CRUDE FEDERALISM: DECENTRALIZATION AND CONTROL OVER OIL AND GAS RESOURCES IN THE RUSSIAN FEDERATION

by

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ABSTRACT

This thesis explores how the decentralization of control over Russia's oil and natural gas resources is shaping Russian federalism. A political-economic methodology is employed that draws from literature on decentralization, federalism, intergovernmental relations in the Russian Federation, and the Russian oil and gas sector. The study focuses on how and why some of Russia's regions have secured relatively more autonomy from the centre. It is argued that under Russia's asymmetrical brand of federalism, regions with the administrative status of "autonomous republic" and natural resource-rich regions have been able to build stronger bases of regional power and authority because they are negotiating from positions of strength in intergovernmental relations. Autonomous republics have been delegated legal and political-administrative powers that the rest of Russia's regions simply do not possess. The distribution of control over Russia's abundant oil and gas resources has changed since the collapse of the Soviet Union and, though there has been some decentralization in the oil and gas sector, the Russian government retains decisive influence in these strategic industries. The other main beneficiaries of oil and gas development are the producing regions, a significant improvement from Soviet times to be sure. Examinations of the Sakha Republic (Yakutia) and Tyumen' Oblast, including the autonomous okrugs of Khanty-Mansiisk and Yamal-Nenets, demonstrate both the importance of republic status, and the political power derived from natural resource wealth. The thesis concludes that the push for Russian "federalization" will continue to be led by republics and resource-rich regions, and that Russian federalism is attainable as long as asymmetries do not become overly acute.

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INTRODUCTION

The disintegration of the Soviet Union has left the Russian Federation in a period of extensive economic, social and political transition, from a totalitarian state to some semblance of democratic federalism. One of the many elements of this transition is to develop and institutionalize a new balance of power between the central government in Moscow and the dozens of regional governments.[1] One of the key issues in the process of establishing a new division of powers between the centre and regions is the redistribution of control over Russia's natural resources. This thesis focuses on the decentralization of economic and political power in post-Soviet Russia, with specific attention to the oil and natural gas sector. Analysis of the Russian oil and gas industries helps to illustrate the type of federal system that is emerging in Russia.

During its last two decades of existence, oil and gas were the Soviet Union's most important and most valuable economic resources. The oil and gas sector continues to be extremely important to the post-Soviet Russian state: it provides employment for many thousands of people; it fuels much of Russia's highly industrial economy; it provides massive revenues for government budgets; and oil and gas account for over half of Russia's foreign currency earnings, for Russia presently has little else to offer. Quite simply, the health and stability of the Russian economy depend critically on the oil and gas industry. Russia's central, regional and local governments are all struggling for control over the oil and gas industries as this control is truly a form of economic and political empowerment. While not all regions in Russia

[1] For the purposes of this thesis, the term "centre" refers to the central government in Moscow, while "region" refers principally to the eighty-nine administrative units or "subjects" (*sub''ekty*) of the Russian Federation.

are endowed with oil and gas resources, oil and gas are important factors in the division of power in post-Soviet Russia.

Decentralization and control over natural resources are considerable issues in any federally organized state, but in Russia these are particularly relevant issues. The collapse of the Soviet system left Russia and the other successor states with a political and economic void. Russia was left to establish new institutions to fill this void and a power struggle between the federal centre and the regions has coincided with this endeavour. Historically subject to strict subordination by Moscow, Russia's regions were quick to use the period of instability to assert power within their perceived jurisdictions, and oil and gas are valuable instruments of power in this process.

The struggle for control over natural resources has various implications for Russian federalism. Just as Peter Rutland argues that if privatization "were really to succeed in Russia, one would expect to see it making inroads into the oil and gas industry,"[2] it is similarly argued herein that if decentralization is really occurring in Russia, one would expect to see evidence of it in the oil and gas sector because it is possible that the struggle for control over Russia's oil and gas is playing a significant part in shaping post-Soviet Russian federalism. Specifically, this thesis investigates how the distribution of control over Russia's oil and gas resources is affecting the nature of Russian federalism. It is argued that natural resource endowment and the "status" of republic within the Russian Federation greatly improve a region's chances of becoming more autonomous from the centre.

