abolished by Yeltsin in April 1998). Perhaps realizing that the sectoral division of the Caspian is inevitable in the long run, that ministry proposed that the Russian government turn that inevitability to advantage by obtaining "priority rights", something like "most favored nation status" in comparison to third parties. Such priority rights could take the form of tax and roy-

alty exemption, preferences in forming joint ventures, selecting export routes and the like.¹²⁹

More recent developments have highlighted the intricacy of continued maneuvering made possible by the region's geopolitical complexity. In late 1996, Russia's Foreign Ministry advanced a new proposal, touted as a "compromise solution". It offered granting each of the five littoral states an exclusive economic zone reaching 40 miles offshore, rather than insisting on a 12-mile limit.¹³⁰ The proposed offshore line, however, would cut through the heart of major oil deposits, and even across individual projects further offshore now claimed by Baku. Under the new Russian proposal, all littoral states would claim ownership over them. Moscow's motion was meant to divide the littoral states, which do not hold fully congruent positions on the right of offshore resources even today. Any acceptance of that proposal would likely to delay offshore exploitation, demanding arbitration as the projects are split up. Most likely, however, that late 1996 suggestion from Moscow was indeed mere maneuvering rather than a serious suggestion.

Whether the latest such proposal, made in the spring of 1998 is really different remains to be seen. In the middle of April 1998, Deputy Foreign Minister, Boris Pastukhov, presented a new document to the Turkmen president, already approved in principle by the presidents and foreign ministers of Russia and Kazakhstan. This newest proposal envisions the division of the Caspian seabed into national sectors along the median lines, but leaves the water surface and depth under common jurisdiction.¹³¹ How would such division deal with subsea drilling and pumping installations, under water gathering lines and pipelines etc. remains unclear. Moscow has been voicing strong objection to any undersea trans-Caspian pipeline from Kazakhstan. It is certain to use any issues of common jurisdiction to press its interest against those of Western oil companies.

Iran has also reentered the fray in November 1997. At the start of production from Azerbaijan's Chirag's offshore deposit, it sent a forceful letter to the UN Secretary General, Kofi Annan, protesting Baku's "claim of sovereignty and unilateral exploitation of resources" under the Sea. According to Paul Goble, the letter represented a signal as much to Russia and to the West and other states in the region. "By raising the visibility of sea-versus-lake argument, Iran is implying that it can and will take measures to prevent any oil from flowing unless it has a seat at the table" where decisions about pipeline routes and settlements of interna-

tional conflicts in the South Caucasus are to be made. Perhaps most interestingly, Teheran's "lodging [that] protest at the United Nations...[was] forcing the Russian government to take a [clear] position, something the latter in recent months has sought to avoid."¹³² Moscow has sought to avoid such a clear stance now for more than a year because, as noted above, the Russian government today does not speak with one voice. A few months later, perhaps to add pressure on Moscow, Iran has expressed approval of the agreement between Baku and Ashgabad to draw a border between their disputed offshore claims.

The furious jockeying about pipeline routes for the "early oil" has continued since mid-1995. Russia's Foreign Ministry continues to reject a compromise, of a two-pipeline scenario, first through the Russian port of Novorossiisk, followed very soon by the second route via Georgia. Both cases involve the resuscitation and extension of old pipelines at a relatively small investment of \$250-300 million for the two combined and thus can be put on line in fairly short order. The tender for the Georgia section was to be held in January 1997 (seven companies and consortia have applied by mid-December 1996),¹³³ while the northward line through Djohar-gala (Groznyi) to Novorossiisk began to be filled on 12 November 1996. The temporary agreement on transit fees, however, expired on the last day of 1997 and, as the year closed, the two sides remained poles apart on such fees for the future. The issue is sensitive both politically and economically. Moscow insists that only domestic pipeline fees (43 cents per ton-km) can apply, while Djohar-Gala wants to be treated as an independent partner, demanding a fee as high as \$2.2 per ton-km.¹³⁴ Officials hope that the pipeline will serve as a major instrument of stabilization for Chechnya, although one may doubt whether anyone can guarantee the safety of that export outlet in the future.¹³⁵ Any future pipeline from Baku to Novorossiisk, even if it bypasses Chechnya, must still transit Dagestan, which may be the most unstable subject of the Russian Federation today.

At any rate, the "two pipeline compromise" (through Russia and Georgia) for "early oil" will simply postpone further struggle for the much larger stakes involved in building the lines for "big oil". The old, refurbished lines for the former will likely handle only some 5 million tons each, though in theory the one through Djohar-gala (Groznyi) could carry at least twice as much. "Big oil" would need transport capacities of at least 50 million tons by the middle of the next decade, and up to 70-75 million or even

more by year 2010. The safety experienced along these corridors in the interim will play a critical role in choosing routes for these far larger volumes, and safety along each of these may be fragile. So far the Russian government's actions in the Caucasus and the evident absence of a coherent policy does not bode well for the future. The well planned ambush to assassinate Georgian president, Eduard Shevardnadze in February 1998 (the second within three years) "came in the wake of the ouster of moderate [on the Karabakh issue] President Levon Ter-Petrosian in Armenia, and the discovery of a bomb in the Palace of Youth in Baku..., just before President Heydar Aliyev was to address a festive crowd." After several coup attempts in Azerbaijan in the past few years, these nearly simultaneous events, linked to forces in Russia, seem to indicate that the struggle over the strategic oil pipeline routes have intensified. Shevardnadze specifically linked the February 1998 attempt on his life to Georgia's determination to become an important transit corridor for Caspian oil and other commodities between Central Asia and Europe. The *Washington Post* reports that acting Armenian president Robert Kocharian proclaimed that "not a single barrel of Azeri oil will reach the world markets."¹³⁶

The struggle for the higher stakes has, in fact, been on since the mid-1990s. When in 1995 the Western media quoted Terry Adams, President of AIOC (the Azerbaijan International Operating Company) to the effect that he expected the main export route to come on stream around 2002, an executive of a Western oil company participating in the consortium immediately disclaimed knowledge of any preference for the Ceyan option.¹³⁷ The issue of oil transport through Georgia also came up during Chernomyrdin's meeting with Shevernadze in Tbilisi, with nothing resolved. The Russian Prime Minister, however, allegedly noted that he believes Georgia itself has oil and that that country would be wiser to explore those than to develop projects designed to transport oil for foreign states.¹³⁸ A senior official in Russia's Foreign Ministry stated in late 1995 that, at most, the Georgian route may be admissible "only as an auxiliary to the Russian route," even for "early oil", and, as of late 1996, Russia kept insisting that the Georgia pipeline route is not price competitive.¹³⁹ At one point, the Russian pipeline monopoly, Transneft' also entered the fray, with reportedly ambiguous statements about its willingness to transport Azeri oil, or at least delaying agreement until the situation in Chechnya was clarified further.¹⁴⁰ President Aliyev of Azerbaijan has shown no signs of backing down under Moscow's pressure, continues to

champion the route to Cheyhan through Turkey, and has referred to US assurances of support for his country's determination of developing its resources. He has harshly criticized certain "foreign forces" which are "seeking to jeopardize Azerbaijan's international contracts."¹⁴¹ However, the several coup attempts during Aliyev's tenure (the Azeri president himself came to power after one deposing his predecessor) foreshadows continued uncertainties for the future.

The strife over Nagorno-Karabakh has been the most critical stumbling block to security in the South Caucasus and pipeline routes through the region. In addition to the nearly insurmountable difficulties among the local players, a resolution of the conflict is impeded by the clash of interests among international powers (US, Russia, Iran, Turkey), and vigorous lobbies *within* these countries themselves. A number of specialists have noted that Karabakh authorities will never agree to any subordinate status to Baku, even if Yerevan were ready to compromise on that issue (one could add that neither would the Karabakh army, which has become the most powerful military force in the South Caucasus). Within Armenia sharp differences of opinion in the upper echelons of the leadership over the Karabakh issue forced the resignation of President Levon Ter-Petrosian, several ministers and other government in early February 1998. President Ter-Petrosian has argued that demand for Nagorno-Karabakh's outright independence from Azerbaijan is unrealistic and would lead to international isolation and economic stagnation for Armenia. The power ministries and as of January 1998, Prime Minister Robert Kocharian himself (who hails from Karabakh) were opposing the Republic subordination to Baku and proposing a confederation in which Azerbaijan and Nagorno-Karabakh would have equal status. Many in Armenia's political elite share the belief that if the Karabakh Republic ceases to exist as an independent military force, Armenia's own military and political influence in the Caucasus would diminish drastically. Playing for time is, therefore, in their interest. Yet the escalation of the leadership conflict may foreclose that option.¹⁴²

Playing for time is in Moscow's interest as well. At present, Russia cannot fully support Armenia as a strategic partner in the Caucasus, in the manner the US acts for Israel in the Middle East. Moscow must try to forestall a situation in which Armenia feels so cornered that it sees no choice but to turn to the West for mediation. Teheran, which was frozen out (unwisely in my view) from the mediating group of the OSCE (Organization and Security Co-

operation in Europe), wants to mediate between Yerevan and Baku. It is urged to do so by Karabakh's recently elected president and the foreign minister of Armenia. Iran has gained the trust of most of the Armenian political elite and has also become Yerevan's most important trading partner after Russia. As the railway connection to Russia through Georgia and Abkhazia has become more vulnerable, Yerevan has become increasingly reliant on its economic outlets to Iran.¹⁴³ Mediation efforts from Teheran would also be critical to overcome procedural obstacles blocking progress on Karabakh status. Baku refuses to engage in direct talks with the leadership from Karabakh (which it regards as Azeri territory); any agreement on phased withdrawal would require a first step, which the "aggressor" should have to make, thereby admitting transgression. In addition, the existence of almost one million refugees in Azerbaijan, which the country will not be able to absorb and integrate into society even with much larger oil revenues, severely constrains the Azeri leadership's options. In fact, the prospect of radicalization of that so far placid mass of refugees may eventually threaten the internal stability of Azerbaijan. Yet, instead of welcoming mediation from Iran to settle the Karabakh conflict, Western attempts towards that goal have explicitly aimed at freezing Teheran out.¹⁴⁴

Expectations of riches from Caspian oil have begun to sow discord among the riparian states of the Caucasus and Central Asia as well. An abrupt challenge by Ashgabad to oil reserves claimed by Baku, Haydar Aliyev's brusque remark to an *Izvestiia* journalist in May 1997, and the subsequent diplomatique *demarché* by Turkmenistan highlights the potential for future embroglios, despite the subsequent smoothing of the issue by the two presidents of the respective countries.¹⁴⁵ *Izvestiia* regards such a sharp confrontation in the early stages of deep water exploration and before 'early oil' even began to flow from the shelf, as merely the 'first swallow' over that "former sea of friendship." Kazakhstan and the international consortium created three years ago have recently completed geological and geophysical exploration of the huge Kazakh part of the shelf and began delimiting blocks for detailed exploration. In the words of *Izvestiia*, plans by Kazakhstan for extensive tanker traffic across the Caspian or an underwater pipeline sooner or later will bring about an "adequate response" by other riparian states *and* from Russia.¹⁴⁶

The offshore Azeri projects are also entangled in wider, three-cornered geopolitical relations among Russia, Iran, and the United

States. In geographic extent, Iran is the preeminent Middle-East state on the old Soviet border. Its area well surpasses that of all the post-Soviet states of the Caucasus and Central Asia combined, Kazakhstan excluded. It not only controls a large section of the Caspian Sea but also the entire Azeri border, aside from a one mile stretch where Turkey touches Azerbaijan's isolated province, Nakhichevan (separated by Armenia from the rest of the country). Iran offers the easiest routeway for a pipeline, not only to the Persian/Arabian Gulf but also to a Mediterranean port through Turkey.¹⁴⁷ In addition, Iran's entire north-west (with Tabriz the regional capital) is situated much closer to Baku and to Azeri offshore developments and refineries than Iran's own oil deposits. Iran would obviously benefit from participating in the Azeri offshore projects, even without having a portion of the export pipeline and transit fees derived from it.

The US government had attempted to shut Iran out of any role in Azeri and Kazakh oil. Its implacable opposition to routing Caspian oil through Iran perhaps can be explained; its determination to prevent any Iranian participation in the "contract of the century" cannot. More than 70 per cent share of that contract for the Gyuneshli, Azeri, and Chirag deposits are held by seven Western companies plus a Turkish one, with American firms alone accounting for 45 percent. Yet, when Baku decided to sell half of its stake, i.e., 5 percent of the total, to Iran, Washington pressured Baku to cancel that sale (threatening to bar US companies and technology). Such a rigid stance may be self-defeating. It has encouraged greater collaboration between Iran and Russia in nuclear development and weapon sales. Iran has also retaliated against Azerbaijan by blockading Azeri trade, fuel and power to Nakhichevan, and with political pressure on Baku's unstable government already reeling from several (perhaps Russian sponsored) coup attempts. None of this will facilitate the offshore oil project. Indeed, the Azeri government had to yield to Iran and offer participation in the development of the smaller but very promising Shaw-Deniz field, next in line.¹⁴⁸

The US position, however, has begun to change since the August 1997 elections, although subsequent US reports on the issue have been highly equivocal. As late as the 11th of November 1997, Stephen Sestanovich, Special Advisor to the US State Department reported that he had "told top officials in the region that it would be a mistake to build pipelines through Iran and asked them to consider alternative routes."¹⁴⁹ Yet some change in the US position,

even a partial détente, with Teheran is probable now sometime in the future, especially after President Mohammad Khatami's historic interview on US television in early January 1998.¹⁵⁰ The US government continues to equivocate about plans for a big 28 billion cubic meter capacity gas pipeline from Turkmenistan to Turkey through Iran. Since Iran *theoretically* would only get transit fees and the gas would originate from Turkmenistan, American sanctions need not apply. Conveniently for an improved US stance towards Iran, it could not be known whether Iran, too, would put gas through that pipeline.¹⁵¹

Kazakhstan is more removed from the immediacy of that struggle than Azerbaijan; yet it, too, was soon facing difficult choices. As noted, in less than two years after President Nazarbayev ruled out equity shares for Russian oil companies, steady pressure and control of exports by the latter forced a shift in the Kazakh position with respect. The original Caspian Pipeline Consortium (CPLC, formed to join existing pipelines to Russia's Novorossiisk terminal) floundered in financial and political troubles and had to be expanded to include eight new members, along with the governments of Kazakhstan, Oman, and Russia, the original participants.¹⁵² The new arrangement has got the project off the ground. However, Russia's oil pipeline monopoly, Transneft' also insists to have part of the project and wants Moscow to back its demands for equity share.¹⁵³ Gazprom, too, was to take part in the development of Karachaganak, the huge gas condensate deposit near the Russian border, from which some gas today flows to the Orenburg treatment plant. It has now pulled out, and it remains unclear how long Kazakhstan must wait before it can develop this resource and market it in Europe through the Russian pipeline system.

Returning to Kazakh oil exports, Almaty could also theoretically ship most of the volume intended for Western markets through the Baku—Georgia—Ceyhan corridor, *provided* the latter materializes by the next century. However, such quantities, if delivered by tankers, would pose very serious environmental risks to the Caspian (badly polluted at Baku already). An underwater pipeline, on the other hand, would be even more expensive than the one to Novorossiisk through Russia. It has been under consideration by Chevron and Kazakhstan for some times now, but it cannot be expected to materialize until well into the next century even if a firm decision is taken immediately. Nor is it likely that Russia will countenance the loss of yet more transit fees, even if it

yields on the Georgian option. Paul Goble writes that "since the Soviet Union collapsed, Moscow has pursued a policy of frozen instability in the Caucasus and Central Asia, a policy of keeping instability at a level that frightens off Western investors and governments while allowing Russia to reclaim its position of influence in the area." In addition, "the competition for sales among these producing states, given the relatively flat demand for petroleum today," and the sheer impossibility of guaranteeing the safety of pipelines from terrorist attacks in this turbulent region add further obstacles to a speedy solution.¹⁵⁴ According to *Izvestiia*, the May 1997 diplomatic 'scandal' (the newspaper's term) is an early herald of what is likely to come, including an "adequate response" from Russia, if such large projects ever begin.¹⁵⁵

Goble envisages a regional petroleum exporting authority as a possible way out of the dilemma of conflicting interests and lack of safety. This would have to involve a maximum number of economically feasible pipelines, deliberately crossing the maximum number of countries, and the division of transit fees irrespective of the actual flow of oil. Obviously, this would also demand long-term commitment of purchase by the governments of Western Europe and Japan. Clearly, all this represents a long shot, and something which could come to fruition only well into the next century at best. Yet, to have any chance, the concept would have to be initiated then pursued vigorously and consistently by the Western powers. For the cast of characters *within* the region (not only governments but various factions and institutions) immediate and short-term interests and even survival dominate too much to allow such long-term strategic vision to come to the fore.

Turkmenistan

The Turkmen case is paradoxical. On the one hand, finding alternative outlets for its huge reserves of gas is even more critical for Turkmenistan than for the other states. On the other hand, geography should allow Turkmenistan a degree of flexibility denied to the other oil and gas-rich new states of the region. Yet this degree of flexibility holds only for modest quantities of hydrocarbon exports. With larger volumes, geographic location turns into a trap, forcing Turkmenistan to play a very subordinate role between Russia and Iran.

The geographic distance from Western markets through the existing Russian and Ukrainian pipeline system imposes a greater

transport burden on Turkmenistan than on any of the others. In addition, the pipelines from Turkmen fields to the Lower Volga were built some 25 years ago. They are among the most worn out and least efficient in the former USSR and among those most prone to ruptures. Up to the end of 1994, Ashgabad received an 11 per cent quota of Russian gas exports, but Russia then annulled this quota. The recent liquidation of the Turkmen-Russian joint company, "Turkmenrosgas", in which Gazprom had a 45 per cent stake at first blush seemed like a victory for Ashgabad and was cheered by some in Ukraine. But, in the words of *Izvestiia*, "who has the pipeline calls the tune." If Turkmenistan will again receive a quota of Russian gas export to West Europe, it will not be the 11 per cent for which Turkmen President Sapurmarat Niyazov was pushing during his meeting with Yeltsin in early August 1997.¹⁵⁶

For three years after 1993, the country could not even export its full quota to the CIS, because Russia made the latter conditional on "coordinating with Russian shipments to Ukraine." This meant that Turkmenistan, as the main supplier to Ukraine's heavily industrialized eastern provinces, had to take the brunt of the delays and delinquencies in payments by Ukrainian enterprises. In early 1997, Russia entirely closed its pipeline system to Turkmen gas transiting to CIS states. On the 30th of January, 1998, Presidents Leonid Kuchma and Niyazov signed a new agreement for the delivery of 20 billion cu. meters of gas to Ukraine, but without Russian cooperation Ashgabad cannot ship that gas.¹⁵⁷

Hard negotiations between former Prime Minister Viktor Chernomyrdin and Turkmen President Niyazov in mid-January 1998, during the former's visit were revealing. Gazprom's management reportedly insisted on prohibitive conditions, offering to *purchase* gas from Turkmenistan but for only 35-40 per cent of the price it would then receive from Ukraine above the amount which is compensation for transit. The gas monopoly's hard-nosed stance towards Turkmenistan is related to its recent agreement with Ukraine, which benefits Gazprom. In December 1997, Ukraine consented to lower transport fees from \$1.75 per 1,000 cubic meters for each 100 kilometers to \$1.01-\$1.19, in exchange for an equivalent cut in the price of gas received for the transport service from \$80 per 1,000 cubic meters to \$50. For many months the Turkmen government refused to accept such a low price, but apparently gave in to Russian demand. If Ashgabad's claim is right, Gazprom's will be able to deliver Turkmen gas to Ukraine at an actual cost of only \$58.¹⁵⁸

Turkmenistan has the third or fourth largest proven gas reserves in the world, but these transport difficulties have forced it to shut its wells and extract no more than 16 billion cu. meters from January through November 1997, less than a fifth of its production capacity. Gazprom's stance toward a substantial competitor on the European gas market no doubt hardened also because demand has limited Russia's own output. Nor are Russian restrictions and increased transit fees the only problem. In 1993, Uzbekistan and Kazakhstan both demanded transit fees per 100 kilometers which were almost double that charged by Russia on the same volume and distance. When Turkmenistan refused, the Uzbek government cut the flow to 60 percent of the original.¹⁵⁹

Turkmenistan's proximity to Iran may soon permit some flexibility for gas exports and oil swaps. The Turkmen gas fields are much closer to Teheran (a city of almost 12 million) than Iran's own fuel sources. In addition, Iran's own Azeri region in the country's north-west lies closer to the Turkmen border than to Iran's deposits near the Persian Gulf. Despite huge reserves, Iran today uses, in heat equivalent, only half as much natural gas as refinery products, due largely to the high distribution cost of gas.¹⁶⁰ A short pipeline network, therefore, can bring Turkmen gas to Iran's capital and north-west. Such lines may also permit swap deals whereby Iran would export an equivalent value of oil to pay for the gas import. Indeed, a 140 kilometer gas pipeline, financed by Teheran, was opened at the end of 1997. It transports only 4 billion cu. meters into the Iranian network today, but has a designed 8 billion cu. meters for 25 years.¹⁶¹

Trilateral deals are also possible and relevant discussions have started with Ukraine and Iran. The former country has run up huge arrears with Turkmenistan and seems unable to barter sufficiently attractive consumer goods in exchange. Ukraine's heavy industrial products have no markets in Turkmenistan. Iran, however, with its almost 70 million people and much larger industrial base could more readily and profitably take ferrous metals, heavy machinery, and weapons from Ukraine and pay Turkmenistan with consumer products in exchange.¹⁶² Turkmen gas is also closer to Turkey, and to the Balkan states, than Iran's southern fields. Another export route may thus emerge here, once political and strategic obstacles are unblocked.