This thesis investigates broadly three elements of post-Soviet Russian federalism: (1) decentralization and the increased power of Russia's regions; (2) asymmetrical federalism, that is, the unequal rights and powers of Russia's four regional administrative units -- autonomous

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[2] Peter Rutland, "Privatisation in Russia: One Step Forward: Two Steps Back?", *Europe-Asia Studies*, Vol. 46, No. 7, 1994, 1109-1131, 1119.

republics, oblasts, krais and autonomous okrugs; and (3) the redistribution of control in the Russian oil and gas sector. Chapter one considers the concepts of decentralization and federalism so that they may be applied to the Russian Federation. The chapter also covers oil and gas development in federal states, with a brief discussion of oil and gas in Canada. Chapter two examines the reorganization of the post-Soviet Russian oil and gas sector to illustrate one aspect of decentralization -- the decentralization of economic power and resources from governments to market, quasi-market and non-governmental organizations. At this point, it is argued that while privatization has led to some decentralization of the oil and gas industries, the central government still retains strategic control. Chapter three is a study of Tyumen' Oblast and the Sakha Republic. In terms of natural resources, these are two of Russia's wealthiest regions. The chapter concludes that republic status and natural resource endowment are two of the most valuable sources of political power for Russia's regions. Finally, chapter four summarizes the main conclusions of the thesis, speculates somewhat about the future of Russian federalism, and offers suggestions for further research in this field.

Chapter 1

TERMS, CONCEPTS, AND RELEVANT LITERATURE

Five years have passed since the collapse of the Soviet Union and some quality literature on Russian federalism has now emerged.[3] A variety of approaches have been employed to investigate Russian federalism. This thesis argues that the most effective approach to the study of Russian federalism is one which examines specific issues of jurisdiction and specific cases of the centre-regional division of powers.[4] Accordingly, a direct approach is taken here, one which investigates the redistribution of control taking place in the Russian oil and gas sector, and analyzes the specific cases of two regions -- the Republic of Sakha (Yakutia) and Tyumen' Oblast -- with emphasis on the oil and gas industries of these regions.

This thesis draws from four separate but related bodies of literature: (1) literature on decentralization; (2) general literature on federalism; (3) recent literature on post-Soviet Russian federalism; and (4) studies of the Russian oil and gas sector. These subject areas are fused herein to determine how the struggle for control over oil and gas resources is shaping the development of Russian federalism. To begin, however, this chapter reviews the pertinent literature in these fields of study.

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[3] Recent research includes Robert Sharlet, "The Prospects for Federalism in Russian Constitutional Politics," *Publius*, 24, Spring 1994, 115-127; Edward W. Walker, "Federalism -- Russian Style: The Federation Provisions in Russia's New Constitution," *Problems of Post-Communism*, July-August 1995, 3-12; Darrell Slider, "Federalism, Discord, and Accomodation," in Theodore H. Friedgut and Jeffrey Hahn, eds., *Local Power and Post-Soviet Politics* (Armonk, N.Y.: M.E. Sharpe, 1994), 239-269; James Voorhees, "Russian Federalism and Reform," *Demokratizatsiya*, Vol. 2, No. 4, 1995, 549-564.

[4] This argument is also made by Steven Solnick, "The Political Economy of Russian Federalism: Problems of Measurement and Analysis," prepared for the 1995 Annual Meeting of the American Political Science Association, Chicago, Ill., 31 August - 3 September, 1995; and Daniel R. Kempton, "The Republic of Sakha (Yakutia): The Evolution of Centre-Periphery Relations in the Russian Federation," *Europe-Asia Studies*, Vol. 48, No. 4, 1996, 587-613.

Decentralization

Decentralization is a frequently used term in academic literature, but one which encompasses a complex and varied set of phenomena that may be interpreted in a number of different ways. It is a term which sparks much interest and is presently a common theme of policy debates in almost all Western countries. Deservedly or not, the concept of decentralization seems to have inherited the halo of efficiency and is leading to major changes in constitutional, financial and other structures in many countries. But what is decentralization? And how, if at all, can it be measured?