Location, therefore, permits some flexibility to Turkmenistan denied to other Caspian states of the former Soviet Union, but only as long as relatively small export volumes are involved.

Larger volumes demand much larger investment and a longer time horizon. They involve geopolitical stakes on a level which will inevitably relegate Turkmenistan to the role of a very junior partner among international players. Ashgabat has escaped internal and international turbulence so far for two reasons. First, because its location beyond the Caspian Sea *and* the Kara Kum (which is among the largest deserts in Eurasia) cuts it off from the ethnic caldrons of the Caucasus, of the Fergana Basin or Tajikistan. Second, because it presented minimal competition to Russia and Iran, or even to the other oil-rich post-Soviet states, which are much more significant oil producers. The protection of the Kara Kum remains, but the benign stand of Iran and Russia is predicated on Ashgabat's subordinate role.

At the close of the 20th century, Iran has much more to gain economically and politically by cooperating with Russia than from acting as a patron to post-Soviet states in the Caucasus and Central Asia. Conversely, for Russia, Iran is the most logical Asian state on the old Soviet border with which to cooperate. Iran's GNP roughly equals that of Turkey and is twice as large as that of Pakistan. Its geographic area surpasses that of all post-Soviet states of the Caucasus and Central Asia combined, Kazakhstan excluded, which necessitates an extensive transport infrastructure. In addition, Iran's oil and gas industries need huge investment in overdue gas injection to repressurize aging oil fields, in developing offshore oil deposits and its barely touched gas reserves. The country, therefore, is the largest market in the Middle East for civilian capital goods, and it is also determined to expand its military capabilities.

Russian companies producing a range of energy-and transport related equipment and machinery find a large market here, as do plants of the military-industrial complex. The virtual US embargo against Iran, even in offshore oil field development, guarantees Russia much elbow room.¹⁶³ And Russian enterprises can more profitably accept barter arrangements in return for consumer goods than can West European firms. Indeed, Russian crews and pipe-laying equipment already work in Iran. The nuclear deal worth \$1 billion to Russia (with some \$800 million on order so far) has solid support across the whole political spectrum. Few among the Russian elite or the public fear Iran, and US pressure to thwart the deal was uniformly resented.¹⁶⁴

Extending the already substantial economic cooperation in the field of nuclear energy and weapon sales, Iran and Russia have

now concurred in principle to create joint ventures in the oil industry for exploration, extraction, and refining. Russian and Iranian media also reported that Deputy Prime Minister Oleg Davidov (also Minister for Foreign Economic Relations) and Iran's Minister of the Oil Industry, have concluded a 10-year agreement on economic cooperation to be signed on the presidential level.¹⁶⁵ Such cooperation is also underpinned by political considerations. Iran, whose Persian population comprises barely more than half of the country's total, has nothing to gain from fawning the fires of ethnic separatism and instability on its northern flank.¹⁶⁶ Conversely, domestic politics in Russia would dictate the exploitation of opportunities from such a cooperation, even with smaller potential economic gains.

Russia, however, also has a stake in stable Turkmen-Iranian relations, since it affects border stability and the tribal balance inside Turkmenistan. Tribal identity among the Turkmen remains one of the strongest in all of Central Asia. The two-three million Turkmen in Iran and an additional million in Afghanistan, belong to tribes with few kinsmen and less political influence in Turkmenistan, where President Niyazov's own Akhal Tekke tribe dominates the government. With the horrendous civil war in Tajikistan before them, harmonious relations between Turkmenistan and Iran is also in Russia's own interest.

As noted, therefore, Turkmen collaboration with Iran will not be at the expense of Russia, even if Moscow's hard nosed stance pushes Ashgabad in that direction. The two stronger powers will not risk weakening mutually advantageous ties for Turkmenistan's sake. On the other hand, a new outlet through Afghanistan to Pakistan would indeed open new export horizons for Ashgabad and break the country's dependence on the Russian pipeline network. Such an outlet seems to have tacit support from Washington (notwithstanding the Taliban's blighted human right record). The Taliban authorities understandably want the transit revenues from a project designed to deliver 15 billion cu.meters per year. A consortium of American, Saudi, and Far Eastern companies, led by UNOCAL, reportedly expects to start construction on the 1,300 km pipeline later this year.¹⁶⁷

Summary and Conclusion

This study has shown that the model of transformation promoted by international financial institutions for countries of the former USSR is largely isomorphic with the export-based model of development. Yet transition from central planning to market is not synonymous with the developmental experience of Third World economies. Nor have the latter, including those most successful, eschewed vigorous state involvement and a degree of protectionism during critical phases of their economic takeoff. Yet both of these are considered harmful to the transformation process by orthodox neoclassical economists.

Primary products comprise the great bulk of Russia's exports, fuels alone accounting for almost half of the total. Energy products and minerals also are the branches which, with the exception of banking, most interest Western investors. In Russia, however, the strategic nature of these industries and the immense wealth they can legally and illegally provide through export earnings have thrust them into the midst of a ferocious political struggle in multiple dimensions. Such struggles are manifest among government agencies, the recently created huge privatized conglomerates, and between the center and the regions. In addition, the oil and gas riches and geographic location of the newly independent states on the Caspian Sea raise this struggle for export wealth onto the plane of international relations.

Restructuring the Russian oil industry from the monolithic, ministerial organization that prevailed in the Soviet era into a few giant vertically integrated companies did not greatly improve efficiency so far. The companies have turned into large conglomerates. The latter forged shareholding alliances with commercial banks, but used their divisions and joint ventures mostly to build up regional monopolies, secure transit routes and extract short term commercial gains. They put precious little resources into expanding oil reserves and exploring new fields. The transfers of equities and divisions among energy companies and commercial banks took place largely through insiders auctions, arranged and lubricated through political connection, and much of it linked to the financing of Boris Yeltsin's reelection campaign.

Nor has restructuring muted the conflicts and lobbying on the level of ministries, government agencies, and their informal "clients" among the corporate entities created in the process of privatization. The struggle on this level recalls the one waged for

resources within Gosplan, except they now take place over export volumes, access to pipelines, excises, tariffs, licenses, development fees, and the like. In addition, the energy and mineral sectors are very much caught up in a fierce bureaucratic conflict over basic economic policy between a "finance" group that essentially follows the policies of Western monetarist advisors and the IMF and a "sectoral" group that wants to stop the slide in industrial production and is nervous about the degradation of Russia's production capacity and rapidly rising unemployment.

I have shown in this study that an ever larger share of Russia's declining oil and gas production and ferrous and non-ferrous metal output are shifted to world hard currency markets. As of now, all these exports were diverted from former Soviet republics, because the latter could not pay the prices which for them have risen almost to world levels. By 1996, however, escalating prices have hit and damaged the domestic Russian economy as well. The attempt to reach world prices, made more difficult by the 20 per cent rise of crude and product prices during 1996, has backfired. The higher cost of domestic energy helped prolong the superdepression in Russian industry and agriculture and severely aggravated the non-payment crisis.

Yet the sharp jump in the world price in 1996 has proved temporary and was followed by a steady slide during the next 15 months. Asia's economic crisis will continue to dampen demand, hence world prices in the near future. Russia's petroleum industry, therefore, did not have sufficient time to translate its higher revenues into a significant modernization of its capital stock. At the same time, the high domestic prices outside the household-municipal sector have met resistance from government officials, including those in the energy industries. The extreme underpricing of energy to the household-municipal sector, however, is acknowledged by everyone to be economically irrational. Yet, while significant price rises to this sector will be inevitable, it will be impossible to eliminate the large subsidies without further impoverishing millions and greatly increasing social strain.

The rise in the world oil price was reversed in 1997, and in early 1998 plummeted to a four year low in the wake of the sharp decline in Asian demand (following the region's financial crisis), warm weather, and anticipation of larger Iraqi sales. Now Russian oil producers will barely make any profit from exports and still less from domestic sales. This will continue to hinder the replacement of the decayed capital stock, the modernization of

the oil industry, and the development of new reserves. Lower oil prices will also put a damper on the unit price of exported gas (tied to a basket of crude oil and oil products), and the only primary export benefiting from an improved term of trade in 1997.¹⁶⁸ Government revenues will be adversely affected as well. Other industries and sectors of the domestic economy will profit from lower energy prices only with a time lag and may, in fact, experience only modest relief, given the monopolization of energy production and transport in Russia.

The shifting of large volumes of metal products from CIS and domestic consumers to hard currency markets, mostly under *tolling* arrangements, have saved these industries from total collapse. At the same time, the large Russian exports contributed to price instability in the world market and to retaliatory anti-dumping measures and import restrictions in Western countries. Meanwhile, increasing extraction and transport costs and the obsolescence of fixed capital, combined with the policy of keeping the ruble fairly strong within an exchange corridor, have begun to erode the competitive position of much of Russia's mineral exports. Within Russia, increased revenues from that export offensive have not so far promoted serious modernization and retooling of the industrial sector, and little of it is evident even in the energy branches. Oil extraction and transport, in particular, continue to suffer from insufficient reserve replacement and the decay of fixed capital. The energy intensity of Russia's industry increased rather than decreased since reforms began, and the drastic decline in investment portends ill for serious structural change over the next decade.

Russia's mineral sector, and especially its oil and gas industries, is also caught up in economic and strategic policy vis-à-vis the successor states. Given their proved reserves and geologically accessible resources, several of the newly independent states around the Caspian Sea could be very important players on the world market not only in oil and gas, but in some other minerals as well. However, their exports would compete with those of Russia. The landlocked position and geographic location of these newly independent states constrain the large scale extraction of their mineral reserves, their massive exports, and the economic bonanza they could provide. These countries are wedged between Russia in the north and Iran, Turkey, and Afghanistan in the south. The opening of export corridors for their oil and gas, therefore, has become a critical component of geopolitical stakes which, in addition to these states and Russia, affects the US, European, and

Asian governments, and the major petroleum companies.

The most populous new state of Uzbekistan has been able to achieve considerable freedom of action from Moscow, because its goal has been energy and food self-sufficiency rather than large-scale oil and gas exports. Azerbaijan, Kazakhstan, and Turkmenistan are already competitors to Russia and have the potential for combined oil exports exceeding that of Russia sometime in the first decade of the next century. Turkmenistan's very large gas reserves are closer geographically to Turkey and the Balkans than those of the Russian Federation. In the coming decade, therefore, the shipment of large volumes of oil and gas from around the Caspian serves Russian interests only if Moscow can acquire large equity stakes in the projects, receive substantial transit revenues, and maintain control over a good portion of pipeline routes. These benefits, however, would not accrue equally to the different participants in Russia (ministries, other government institutions, parastatals, and commercial agents). The voices from Moscow speak with considerable variation, pursuing their own economic and political agendas.

Kazakh oil cannot reach markets in the near and medium term except through Russia. Kazakhstan and Western firms in that country must accommodate themselves to that reality. Azeri oil could avoid Russia more readily, if volumes, distance, and costs were sole considerations. Alternative routes to Mediterranean ports, however, through Georgia, Turkey, or Iran are unpalatable to Russia and the US respectively, while Iran also would gain nothing from a pipeline corridor which would by-pass it. Outside opposition to one or more of these routes thus adds to the insecurity present within the region of the Caucasus itself. None can guarantee the safety of either the Russian pipeline corridor, going through Dagestan and Chechnya, or that through Georgia today. A regional petroleum authority which would distribute transit fees irrespective of the volumes transported would be a bold and imaginative solution in theory. Yet it is very unlikely to come to fruition, at least in this decade. The institutional and informal agents who would need to concur and continue to agree are simply too numerous.

Turkmenistan plays and will continue to play only a minor role in oil production among the Caspian states. It is a major gas producer and its potential is greater still. Yet the new state is destined to remain very subordinate to the larger economic and geopolitical interests of Russia and Iran. Its location provides it

with a flexibility in supplying gas to northern Iran and in cooperating with the latter state through swap deals and even three-way arrangements, but only as long as relatively modest quantities of gas and oil are involved. Presently and for the rest of the century at least, much bigger pipeline projects and other energy deals are very unlikely, for they are not in the interest of either Russia or Iran. The interests of these two countries, however, do coincide in a stable Turkmen state which avoids the turmoil of Tajikistan and the Caucasus. Geographically Afghanistan could provide economical outlets for Turkmen (as well as Kazakh) gas and oil to Pakistan and India. The construction of such a pipeline reportedly could begin soon, if the complex issues of security and politics can be resolved. Similar outlets for massive oil and gas shipments to China's central and eastern provinces (where this country's energy demand is concentrated) cannot materialize until well into the next century, given the spectacular size of such a project and the massive investment requirement. From a geological and engineering perspective, the Caspian basin today is the most promising region for incremental energy supplies outside the Persian Gulf. The geopolitical and strategic complexities of the region, however, match its endowment and may stymie large scale exploitation of its riches for some times to come.

Notes

¹ In addition, the success of the East Asian “tigers” was greatly aided by a very liberal US trade policy towards them, partly explained by the post-World War Two political confrontation with the USSR and China, and by the Korean and Vietnam wars.

² The export base model of economic growth stresses the multiplier effect of exports from a region. Direct and indirect linkages of inputs for the exported goods and the extra income generated by it should result in the spread and increased complexity of production processes until a stage of self-sustaining development is reached. However, in the case of mineral exporters most industrial linkages are forward linkages, generated in downstream, processing stages, locationally removed from the regions of extraction. In addition, in Third World countries a large share of the inputs and the skilled labor must be imported, resulting in substantial import leakages and a weak regional income multiplier. Environmental damage is left behind, while most additional income from the export of the commodity accrues to a narrow oligarchy and spent elsewhere. In East and South-East Asia, where labor intensive and assembly type products provided the export base, the latter were gradually upgraded, increasing local content. In that case, locationally associated backward linkages and the induced multiplier from rising wages have helped to generate more widely spread growth and development.

³ In the case of West Europe’s processed food exports, much of which end up in the former Communist states, the subsidy is a double one, that for production and for export.

⁴ The textile and, to a somewhat lesser extent, the apparel industries in most East European states were indeed bludgeoned by the transition process. However, the loss of the former Soviet market, which is a crucial part of the transition but exogenous to the process within the economies of East Europe, bears the major responsibility for that collapse. In addition, by the 1980s, the comparative advantage of East European labor in these industries have been critically eroded from Third World competition.

⁵ *Ekonomika i zhizn'*, No. 20 (May 1997), p. 26 and No. 7 (February 1998), p. 26.

⁶ Vladimir Raszuwayev, "Managing Russia's Oil," in *The Moscow Times*, (12 March 1995), p. 25.

⁷ "Chas pik," on Russian TV, St. Petersburg, 24 August 1994, quoted in Elena Chinayeva, "A Kremlin Survivor," in *Transition* (Prague), 1 December 1995, pp. 39 and 69.

⁸ After deducting depreciation, the prices used to compute January 1992 asset values for voucher privatization were close to those prevailing in the 1970s and 1980s. See L. Nesterov and E. Bukhvald, "Vouchernaia privatizatsiia: vch'iu polzu shchet?" in *Ekonomka i zhizn'*, No. 6 (February 1996), p. 2. At the start, directors of each oil producing association were to be provided with five percent of all the shares at extremely preferential rates. During the period of voucher privatization, they greatly increased their holdings. The process provided ample opportunities for a variety of manipulative schemes to acquire controlling block of shares from workers. Directors frequently collaborating with banks or investment funds to purchase the additional shares. See Isabel Gorst, "Siberia's Oil Generals Look for Freedom and Finance," *The Petroleum Economist* (London), Vol. 60, No. 2 (February 1993), p. 5; and Michael McFaul, "Agency Problems in the Privatization of Large Enterprises in Russia," in Michael McFaul and Tova Perlmutter (eds.), *Privatization, Conversion, and Enterprise Reform in Russia* (Boulder, Colo.: Westview Press, 1995), pp. 44-48. The situation was similar in other branches of the mineral industries.

⁹ McFaul, "Agency Problems," p. 45.

¹⁰ Subsequently, *Finansovye izvestiia* (Moscow), quoting *Business Week*, gave 60 percent as Trans-World Metal's share in the Saian combine and 50 percent as its share in the Bratsk factory, while *Ekonomicheskaiia gazeta* (formerly *Stroitel'naia gazeta*), No. 3 (January 1997), p. 6 gives a 70 per cent share of foreign ownership for the Saian plant. See also The Jamestown Foundation, *Prism*, electronic mail version, Part II (17 November 1995); and *Finansovye izvestiia*, No.108 (26 November 1996), p.V.

¹¹ *Izvestiia* (Kiev ed.), 6 June 1997, p. 5.

¹² Leslie Dienes, István Dobozi, and Marian Radetzki, *Energy and*

Economic Reform in the Former Soviet Union (London: Macmillan, 1994), chapter 2.

¹³ According to the *Wall Street Journal*, cited in *Russia Today* (19 August 1997), and (11 September 1997).

¹⁴ *Russia Today* (1 November 1996).

¹⁵ Valery Kyukov and Arild Moe, "Controlling the Russian Oil and Gas Complex," Paper presented at the NATO Economic Colloquium, Brussels (30 June—2 July 1993).

¹⁶ Leslie Dienes, *Corporate Russia: Privatization and Prospects in the Oil and Gas Sector. The Donald W. Treadgold Papers*, No. 5. Seattle, Wash.: The Henry Jackson School of International Studies, 1996.

¹⁷ Kryukov and Moe, "Controlling the Oil and Gas Complex," (Endnote 15).

¹⁸ In a later article, Moe and Kryukov discuss the example of Varyeganeftgaz, whose biggest subordinate unit (Varyeganeft'), responsible for about half of the company's oil production, rebelled against such tutelage. It declared itself an independent state enterprise in the summer of 1992, starting a long struggle. For a while, Varyeganeft' received the support of the Ministry of Fuel and Energy, but a year later, the course of the privatization program for the oil industry turned against decentralization. See Arild Moe and Valery Kyukov, "Observations on the Reorganization of the Russia Oil Industry," in *Post-Soviet Geography*, Vol. 35, No. 2 (February 1994), p. 95-96.

¹⁹ P. Sergeev, "Degradatsiia energeticheskogo kompleksa Rossii," in *Voprosy ekonomiki*, No. 12 (December 1994), p. 111.

²⁰ Aleksei Sukhodoev, "Eshche tri 'legal'nye' neftekompanii," in *Kommersant-Daily* (Moscow), 17 August 1995, p. 1.

²¹ *Izvestiia* (1 September 1995), p. 2.

²² *OMRI Daily Digest* (October 1996). Academician Dmitriy L'vov argued in a Russian-Finnish economic seminar in Helsinki that Russia's economy is not really reforming. "Queues for resources

have been transformed into queues for payments," and "planning of product output has been replaced by planning of monetary balances," with monthly reports submitted to the IMF. *OMRI Analytical Reports* (27 September 1996), electronic mail version.

²³ Such as in Latin America and Africa, for example. Beyond this, however, it is entirely misleading to lump former Communist countries with authoritarian regimes in Latin America and elsewhere, since only the former were subject to central planning and had state sectors which dominated their economies.

²⁴ *Ekonomika i zhizn'*, No. 13 (March 1997), p. 26 and No. 7 (February 1998), p. 26.

²⁵ Anatolii Kruglov, "V ch'iu pol'zu vneshniaia trgovlia?" in *Ekonomika i zhizn'*, No. 14 (April 1997), p. 1.

²⁶ *Ekonomika i zhizn'*, No. 47 (November 1997), p. 1 and No. 40 (October 1997), p. 27.

²⁷ In 1996, world oil prices soared by about 30 per cent, to their highest in 6 years. Surging Asian demand, harsh winter weather, and the delay of the partial lifting of the UN embargo allowing Iraq the monitored sale of \$2 billion worth of oil have all played their part.