Simply, decentralization refers to the dispersal or distribution of power and authority away from a centre. A "centre" may exist on many different levels -- global, national, regional, local, or even within a community -- anywhere power and authority are concentrated relative to the "periphery" of a given territory or organization. With such a definition of decentralization, however, a proper understanding of power and authority is necessary. Max Weber offers a useful conceptualization of the nature of power and authority. In Weber's view, power consists of the ability of a person or group of people to realize their own will even against the resistance of others who are participating in the action. Authority is power acknowledged to be legitimate or right by both superordinate and subordinate.[5]

Given the multitude of organizational structures that may exist, decentralization is difficult to measure. Rousseau and Zariski (1987) view centralization and decentralization as "sensitizing concepts" that force us to ask what the concentration or dispersion of power means in terms of the functioning of specific organizational structures.[6] In this vein, power, in its centralized or decentralized form, is best conceptualized as varying along a continuum rather than as a simple

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[5] H. H. Gerth and C. Wright Mills, eds., *From Max Weber: Essays in Sociology* (Boston: Routledge & Kegan Paul Ltd., 1948).
[6] Marc O. Rousseau and Raphael Zariski, *Regionalism and Regional Devolution in Comparative Perspective* (New York: Praeger, 1987).

dichotomy, because structures and processes of central and regional power inevitably vary between countries and over time.

An understanding of decentralization is essential to the study of contemporary Russia. Since the collapse of the Soviet Union, decentralization of power and authority in Russia has proceeded at a relatively rapid pace. This has much to do with Russia's former position as a member of the Soviet Union. The Soviet system was extremely centralized, a characteristic viewed by some as the main reason behind the failure of the system. Decentralization, then, may be considered a natural reaction to the hypercentrism of the Soviet state. Political democracy and a market economy both require a level of decentralized power and authority that did not exist in the Soviet Union.

This thesis pursues two principal aspects of decentralization. The first is the decentralization of economic power and resources from governments to markets and non-governmental organizations; and the second is intergovernmental, that is, the decentralization of political power and authority, and administrative discretion, from the central government to regional governments.[7] Decentralization differs from devolution which refers to the "transfer of power or authority from a central government to a regional or local one."[8] Such a definition of devolution makes it inappropriate for general use in this thesis for two key reasons. First, devolution does not encompass the passage of power from governments to markets. Second, as a *transfer* of power and authority, devolution implies a conscious effort by the centre to decentralize, and this has often not been the case in Russia's chaotic constitutional-legal environment where much power and authority has decentralized *de facto.*

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[7] Robert J. Bennett, "Decentralization, Intergovernmental Relations and Markets: Towards a Post-Welfare Agenda," in Robert J. Bennett, ed., *Decentralization, Local Governments, and Markets* (Oxford: Clarendon Press, 1990), 1-26.

[8] Peter Clancy, "Politics by Remote Control: Historical Perspectives on Devolution in Canada's North," in Gurston Dacks, ed., *Devolution and Constitutional Development in the Canadian North* (Ottawa: Carleton University Press, 1990), 13-42.

For the purposes of this thesis, then, decentralization remains broadly defined along both market and governmental dimensions. As these two forms of decentralization occur, a new arrangement or organization of power and authority is required among different tiers of government and between government and non-governmental organizations. In other words, both governmental and non-governmental relationships enter a state of flux. These fluid relationships, and the importance of oil and gas to the reorganization of power and authority in the Russian Federation is studied here.

Federalism

Following the disintegration of the Soviet Union, the territory that comprised the former Russian Soviet Federated Socialist Republic (RSFSR) became the Russian Federation. This new name implies that Russia now possesses a "federal" system. But is Russia truly federal? Although a thorough analysis of Russian federalism is beyond the scope of this thesis, the study of natural resources in general, and oil and gas in particular, can illuminate certain dimensions of intergovernmental relations. To do so, however, we need to question what the term federalism represents, and how we may distinguish between federalism and regional devolution.

Federalism refers to a constitutional division of power between central and regional levels of government, in which each of these two orders of government possesses some exclusive jurisdiction of its own. Other conditions to be met in order for a country to be deemed federal include (1) a constitutional guarantee of the continued existence and territorial integrity of the regional units of government; (2) an upper house of parliament, normally elected directly or indirectly by the people of the regions, which represents the regions and which has some power to block or delay legislation originating in the lower house; (3) possession by the regions of some measure of discretion in shaping and regulating their respective systems of local government; and

(4) the exercise of some control over centre-regional relations by a constitutional court wielding the power of judicial review.[9]

Regional devolution is evident in unitary systems where central government power is supreme. Under a system of regional devolution, a constitution may recognize the existence of regional governments, but the regions possess no exclusive powers and a central government agent can intervene directly in regional affairs by blocking or repealing regional legislation. Also, and similar to federalism, with regional devolution the regions have an elected parliament and cabinets responsible to that parliament, both of which may not be dissolved or suspended by a central government official. This immunity is an important distinction between regional devolution and a unitary prefectoral system.[10] Thus, with regional devolution, regional governments exist, but they are highly subordinate to the central government, far more so than with federalism.

A. H. Birch identifies four approaches to the study of federalism.[11] The first is the institutional approach stemming from K. C. Wheare's seminal book *Federal Government* (1946). Wheare's comparative study viewed federalism as a system of government in which the federal and regional governments are both coordinate and independent.[12] However, Wheare's narrow definition, based on legal-juridical writings, has been challenged by other scholars who suggest that a country may be defined as federal not simply by what the constitution says, but how it is employed.

Second is the sociological approach, advanced by W. H. Livingston in *Federalism and Constitutional Change* (1956). For Livingston, the essence of federalism is to be found not in the

[9] Rousseau and Zariski, *Regionalism*, 32.
[10] Ibid., 33.
[11] A. H. Birch, "Approaches to the Study of Federalism," *Political Studies*, February 14, 1966, 15-33.
[12] K. C. Wheare, *Federal Government* (London: Oxford Press, 1946).

constitutional or institutional structure, but in the society itself.[13] Social diversity is said to be reflected in political phenomena which Livingston calls "federal instrumentalities." Perhaps Livingston's greatest contribution was his conclusion that federalism is not an absolute, but a relative term -- that there exists no model of federalism, rather federalism is more accurately viewed as a spectrum.[14]

A third approach treats federalism as a process rather than as a static form of government. It argues that federal relations are always in flux, thus a federally organized country must have institutions that are capable of directing the periodic revision of its structure. C. J. Friedrich champions this approach in *Trends of Federalism in Theory and Practice* (1968), with the following definition of federalism:

> the process of federalizing a political community, that is to say, the process by which a number of separate political communities enter into arrangements for working out solutions, adopting joint policies, and making joint decisions on joint problems, and, conversely, also the process by which a unitary political community becomes differentiated into a federally organized whole.... In short, we have federalism only if a set of communities coexist and interact as autonomous entities, united in a common order with an autonomy of its own.[15]

With this approach, one must seek to identify the factors which foster or impede differentiation or integration because federalism may operate in both directions.

The fourth approach identifies federalism as a bargain, focusing directly on political and administrative aspects. In connection with this approach, W. H. Riker defines federalism simply, indicating that a country's "constitution is federal if it provides for two levels of government, each of which has at least one area of action in which it is autonomous, and each of which has "some guarantee (even though merely a statement in the constitution)" of its contained autonomy within

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[13] W. H. Livingston, *Federalism and Constitutional Change* (Oxford: Oxford Press, 1956).
[14] Ibid., 4.
[15] Carl J. Friedrich, *Trends of Federalism in Theory and Practice* (New York: Frederick A. Praeger, 1968), 7-8.

its sphere."[16] He suggests that such a constitution is always the result of a political bargain. Also, an important distinction is made between centralized and peripheralized federal systems: centralized if the federal centre is relatively powerful, peripheralized if the federal centre is sharply constrained. Riker goes on to conclude that such factors as the division of governmental powers, the extent of governmental activities, and the survival of provincial loyalties and belief in region's rights will influence the nature and working of the federal system, but it is the structure of the party system that determines how long the system is maintained.[17]