²⁸ I projected a little over 400 million tons as a possible level by 2005, provided that such large scale investment begin in the early 1990s, which clearly has not happened. See Dienes, Dobozi and Radetzki, *Energy and Economic Reform*, pp. 35-119; and Leslie Dienes, "Prospects for Russian Oil in the 1990s: Reserves and Costs," in *Post-Soviet Geography*, Vol. 34, No. 2 (February 1993), pp. 79-110, and especially Fig. 8, p. 97. In Russia's most important province, West Siberia, oil extraction fell to 192 million tons in 1996 (75.5 million below that in 1992). Although a portion of that huge decline was demand related, Abel Agenbegian clearly stated that only regular yearly investment of \$3-4 billion could pull West Siberian extraction back even to 210 million tons. See *Business Information Service for the Newly Independent States* (BISNIS), 3 November 1997, electronic service; and *Ekonomika i zhizn'*, No. 26, (June 1996), p. 2. Developmental drilling and well commissioning continues to decline. In 1995, they were down by 89 per cent and 86

per cent respectively relative to the year before; in the first 8 months of 1997 the number of wells commissioned again fell 17 per cent below the numbers commissioned the first 8 months of the previous year. *Ekonomika i zhizn'*, No. 6 (February 1996), p. 39; and No. 47 (November 1997), p. 30. The deputy minister for fuel and energy noted in December 1996 that in that year Russia conducted no exploration for new oil fields for the first time since World War II. *Russia Today* (9 January 1997).

²⁹ Ol'ga Afanas'ev, "Ekonomicheskaiia bezopasnost' Rossii zavisit ot uspekha soglashenii o razdele produktsii," in *Delovoi mir*, No. 24 (20-26 December 1996), p. 1.

³⁰ Gas output actually rose slightly in 1996 after a slow continuous decline through the first half of the 1990s, but dropped again by 6.3 per cent in the first seven months of 1997. *Delovoi mir* (2-8 August 1996), p. 5; and *Ekonomika i zhizn'*, No. 36 (September 1997), p. 1.

³¹ *Financial Times* (24 November, 1997), electronic version.

³² Through 1995-1996, practically all enterprise and household savings was funneled into government securities (GKO) to cover the deficit in a sterile circulation (GKO—budget—reinvestment in GKO) and not into productive or infrastructural investment for future growth. See Pavel Teplukhin, "Defitsit biudzheta prekryvaet puti investitsiiam v real'noe proizvodstvo," in *Finansovye izvestiia* (15 August 1996), p. III; and Vadim Mikhnevich, "Epitsentr krizisa raspolozhen v sfere finansov," in *Moskovskie novosti. Biznes*, No. 24 (19 July 1996), p. 3. In mid-1996, outstanding government securities exceeded those issued by corporations by 10-15 times, and unheard of ratio. Elsewhere in the world, the former ranges from 20 per cent to 60 per cent of the latter. *Finansovye izvestiia*, No. 82 (22 August 1996), p. V. Even in the first quarter of 1997, higher returns were possible on the market for state short-term securities (GKOs) than from productive investment. Direct foreign investment (DFI) stagnated during 1995-1996 and foreign capital inflow also shifted dramatically into government securities. And despite the sharp rise of DFI in the first half of 1997, it barely exceeded \$2.1 billion, and two-thirds of foreign capital flow (\$4,354 million) continued to stream into government bonds. See *Ekonomika i zhizn'*, No. 42 (October 1997), p. 1.

³³ Recent reports which have played up the alleged 0.2 per cent rise in Russian GDP in the first nine months of this year are highly dubious, given scholarly evidence by experts concerning the extreme unreliability of Russian statistics. "In some respects, the statistics available today from the State Statistics Committee are less reliable than in the Soviet era. Macroeconomic data are compiled by Goskomstat only for the purposes of reporting to international financial agencies, and are not based on systematic collection of economic data. Anybody who makes confident assertions about whether the Russian economy is rising or falling is indulging in a leap of faith." — Misha V. Belkindas, World Bank, "Transitional Problems of Statistical Systems." See also Olga V. Ivanova, "Monitoring Economic Performance in the FSU: Levels and Trends of Macroeconomic Aggregates," Papers presented at the 1997 National Convention of the American Association for the Advancement of Slavic Studies, Seattle, Washington, 22-23 November 1997.

³⁴ *Russia Today*, Press Review (3 February 1997).

³⁵ Pekka Sutela, "The Strategic Role of Banks in Financing Russian Economic Growth," Paper presented at the 29th National Convention of the American Association for the Advancement of Slavic Studies. Seattle, Washington, 20-23 November 1997.

³⁶ *Ekonomika i zhizn'*, No. 41 (October 1997), p. 1 and No. 24 (June 1997), p. 2; and Lev Makarevich, "Vlast' zakrepliaiet protsess razvala proizvodstva," in *Finansovye izvestiia*, No. 9 (11 February 1997), p. II.

³⁷ *Ekonomika i zhizn'*, No.44 (November 1997), p. 1; No. 40 (October 1997), p. 2 and No. 23 (June 1997), p. 1. During 1997, Moscow's share in such direct investment flows reached an astounding 83 per cent. It also is no coincidence that Moscow and St.Petersburg, with a tenth of the country's population alone account for half of all non-wage income. See *Ekonomika i zhizn'*, No. 18 (May 1997), p. 1.

³⁸ *Ekonomika i zhizn'*, No. 35 (August 1997), p. 30; and Richard Layard, "Economic Prospects in Russia," in *US Relations with Russia*, The Aspen Institute, Twenty First Conference, 18-22 August 1997, Washington DC, p. 17.

³⁹ *Reuters* (5 September 1996) and (12 August 1996).

⁴⁰ The term is that of Professor Eugene Huskey, Stetson University. As some others, he notes that Yeltsin has revived one of the most important mechanisms of Russian and Soviet history, that of creating parallel organizations, one to check the other. Yet the process becomes never-ending, because the new organization becomes an established one and may require further checking. E. Huskey, "The Politics of Russian Exceptionalism," Address at the University of Kansas, Lawrence, Kansas, Summer Research Seminar for Russian Social Scientists, 6 September 1996.

⁴¹ Another close observer of the Russian political scene writes that by now, "virtually all state institutions had grown in size and in strength; all had acquired greater autonomy; all had seized control of significant parts of the economy...stak[ing out] a defined space within which its interests and authority [are] paramount." Alexander J. Motyl, "Toward Fascism? The Soviet Legacy and the Russian State," in Charles Fairbanks (ed.), *Neo-Communism and Democratic Change*, manuscript in progress.

⁴² *Analytica Moscow, Economica Weekly Press Summary* (18-24 November) and (25 November - 1 December 1995), electronic version.

⁴³ *Delovoi mir*, No. 5 (2-8 August 1996), p. 6; and *Nezavisimaia gazeta* (12 November 1996), p. 4; and *Monitor*, The Jamestown Foundation (20 October 1997), electronic version; and *Russia Today* (16 October 1997). I predicted almost two years ago that the IMF and Russia would engage in some consensual self-deception concerning the relationship of wholly unfettered oil exports and related conditions for the disbursement of the stabilization funds. It has been revealed that, in fact, a secret deal was struck between the IMF and the Russian government just before the presidential election, permitting Russia a bigger budget deficit than was agreed on and demanded by the strict conditions for the loan. See Dienes, *Corporate Russia*, p. 59, endnote 58; and *Russia Today* (2 September 1996).

⁴⁴ *OMRI, Daily Digest* (20 January 1997).

⁴⁵ A sharp rise in exports would also leave domestic oil consumers

dependent on more marginal oil producers, making their position still more precarious.

⁴⁶ *Moskovskie novosti. Biznis*, Nos. 10-11 (6 March 1996), p. 8 and (27 March), p. 1; A. A. Konoplianik, "Kredit MBF Rossii i ego posledstviia dlia neftianoi promyshlennosti strany," in *Neftianoe khoziaistvo*, No. 5 (May 1996), pp. 14-15; and *Ekonomika i zhizn'*, No. 22 (July 1996), pp. 42-43. Refinery light products became more expensive in Russia than in the US and a few other countries already by the summer of 1996.

⁴⁷ *Moskovskie novosti. Biznis*, No. 26 (5 July 1996), p. 2; and *Delovoi mir* (2-8 August 1996), p. 6.

⁴⁸ *Ekonomika i zhizn'*, No. 30 (July 1996), p. 3; and *Russia Today* (5 September 1996), p.4.

⁴⁹ *Ekonomika i zhizn'*, No. 15 (April 1998), p. 4; and *Ekonomika i zhizn'* No. 36 (September 1996), p. 2.

⁵⁰ *Ekonomika i zhizn'*, No. 15 (April 1998), p. 27; No. 47 (November 1997), p. 30; No. 2 (January 1997), p. 10 ; No. 6 (February 1996), p. 39; and Viktor Filippov and Stanislav Zhdanov, "Sozдание i vnedrenie tekhnologii nefteizvlecheniia," in *Neft' i kapital*, No. 7 (June 1997), p. 81.

⁵¹ *Ekonomika i zhizn'*, No. 50 (December 1996), p. 10; and *Pipeline News* (14 December 1996), Part II, p. 4.

⁵² *Moskovskie novosti*, No. 11 (6 March 1996), p. 8.

⁵³ *Moskovskie novosti. Biznis*, No. 26 (5 July 1996), p. 4.

⁵⁴ *Ekonomika i zhizn'*, No. 22 (June 1996), p. 43.

⁵⁵ Total imports from the other CIS states rose sharply in the first quarter of 1996 (by 72 percent), but dropped again in 1997, owing to tariffs and taxes imposed by Russia. Ukraine's exports to Russia decreased by 28 per cent in the first eight months of 1997, mainly owing to barriers erected against sugar and alcohol exports, but Ukrainian exports of steel pipes also may have been affected. See *Ekonomika i zhizn'*, No. 20 (May 1996), p. 40 and No. 40 (October

1997), p. 27; and *Prism*, The Jamestown Foundation, Vol. 3, No. 18 (7 November 1997), Part 1, electronic version.

⁵⁶ *The Financial Times* (5 February 1998) and (12 January 1998), electronic version.

⁵⁷ *Finansovye izvestiia*, No. 80 (15 August 1996), p. 1; and Yu. Bobylev, "Energy Resources Exports: Real Trends," Institute for the Economy in Transition, *Russian Economy: Trends and Perspectives* (June 1996), electronic version.