Each of these approaches is more or less applicable to the Russian case, and each certainly has merit and contributes to the study of federalism. This thesis draws somewhat from each approach in an effort to better understand Russian federalization. But it is insufficient to discuss Russian federalism without examining specific aspects of the division of powers. Thus, much of the focus herein is on the decentralization of powers -- generally, as they exist in the Russian natural resources sector, and specifically the oil and gas industries. During this time of transition and structural reform, control over oil and gas is a particularly valuable source of economic and political power, and the struggles for this control -- between both centre and region, and public and private -- offer excellent insights into the dynamics of Russian federalism.

Oil and Natural Gas in a Federal State

In a federal state, oil and natural gas development raises many questions: Who will develop the resources? What is the time preference for development? Who will collect the resource rent[18] from development? How will resource rent be distributed amongst the population? And which government will have the power and authority to manage the resources?

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[16] W. H. Riker, *Federalism: Origin, Operation, Significance* (Boston: Little, Brown and Co., 1964).
[17] Ibid., 20-21.
[18] Resource rent represents income generated in excess of what a producer would normally receive in terms of returns on investment (i.e. labour and capital) and is discussed more thoroughly in Chapter 2.

In a federal state, these issues are normally resolved cooperatively between the central, regional and, occasionally, local governments. Issues of resource rent and revenue redistribution are often the most contentious and cumbersome in federal oil and gas negotiations. However, from questions of revenue and resource rent we must proceed to more comprehensive questions of *control* over oil and gas development because the existing distribution of control over oil and gas development in a federal state has a direct connection with the more specific questions of resource rent and its distribution. Issues concerning control over oil and gas, such as ownership of land and resources and the jurisdiction to manage the resources, will affect the quantity and distribution of resource rent from oil and gas development.

Issues surrounding the collection of resource rent and its redistribution may test even the most stable of federations. In Canada, for instance, windfall profits from oil and gas during the late 1970s and early 1980s led to serious centre-regional conflict. In Canada, the provinces (i.e. regions) have the authority to control oil and gas development in all its aspects: "they have the authority to control where wells are placed; the rate of production; construction of roads, processing plants, and local pipelines; safety for workers; pollution; accidents; noise; and impacts on wildlife among other things."[19] The province of Alberta, producer of over 80 percent of Canadian oil and gas and legal owner of its natural resources under the Canadian constitution, enjoyed windfall profits as a result of the world oil price increases of the 1970s. Alberta's economic boom, however, skewed the existing system of federal revenue redistribution.[20] In response to this systemic stress, the Canadian government introduced new taxes and attempted to

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[19] Susan Blackman, "The Powers of Canadian Provincial and Federal Governments With Respect to Management of Oil and Gas Resources," in *Energy Resources Development in Federal States* (Calgary: Canadian Institute of Resources Law, 1995), 6-11. Federal and provincial powers in natural resource industries are found mainly in Articles 91 and 92 of the Canadian constitution, respectively.

[20] See John F. Helliwell, *The Distribution of Energy Revenues within Canada: Functional or Factional Federalism?*, Resources Paper No. 48 (Vancouver: University of British Columbia Department of Economics, February 1980).

restructure the existing tax regime for the oil and gas sector in order to capture a greater share of resource rent. Alberta then reacted by restructuring its system of royalty payments. The ensuing jurisdictional feuds did not abate until well into the 1980s.