⁵⁸ Ukraine and Belarus account for the overwhelming part of CIS's fuel debt to Moscow. Sometimes in early 1995, the former has begun regular payments for current imports plus the interest on the debt accumulated during 1993-1994 (\$5 billion of Ukraine's \$8 billion international debt is owed to Russia and Turkmenistan). Ukrainian government officials expressed their intention of starting payment on the principal itself in 1997.— *Ekonomika i zhizn'*, No. 37 (September 1996), p.16. Until an alternative pipeline through Belarus is built, nearly all exports to Eastern and Western Europe must flow through Ukraine. Gazprom, therefore, cannot cut off the gas flowing through Ukraine; nor does it have other outlets for its gas among the former republics. Central Asia is also an exporter of gas and supplies Kazakhstan as well, while Transcaucasia can afford to pay even less than Ukraine and is more unsettled politically. As long as Ukraine pays for current imports, which it is doing partly through international loans, Russian leverage on Ukraine for delays on installments of past energy debt is thus quite limited.

⁵⁹ *Ekonomika i zhizn'*, No. 4 (January 1998), p. 1; and *Biznis Segodnia*, No. 33 (1996), p. 7, quoted in *Analytica Moscow, Economica Weekly Press Summary* (31 August-6 September 1996). In these industries, the number of firms in the red rose 4.6, 2.3, and 2.1 times respectively, when compared to the first half of the previous year. 61 per cent of all enterprises in non-ferrous metallurgy and 51 per cent of light those in light industry were in the red during the first half of 1996. Interestingly, the share was significantly lower (27 per cent and 34 per cent respectively) in ferrous metallurgy and 34 per cent.— *Ekonomika i zhizn'*, No. 38 (September 1996), p. 10. The still lower share (19 per cent) of loss-making firms in the electric power industry is less surprising, when one notes that 2/3 of all

electricity in Russia is generated by natural gas, and non-payment notwithstanding, pipeline gas continues to be delivered to consumers.

⁶⁰ *Ekonomika i zhizn'*, No. 36 (September 1997), p. 1.

⁶¹ "Analiz tendentsii razvitiia regionov Rossii v 1992-1995 godakh," in *Voprosy ekonomiki*, No. 6 (June 1996), p. 57.

⁶² *Nezavisimaia gazeta* (3 October 1996), p. 4; and *OMRI Daily Digest* (11 October 1996), p. 4.

⁶³ "We have given the government a lot of marks for moving towards world prices...[and] I would have thought that the argument for lower energy prices was dead and buried a year or so ago," said World Bank chief Moscow economist V. Konovalov. *Russia Today*, Business Report, No. 1 (4 October 1996).

⁶⁴ Gazprom states that Russian customers owed it 49.1 trillion rubles by October 1996, while former republics owed it an additional 10.3 trillion. Igor A. Evsteev, "Porogi neplatezhei gazovoi reki" *Ekonomika i zhizn'*, No. 40 (October 1996), p. 38; and *Monitor*, The Jamestown Foundation (3 October 1996), electronic version. The debt of former republics, however, overwhelmingly represents the principle on converted past debt on which interest is now being paid.

⁶⁵ Matthew J. Sagers, "The Russian Natural Gas Industry in the Mid-1990s," in *Post-Soviet Geography*, Vol. 34, No. 9 (November 1995), p. 527; and Jonathan Stern "Prospects for Russian Gas Demand and Exports," in *Oxford Energy Forum* (November 1995), p. 4.

⁶⁶ *OMRI Daily Digest* (11 October 1996). Another Russian source states that during the first half of 1996 the price of gas in Russia was 96 percent of the international average, presumably meaning the average at borders. *Russia Today* (2 October 1996), Business Report, No. 4.

⁶⁷ Sagers, citing the Russian Ministry of Fuel and Energy, notes that already by September 1995, the average wholesale price was 257,151 rubles per 1,000 cu. meters, i.e., 78.8 per cent of the border

price.— Sagers, *The Russian Natural Gas Industry in the Mid-1990s*," in *Post-Soviet Geography*, Vol. 34, No. 9 (November 1995), p. 527. The weighted average border price of gas in Western Europe was \$2.67/million BTU in 1995, 83.2 per cent of a mix of gas oil and fuel oil of equivalent heating content. The weighted average of end use prices for natural gas (excluding all taxes), however, was 13.3 per cent higher. Peter R. Odell, "The Cost of Longer-Run Gas Supply to Europe," in *Center for Business and Policy Studies, European Natural Gas Economics in a Global context: The Longer Run. Proceedings: SNS Energy Day*, Marian Radetzki (ed.), Vol. 7, No. 2 (1995), p. 96-99. The huge volume consumed in the US at prices far below those in West Europe pulls the international average to a significantly lower level than those prevailing in Western Europe.

⁶⁸ *Ekonomika i zhizn'*, No. 31 (August 1996), p. 2.

⁶⁹ Stern, "Prospects for Russian Gas," p. 2; and Odell, "The Cost of Longer-Run," p. 98.

⁷⁰ *Izvestiia* (Kiev ed.), 21 June 1997, p. 2.

⁷¹ *OMRI Daily Digest* (1 October 1996), p. 4.

⁷² *Delovoi mir* (30 August –5 September 1996), p. 6; and United Nations, *Energy Statistics Yearbook* (New York: U.N. Publications, 1994), p. 51.

⁷³ *Monitor*, The Jamestown Foundation (3 October 1996); and *OMRI Daily Digest* (2 October 1996), p. 4. Notwithstanding its unpaid tax arrears, the energy sector claims it accounts for 66 per cent of all taxes collected by the Russian government. See *Ekonomika i zhizn'*, No. 30 (July 1996), p. 3. The social argument has gained important supporter in the Duma for Gazprom during the 1997 budget debate. The row erupted over Gazprom and intensified IMF pressure to break it up when most officials responsible for the economy were in Washington (meeting with the IMF and the World Bank), and on the eve of Gazprom's launching the \$400 million share offering to foreign investors for a 1 per cent stake in the company. The incident illustrates the deepening fissures and power struggle within the Russian government.

⁷⁴ *Zerkalo nedeli* (Kyiv), No. 27 (5-11 July 1997), pp. 1 and 7; and Peter Rutland, "Battle Rages over Russia's Natural Monopolies," in *Transition* (The World Bank), Vol. 8, No. 3 (June 1997), pp. 13 and 15.

⁷⁵ The document says that the trust manager will not have use right of the shares, and important issues must be decided by agreement with the collegium of state representatives in Gazprom, headed by Boris Nemtsov. The signing of that document has been postponed several times, reportedly because of disagreement between Viakhirev and Nemtsov. Meanwhile, Gazprom continues to manage the government's share.— *Russia Today* (28 November 1997), Moscow press report, quoting *Komsomol'skaia pravda*.

⁷⁶ *The Financial Times* (23 December 1997), electronic version. Nemtsov has been under further attack from the Duma as well and received only lukewarm support from Yeltsin. See *Monitor*, The Jamestown Foundation (5 January 1998), electronic version.

⁷⁷ Anders Åslund, "Adapting to the World Economy: Interests and Obstacles," in Stephen Sestanovich (ed.), *Rethinking Russia's National Interests*. (Washington, D.C: Center for Strategic and International Studies, 1994), pp. 87 and 93.

⁷⁸ *Finansovye izvestiia*, No. 1 (13 January 1998), p. V; and *Ekonomika i zhizn'*, No. 40 (October 1997), p. 27.

⁷⁹ *Finansovye izvestiia*, No. 1 (13 January 1998), p. V. For 1996 and the first half of 1997, see *Ekonomika i zhizn'*, No. 40 (October 1997), p. 27; No. 13 (March 1997), p. 26; and No. 36 (September 1996), p. 4; *Delovoi mir* (15-19 December 1996), p. 7. Precious metals, stones, furs, hides and products from them are included in that group of raw and intermediate materials, with a 4 per cent share in 1996.

⁸⁰ See endnote 57.

⁸¹ *The Financial Times* (23 January 1998), electronic version; and *Interfax-AiF*, No. 9, p. 9, quoted from *Russian Oil and Gas Monitor*, No. 1 (March 1998).

⁸² *Ekonomika i zhizn'*, No. 32 (August 1996), p. 26. The share of ferrous and non-ferrous metals reached 19 percent of total exports

in the first quarter of 1996, but almost 22 percent of shipments beyond the former USSR. See *Ibid.*, No. 20 (May 1996), p. 40.

⁸³ "Vneshneekonomicheskie sviazi Rossii," in *Ekonomist*, No. 5 (May 1996), p. 39.

⁸⁴ *The Financial Times* (20 January 1998), electronic version.

⁸⁵ *The Economist* (20 December 1997), pp. 19-20.

⁸⁶ *Ekspert* (Moscow), No. 8 (2 March 1998), electronic version.

⁸⁷ By 1.5 times and 3.3 times in the first nine months of 1994 alone, and 78.2 per cent and 64 per cent. of the production of these two metals were exported.— *Izvestiia* (18 January 1998), p. 2; *Ekonomika i zhizn'*, No. 51 (December 1994), p. 4; and *The Christian Science Monitor* (11 January 1994), p. 11 and (31 March 1994), p. 9.

⁸⁸ *Finansovye izvestiia*, No. 80 (15 August 1996), pp. I and II.

⁸⁹ S. Sukholinskii-Mestechkin, "Ne izmeniv strategiiu razvitiia, rossiiskii aliuminii riskuet proigrat' konkurentam," in *Finansovye izvestiia*, No. 39 (29 May 1997), p.IV.

⁹⁰ *Finansovye izvestiia*, No. 80 (15 August 1996), p. II.

⁹¹ Matthew J. Sagers, "The Iron and Steel Industry in Russia and the CIS in the Mid-1990s," in *Post-Soviet Geography and Economics*, Vol. 37, No. 4 (April 1996), p. 203.

⁹² *Nezavisimaia gazeta* (31 October 1996), p. 4.

⁹³ Already by 20 October 1995. Sagers, "The Iron and Steel Industry in Russia and the CIS in the Mid-1990s," in *Post-Soviet Geography and Economics*, Vol. 37, No. 4 (April 1996), p. 203.

⁹⁴ The imposition of value added tax on exported steel (hitherto free from it) alone raised cost for exporters by 20 per cent. *Finansovye izvestiia*, No. 38 (27 May 1997), p. IX.

⁹⁵ *Ekspert* (Moscow), No. 8 (2 March 1998), electronic version.

⁹⁶ The *Izvestiia* journalist admits that managers of Russian mills have failed to answer the 25 page "inquiry list" by the EU about the economics of production of the exported commodities, for the completion of which they had only one month. *Izvestiia* (Kiev ed.), 14 June 1997, p. 2.

⁹⁷ According to the president of South Africa's Impala Platinum, who spoke about the defensive, besieged situation in the platinum and palladium industries. *Finansovye izvestiia*, No. 82 (22 August 1996), p. VI.

⁹⁸ *Finansovye izvestiia*, No.2 (16 January 1997), p. 4. The price of that metal fell considerably in the second half of 1996, with an expected rise in the first half of 1997, again followed by a serious fall.