Other than the threat posed by Quebecois nationalism, the intergovernmental dispute over oil and gas during the late 1970s and early 1980s was arguably the strongest test of Canadian federalism in the past thirty years. Control over oil and gas has also become a primary goal of Canada's territorial governments in recent years as they pursue greater autonomy from the Canadian government.[21] As Susan Blackman argues, "conflict over energy resources has been some of the most antagonistic intergovernmental conflict in Canada."[22] Oil and gas issues have caused similar centre-regional disputes in the United States where the regions (or states) also have the power to control natural resource development.[23]

Oil and gas issues are of even greater significance in Russia than in federations such as Canada or the United States, both of which have relatively stable, diversified market economies. Moscow is not about to forfeit oil and gas revenues, and the power that they bring, to the sparsely populated oil and gas producing regions of Siberia. Thus, as with the process of federalization, the process of redistributing control over Russian oil and gas remains very fluid. As Dienes (1996) explains:

> The long, drawn out tug-of-war between the federal center and Russia's factious republics and regions also has a bearing on the way the Russian oil and gas industry is privatized and managed in the future. In turn, the transformation of administrative, semi-feudal control into one exercised through newly acquired ownership (essentially by the same elite) is greatly

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[21] For an analysis of devolution and control over oil and gas in Canada's territories see Gurston Dacks, "The Quest for Northern Oil and Gas Accords," in Gurston Dacks, ed., *Devolution and Constitutional Development in the Canadian North* (Ottawa: Carleton University Press, 1990), 225-266.

[22] Susan Blackman, "Introduction to Intergovernmental Agreements," in *Energy Resource Development in Federal States* (Calgary: Canadian Institute of Resources Law, 1995), 12-18.

[23] See, for example, David Howard Davis, *Energy Politics* (New York: St. Martin's Press, 1993), chapters 3 and 4.

> facilitated by that struggle. The unfinished legal framework is both the result of and an instrument in that still uncompleted drive for power.[24]

Governments across all of Russia are grappling with budget crises, and oil and gas resources are important components of this problem -- for producing regions looking to increase revenues and for regions of high consumption trying to minimize costs. Russia, like Canada, possesses an economy dominated by raw material extraction and export. In 1994, for example, fuel exports accounted for over half of all export earnings for the Russian Federation, with metals and diamonds accounting for another 25 percent.[25] Who in fact controls Russia's petroleum resources is of consequence to every region of the country and the distribution of this control is playing a significant role in shaping Russian federalism.

The issue of control over oil and gas is still more consequential because, at present, Russia's system of federal revenue redistribution is weak at best. For example, in 1994 the Sakha Republic withheld all its taxes from the federal government, but financed both federal and regional programs from its own budget.[26] A similar arrangement may be appropriate for oil- and gas-rich regions because tax collection remains unreliable and federal subsidies appear to be based more on political motives than on the actual needs of given regions.[27] But for the sake of efficiency and fairness, a stable centre-regional division of powers and an effective system of taxation and collection will need to precede a concrete federal system of revenue redistribution.

The question of which level of government should have the power to capture resource rents from Russia's oil and gas remains complex. The struggle for this power is intense and has numerous implications for Russia's continued federalization and state-building. Clearly, control

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[24] Leslie Dienes, *Corporate Russia: Privatization and Prospects in the Russian Oil and Gas Sector*, Paper No. 5 (University of Washington: Jackson School of International Studies, 1996), 11.
[25] Ibid., 43.
[26] Voorhees, "Russian Federalism and Reform."
[27] For more on this see Christine I. Wallich, ed., *Russia and the Challenge of Fiscal Federalism* (Washington, D.C.: The World Bank, 1994).

over oil and gas is a matter of shared jurisdiction and will require cooperation and compromise from all levels of government. Joint authority over all mineral resources, including oil and gas, is entrenched in Article 72 of the constitution of the Russian Federation. A central concern of this thesis then, is how "joint authority" is actually being interpreted and practiced.

Russian Federalism

Given the size and diversity of the Russian Federation, centre-regional relations are critical to federal state-building. The Russian federalization process is moving in the direction of differentiation discussed by Friedrich;[28] consequently, the relationship between the centre and the regions is changing quickly, profoundly, and often unpredictably. Nationalism is gaining strength in some regions, making central authorities wary about the extent and pace of decentralization.