⁹⁹ *Ekonomika i zhizn'*, No. 30 (July 1996), p. 5.

¹⁰⁰ It fell to 30 per cent of the 1990 level by the end of 1995 and plunged another 18 per cent during January-October 1996 when compared to the same period of 1995.— *Ekonomika i zhizn'*, No. 24 (June 1996), p. 1; and *OMRI Daily Digest* (15 November 1996), electronic version.

¹⁰¹ S. Spartak, "Rossiia v sisteme mezhdunarodnogo razdeleniia truda," in *Ekonomika i zhizn'*, No. 32 (August 1996), p. 26.

¹⁰² D. Kirillov and M. Perfilov, "Otechestvennye eksportery teriaut evropeiskii rynek diztopliva," in *Finansovye izvestiia*, No. 83 (27 August 1996), p. II.

¹⁰³ Peter Rutland, "Firms Trapped Between the Past and the Future," in *Transition* (22 March 1996), pp. 26-30. That conference report also notes that "market pricing of transport has been tremendously disruptive in Russia, given the country's huge size...At the very least, rising transport costs have led to increasing regional segmentation, [while]...many sections of northern and eastern Russia are essentially uninhabitable," a conclusion with "mind boggling political implications. Is Russia as a country viable in a market economy?"

¹⁰⁴ Shinishiro Tabata, "Changes in the Structure and Distribution of Russian GDP in the 1990s," in *Post-Soviet Geography and Econom-*

ics, Vol. 37, No. 3 (March 1996), p. 140. During 1989 through December 1993 alone, the share of the finance sector in Russia's GDP grew from 1.8 per cent to 20 per cent but the contribution of profit and mixed income to value added reached 82 per cent. The share of the trade sector in GDP soared from 0.9 per cent to 9.5 per cent but the contribution of profit and mixed income to value added reached 85 per cent. In the economy as a whole, only half of the GDP was represented by profit and mixed income. Mixed income, as a term, was introduced only in 1993 and refers to non-wage income households from unincorporated enterprises, mostly trade, intermediary activities and the private plot in agriculture.

¹⁰⁵ Taken from M. Troschke, Al Sekarev, H. Clement, and V. Vincentz, *Überlegungen zur Verbesserung der Erfassung und Darstellung von Strukturveränderungen im Transformationsprozess Russlands und der Ukraine*, (Munich: Osteuropa-Institut, March 1996).

¹⁰⁶ Evgeny Gavrilentsov, "Adjustments of Output and Price Proportions in Russia," paper presented at the 29th National Convention of the American Association for the Advancement of Slavic Studies, Seattle, Washington, 20-23 November 1997.

¹⁰⁷ *Moskovskie novosti. Business*, No. 7 (1 March 1995), p. 4; and Troschke, Sekarev, Clement, and Vincentz, *Überlegungen zur Verbesserung*, pp. 28-29. Machine building continued its decline in 1996. Only 7 of 54 major products registered some growth during the first half of that year. *Finansovye izvestiia*, No. 82 (22 August 1996), p. II.

¹⁰⁸ István Dobozi and G. Pohl, "Real Output Decline in Transition Economies—Forget GDP, Try Power Consumption Data," in *Transition*, Vol. 6, Nos. 9-10 (September-October 1995), pp. 19-20. A strong challenge to that argument is made by the authors of the monograph, Troschke, Sekarev, Clement and Vincentz, *Überlegungen zur Verbesserung*, pp. 29-30.

¹⁰⁹ *Narodnoe khoziaistvo RSFSR v 1997.g.* (Moscow: Goskomstat RSFSR, 1998), p. 53.

¹¹⁰ *Delovoi mir* (19 June- 2 July 1995), p. 10.

¹¹¹ Tabata, "Changes in the Structure," p. 140.

¹¹² Arnold Toynbee, *Civilization on Trial* (New York: Oxford University Press, 1948), p. 155.

¹¹³ At the height of the conflict, the Imperial army deployed 300,000 troops, costing 1/6 of the entire Russian state budget. See *East European Newsletter* (11 May 1992), p. 1.

¹¹⁴ *Food and Agricultural Policy Reforms in the Former USSR. Agenda for the Transition*, Studies in the Economies of Transformation, Paper #1 (Washington D.C.: The World Bank, 1992), p. 29.

¹¹⁵ *Izvestiia* (16 September 1994), p. 4; and *Kommersant*, No. 42 (16-22 November 1992).

¹¹⁶ *Izvestiia* (16 September 1994), p. 4; and *Kommersant-Daily* (23 September 1995), quoted from *Analytica Moscow, CIS World Press Summary* (23-29 September 1995), electronic version.

¹¹⁷ Cotton is a very high value commodity per ton. Distance from ports, sharply rising rail freights, and commodity competition from Russia, therefore, have not seriously eroded its profitability on the world market. This remained true even in 1996, which saw a significant decline in the world price of that crop.

¹¹⁸ Kambiz Manafi, "Refining, Oil Balances and Trade in the Black Sea, Transcaucasian and Central Asian Republics," in *OPEC Bulletin* (September 1993), pp. 10-11.

¹¹⁹ Matthew Sagers, "Oil Industry in the Southern-Tier Former Republics," in *Post-Soviet Geography*, Vol. 35, No 5 (May 1994), p. 276.

¹²⁰ *OMRI, Daily Digest* (18 April 1996); and Matthew J. Sagers, "Long-Term Program for Turkmenistan's Oil and Gas Sector," in *Post-Soviet Geography*, Vol. 35, No. 1 (January 1994), pp. 50-56. Nazerbayev personally requested that Chernomyrdin double the Kazakh export quota to 6 million tons, a request which evidently was not fully granted.— *OMRI, Daily Digest* (28 September 1995), electronic version.

¹²¹ Laurent Ruseckas, "Caspian Oil: Getting Beyond the 'Great Game'," in *Analysis of Current Events*, Vol. 9, No. 10 (October 1997), p. 4.

¹²² "The New Russia/CIS in Asia," Unpublished paper (The National Bureau of Asian Research and the International Research and Exchanges Board, Washington D.C., 5-6 October 1995).

¹²³ *Pipeline News*, No. 42, Part III (14-20 December 1996) and No. 43, Part II (11-17 January 1997), electronic version. In early March 1998, Chevron signed an agreement with Georgian Petroleum Products Co. and Britain's Caspian Trans Co. to take over the existing 232 km Georgian pipeline to Batumi, rebuild it and join it to the one which is to be laid in Azerbaijan. Chevron's president, Richard Matske, said the work should take four months. The pipeline will enable Chevron to transport 3-3.5 million tons of crude oil a year. The full capacity of the line in Azerbaijan, to be completed in mid-1999, could bring annual transport volumes to between 7 and 8 million tons, but this volume will apparently include Azeri oil as well. Chevron will also continue rail transport through Azerbaijan and Georgia to the Black Sea, which began in March 1997.— *Russia Today*, Business News, No. 4 (3 March 1998), electronic version.

¹²⁴ A. V. Romanikhin, "Neftegazovye i voenno-promyshlennye komplekсы: problemy vzaimodestvii," in *Gazovaia promyshlennost'*, No. 5 (May 1995), p. 5.

¹²⁵ *Nezavisimaia gazeta* (11 November 1996), p. 4.

¹²⁶ a) The projects and Lukoil's stakes are the following: AIOC (Azerbaijan International Operating Company), dubbed the "deal of the century," for the Azeri, Chirag, and Guneshli fields. Total: \$7.5 billion: Lukoil's share: 10 per cent.

b) CIOC (The Caspian International Oil Company) for the Karabakh structure: Lukoil's share: 32.5 per cent.

c) Shah-Deniz field. Lukoil's share: 10 per cent.

d) CPC (The Caspian Pipeline Consortium) for the pipeline to Novorossiisk. Lukoil's share: 12.5 per cent. Another Russian company, Rosshelf, in joint venture with Royal Dutch-Shell holds 7.5 per cent

e) TengizChevron project. \$20 billion. Lukoil was set to buy a 5 per cent stake, as announced by its president in mid-January, 1997. Lukoil is pushing for an even higher share, reportedly up to a fifth of the total. It has offered the American company and the Kazakh government better access to the Russian pipeline network in ex-

change for a stake amounting to ca. a fifth of the entire project. Sources: *Pipeline News*, Part II (14-19 December 1996), and (11-17 January 1997).

¹²⁷ Russia, too, has a shoreline on the Caspian. Most of it, however, is located in the Republics of Dagestan and Kalmykia, which will certainly claim joint ownership with the federal government. At any rate, the finds anticipated in offshore waters in the Russian Federation are small. It can hardly be coincidental that on the eve of signing the \$7.5 billion international agreement, Azeri President Aliyev's personal bodyguard and the Deputy Speaker of the Azeri parliament (who also was Aliyev's illegitimate son) were both shot and killed. While denying involvement in the assassination attempt, Russia forcefully denounced the international oil deal just signed, then Foreign Minister Kozyrev calling it "unacceptable." When Aliyev launched an investigation into the killings, an attempted mini-coup took place within a week, led by the same Suret Guseinov, who (as a Russian loyalist), brought Aliyev to power in an uprising against the strongly pro-Turkish former Azeri Prime Minister Elcibey. Guseinov denied the coup charges but escaped to a Russian base and was flown to Moscow. See Ian Bremmer, "Spilling Blood Over Oil: Russian Domination in Chechnya and Azerbaijan," in *Analysis of Current Events* (April 1995), pp. 1-4. Since that time, at least two other coup attempts were thwarted against Aliyev himself, the latest on 7 February 1997 as per OMRI, *Daily Digest* (10 February 1997), electronic version.

¹²⁸ Sergey Karaganov, "Nachinayetsia novaia igra," in *Ogonek*, No. 33 (August 1995), p. 78. Also *Moskovskie novosti. Business* (21 June 1995), p. 5.

¹²⁹ *Monitor*, The Jamestown Foundation (6 December 1995), electronic version.

¹³⁰ OMRI, *Daily Digest* (11 November 1996), electronic version.

¹³¹ *Monitor*, The Jamestown Foundation (17 April 1998), electronic version.

¹³² Paul Goble, "Analysis from Washington: Caucasus—Iran Reenters the Caspian Fray," in Radio Free Europe/Radio Liberty, *Special Reports* (14 November 1997), electronic version.

¹³³ Russia, however, keeps insisting that the Georgia pipeline route is not price competitive. See *Pipeline News*, No. 42 (14-20 December 1996), Part I and No. 43 (11-17 January 1997). For earlier newspaper sources, see *The Christian Science Monitor* (4 October 1995), p. 19 and (11 October 1995), p. 6.

¹³⁴ Floriana Fossato, "Russia: Negotiating a New Transport Deal With Chechnya," in Radio Free Europe/Radio Liberty, *Special Reports*, (29 December 1997) electronic version. Russia's then Fuel and Energy Minister (now Prime Minister), Sergei Kirienko, expressed doubt that the news agreement will be a final one, and noted that "a sequence of agreements may be the best solution."

¹³⁵ *Russia Today*, Business Report #1 (11 September 1997); and *Pipeline News*, No. 42 (14 December 1996), Part IV and (10 January 1997), Part I, electronic version.

¹³⁶ *Monitor*, The Jamestown Foundation (17 February 1998); and *The Washington Post* (8 March 1998), p. C3.

¹³⁷ *The Christian Science Monitor* (11 October 1995), p. 6. As was expected, the Turkish government immediately declared that the acceptance of the Georgia route signals "that the Baku-Ceyhan line will work." See *OMRI, Daily Digest* (10 October 1995), electronic version.

¹³⁸ "We are searching for that oil but cannot find it," Shevernadze replied gloomily, according to *Kommersant-Daily* (16 September 1995), pp. 1 and 3.

¹³⁹ *Moskovskie novosti. Business*, (21 June 1995), p. 5; and *Pipeline News* (14-20 December 1996) and (11-17 January 1997) electronic version. For earlier newspaper sources, see *The Christian Science Monitor* (4 October 1995), p. 19 and (11 October 1995), p. 6.

¹⁴⁰ *OMRI, Daily Digest* (6 and 10 February 1997), electronic version.

¹⁴¹ *Pipeline News*, No. 42, Part IV (14 December, 1996-10 January 1997), electronic version.

¹⁴² See *inter alia* Paul Goble, "Armenia: Analysis from Washington—Ter-Petrossian Lost Popular Support," in Radio Free Europe/

Radio Liberty, *Special Report* (6 February 1998); and *Monitor*, The Jamestown Foundation (4 February 1998) and (15 February 1998).

¹⁴³ Vahan Hovaisian, "Central Asia: Growing Links Improve Economies," in Radio Free Europe/Radio Liberty, *Special Report* (23 April 1997), electronic version.

¹⁴⁴ Radio Free Europe/Radio Liberty, *Newsline* (11 November 1997); and Paul Goble, "Azerbaijan: The Homeless Millions Create Serious Problems," in Radio Free Europe/Radio Liberty, *Special Report* (4 March 1998), electronic version.

¹⁴⁵ On his official visit to Almaty, a correspondent posed the question to Aliyev whether the dispute with Ashgabad over the Caspian shelf hinders development. The Azeri president laconically replied: "Problems exist, but they do not hinder us." In the course of an official visit, such a brusque reply is highly unusual and was taken as a provocation by Turkmenistan. It was immediately followed by the sharp *démarché* addressed to Baku "expressing the hope that exploratory work in the disputed waters would cease at once, else the Turkmen government would not be responsible for the consequence. See *Izvestiia* (Kiev ed.), 9 July 1997, p. 2.

¹⁴⁶ *Ibid*, p. 2. By December 1997, there were signs that Baku and Ashgabad were anxious to find common ground and smooth over their disagreement. Presidents Aliyev and Niyazov met at the Islamic summit in Teheran and announced their decision to create a joint commission, mandated to determine the maritime border between the two states "in accordance with the median line principle." See *Monitor*, The Jamestown Foundation (10 December 1997), electronic version.

¹⁴⁷ A pipeline to a Turkish Mediterranean port would pass closer to Kurdish territory than a pipeline through Georgia, but could still avoid the insurgent areas.

¹⁴⁸ Rossen Vassilev, "The Politics of Caspian Oil," in *Prism*, Jamestown Foundation (12 January 1996), Part 3, electronic version.

¹⁴⁹ Sonia Winter, "Central Asia/Caucasus: A Mission to Deter Iranian Connections," in Radio Free Europe/Radio Liberty, *Special*

Reports (11 November 1997), electronic version.

¹⁵⁰ President Khatami came close to apologizing for the seizure of the U.S. embassy in Teheran by militants in 1979, regretting the event and the pain it caused to the people of the United States. See *Reuters* (8 January 1998).

¹⁵¹ *The Economist* (2 August 1997), p. 30; and *Russia Today*, Business Report, #1 (30 December 1997).

¹⁵² Originally, the consortium offered Chevron a much smaller equity stake than its contribution of investment capital, while the Russian government refused to guarantee sufficiently high transit fees through its Finance Ministry. Oman's much more modest contribution was conditioned on the pledge of Western credit *for the rest of the \$ 1.5 billion project*. The risky undertaking thus could not get off the ground.

¹⁵³ *Pipeline News*, No. 42, Part IV (14 December 1996-10 January 1997).

¹⁵⁴ Paul A. Goble, "Light at the End of the Tunnel? Pipeline Politics in the Former Soviet Union," in *Prism*, Jamestown Foundation (3 November 1995), Part II, electronic version.

¹⁵⁵ Hovassian, "Central Asia," electronic version.

¹⁵⁶ *Izvestiia* (Kiev ed.), 8 August 1997, p. 1.

¹⁵⁷ *Monitor*, The Jamestown Foundation (30 January 1998), electronic version.

¹⁵⁸ *Delovaia nedelia* (Kiev), No. 33 (15 December 1997), p. 8; *Russia Today*, Business Report (15 January 1998), electronic version; and *Monitor*, The Jamestown Foundation (30 January 1998); and Radio Free Europe / Radio Liberty, *Newsline* (19 February 1998), electronic version. The Russian side proposed to transport and sell Ukraine 25 billion cu. meters of Turkmen gas, initially offering to Ashgabad only \$32 per 1,000 cu. meters, a price later raised to \$42. In contrast to the \$1.09 per 1,000 Russia pays Ukraine for transit, it demanded \$1.6-\$1.75 for the same from Ashgabad, also reserving the right to send the gas through a longer 1,600 km route rather

than through direct connection, which measures only about 600 km. It should be noted that the Turkmen pipelines were built specifically to ship that gas to the eastern provinces of Ukraine, through Ukraine to Europe, and from a transshipment node near the Lower Volga to Moscow. Location prevents them to be used by Russia for supplying Siberian gas either to Ukraine or to its own provinces. See *Russia Today*, Business Report, No. 1 (15 January 1998), p. 4.

¹⁵⁹ *Russia Today*, Business Report, No. 1 (15 January 1998); and Matthew J. Sagers, "Long-Term Program for Turkmenistan's Oil and Gas Sector," in *Post-Soviet Geography*, Vol. 35, No. 1 (January 1994), pp. 50-56. In mid-November 1996, Uzbekistan also shut off its own gas shipments to Almaty the capital of Kazakhstan when it failed to pay its gas bills. See *Russia Today*, Business News, No. 4 (14 November 1996).

¹⁶⁰ *Energy Statistical Yearbook* (New York: U.N. Publications, 1994), p. 51.

¹⁶¹ *Monitor*, The Jamestown Foundation (28 January 1998) and (18 October 1995), electronic version; and OPEC *Bulletin* (October 1995), p. 18.

¹⁶² *Monitor*, The Jamestown Foundation (11 September and 18 October 1995), electronic version.

¹⁶³ In 1995, the U.S. administration acted three times to restrict Iran's maneuvering room. In early spring, it prevented CONOCO from signing a major, long-term oil and gas development deal. Three months later it severed other links between U.S. enterprises and Iran. Finally, in December the Clinton administration worked out a compromise bill with Senator D'Amato and Inouye to put certain sanctions on foreign firms that trade with that country. Iran's imports in 1994-95 dropped sharply, reflecting its difficulty in securing credit. See Neal M. Sher's letter, in *The Christian Science Monitor* (5 January 1996), p. 18. According to Russian sources, it was the U.S. mission in Baku that pressured Azerbaijan to rescind its decision to transfer to Iran 5 percent of its share in the consortium for the development of the Azeri, Chirag, and Gyuneshli oil deposits in exchange for an investment payment of \$1.8 billion. See *Kommersant-Daily* (31 January 1995), p. 4.

¹⁶⁴ Micheal Mihalka, "The Russia-Iran Nuclear Deal: 'Diplomacy of Several Doors'," in *Transition* (17 November 1995), pp. 40-44.

¹⁶⁵ *Monitor*, Jamestown Foundation (3 January 1996), electronic version.

¹⁶⁶ Iran has not done so in the Tajik civil war, and it has tried to mediate between Azerbaijan and Armenia in the Caucasus. On the dispute over the division of the Caspian Sea, Iran has taken Russia's side, even if mutedly. It should be remembered that Iran was engaged in a struggle for influence and control over the Caucasus with its traditional rival Turkey for more than 300 years before Russia entered the scene.

¹⁶⁷ *Monitor*, The Jamestown Foundation (28 January 1998), electronic version. The politics of Ashgabad's relationship with Western companies concerning gas and oil extraction and the trans-Afghan pipeline has been highly complex. The Argentine firm Bidas became the first Western company to take a stake in newly independent Turkmenistan and so far invested \$400 million in the country, discovering a huge new gas field as well, and first drew up plans for export Turkmen gas to Pakistan. Bidas, however, fell out with Turkmen president Niyazov, who (bidding for US support) began negotiations with UNOCAL, terminated Bidas' contract, and shut down all its operations. Bidas moved to court, suing UNOCAL as well. See the highly informative discussion by Ahmed Rashid, "The Turkmen-Afghan-Pakistan Pipeline—Company-Government Relations and Regional Politics," in *Pipeline News*, No 78 (3-9 November 1997). The latter source claims that "UNOCAL now has full support of Turkmenistan and Pakistan but remains on shaky ground as far as support from the Taliban is concerned. Bidas, on the other hand had no support from Turkmenistan or Pakistan, but has much greater influence with all the Afghan factions. Bidas' strategy has been to tie up deals with the Afghan factions, thereby making the construction of the pipeline impossible without its participation." UNOCAL and US government officials are apparently counting on Pakistan for sufficient influence on the Taliban to guarantee the security of the pipeline, which may in fact be a pipedream. Hard-headed business and geopolitical considerations apart, the human rights record of the Taliban inspires little support for the project outside specific business and government circles.

¹⁶⁸ From January through August 1997, the physical volume of gas exports beyond the borders of the former USSR declined by 8 per cent; yet these exports earned 4.5 per cent as much as during the same time period the year before. See *Ekonomika i zhizn'*, No. 47 (November 1997), p. 30.

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