Research on centre-regional relations in the Russian Federation is emerging. Some of the literature deals directly with the two regions studied here -- the Sakha Republic and Tyumen' Oblast.[29] Balzer and Vinokurova take a social anthropological approach to studying Russo-Sakha relations. Their focus is on the priorities of different political and cultural groups in Sakha, and the ways in which these priorities are sometimes compatible and sometimes clash. A notable conclusion is that the "best antidote against virulent forms of nationalism is a well-managed federalism."[30] Daniel Kempton takes a political-economic approach to Russo-Sakha relations, one which is more congruent with this thesis. Kempton concludes that the success Sakha has had

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[28] Friedrich, *Trends of Federalism.*

[29] Research on Sakha includes Marjorie Mandelstam Balzer and Uliana Alekseevna Vinokurova, "Nationalism, Interethnic Relations and Federalism: The Case of the Sakha Republic (Yakutia)," *Europe-Asia Studies*, Vol. 48, No. 1, 1996, 101-120; and Kempton, "The Republic of Sakha;" research on Tyumen' includes Bruce Kellison, "Siberian Crude: Moscow, Tiumen and Political Decentralization," in Stephen Kotkin and David Wolff, eds., *Rediscovering Russia in Asia: Siberia and the Russian Far East* (Armonk, N.Y.: M.E. Sharpe, 1995), 193-206; Alexei I. Ivandaev, "The Struggle for Power Allocation Between the Central Government in Moscow and the Administration of the Tyumen Region," in James E. Hickey Jr. and Alexej Ugrinsky, eds., *Government Structures in the U.S.A. and the Sovereign States of the Former U.S.S.R.: Power Allocation Among Central, Regional, and Local Governments* (Westport, CT.: Greenwood Press, 1996), 222-229.

[30] Balzer and Vinokurova, "Nationalism, Interethnic Relations and Federalism," 116.

in building regional autonomy stems from pursuing a "coherent strategy" to maximize its autonomy and the close interpersonal relations between Russian president, Boris Yeltsin, and Sakha president, Mikhail Nikolaev.[31]

As for Tyumen' Oblast, Bruce Kellison offers a comprehensive study which deals with decentralization to Tyumen', to the autonomous okrugs within Tyumen', to the municipality of Nizhnevartovsk, to the firm level, as well as the decentralization of Moscow's control in the oil industry. Kellison observes that, in Tyumen', Moscow still retains much of the authority over natural resource development that it enjoyed during the Soviet period, but that as market mechanisms take hold, "Moscow is finding it has less control than it would like."[32] Alexei Ivandaev's investigation of Russo-Tyumen' relations focuses on the oil and gas sector and on Tyumen's relationship with the Khanty-Mansiisk and Yamal-Nenets autonomous okrugs. It analyzes some of the legislation and presidential decrees that serve to define the relationship between Moscow and Tyumen'. Ivandaev asserts that in the power struggle between Moscow and Tyumen', "there has always existed a striving to be able to set quotas, to give out crude oil drilling and export licenses, and to be able to draw foreign investments into the local oil and gas industry."[33]

For the most part, Russia's current federal structure was inherited from the Soviet Union. The formal structure of the RSFSR included various types of territorial-administrative units, each with somewhat different rights. These included forty-nine non-ethnically defined oblasts, six krais, and thirty-one ethnically-defined "autonomous" areas; sixteen of the latter were republics, five were oblasts, and ten were okrugs. A significant modification was made to the RSFSR's administrative-territorial hierarchy in 1991, shortly before the disintegration of the USSR. The

[31] Kempton, "The Republic of Sakha," 608.
[32] Kellison, "Siberian Crude," 205.
[33] Ivandaev, "The Struggle for Power," 225-226; these issues are discussed in detail in Chapter two.

sixteen autonomous republics and four of the five autonomous oblasts received the status of "republic," while the rest of the subjects of the federation became grouped officially as "regions" (see Fig. 1-1).[34] These changes were later included in the Federation Treaty of March 1992 and the constitution ratified in December 1993.

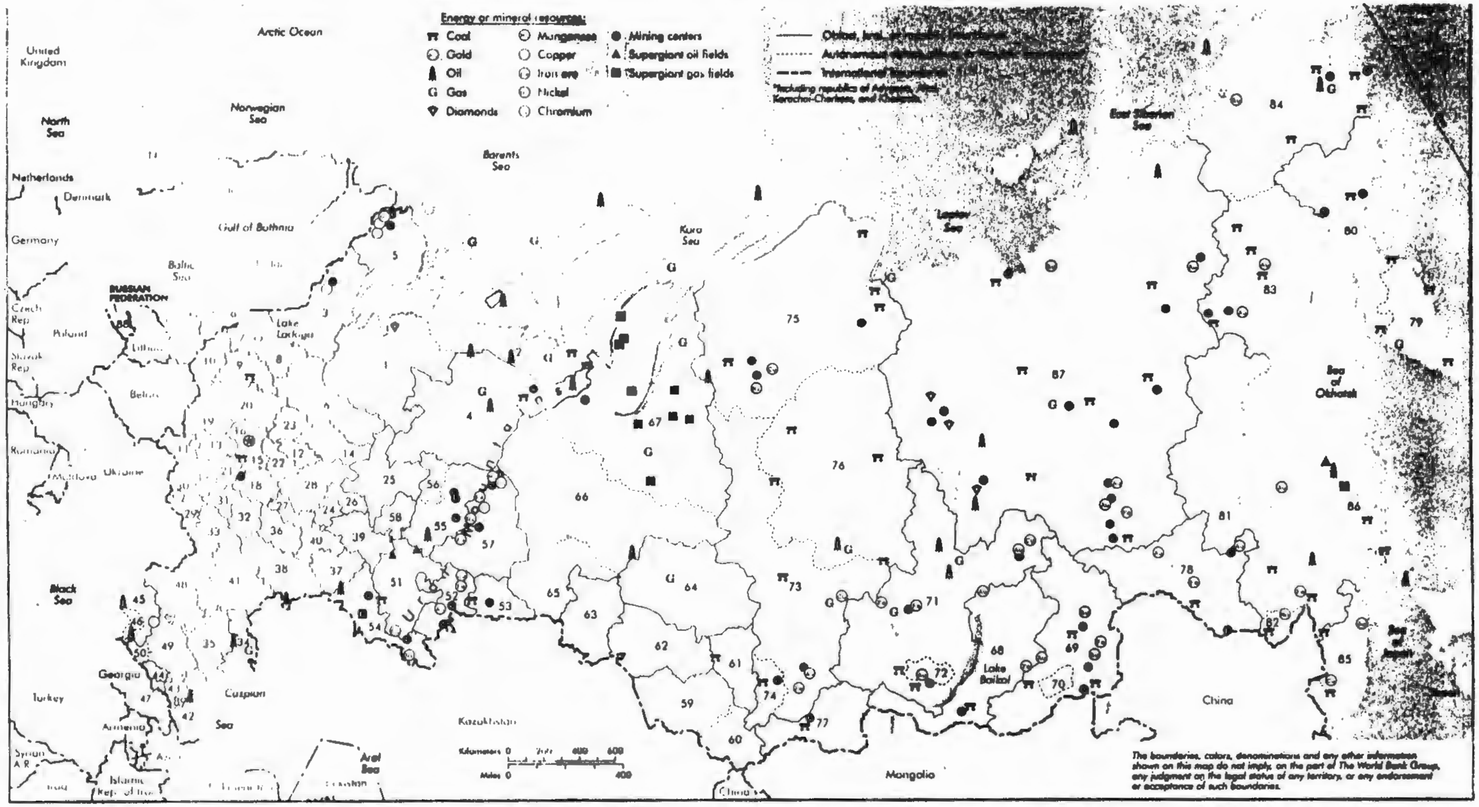
In a state as highly centralized as the Soviet Union once was, having ethnically-defined units was not a serious problem. However, with decentralization, ethnic nationalism gained momentum in many of Russia's regions. Long-pent up desires for greater regional autonomy or outright independence burgeoned in several regions, the most notable being the Chechen Republic. Many Russians supported the creation of new, non-ethnically defined regional units modeled after Canada or the United States.[35] They argued that a country as geographically large and ethnically diverse as Russia could neither remain united nor sustain democracy as long as administrative divisions reinforced ethnic ones. It has become clear, however, that political realities make it virtually impossible to carry out a redistricting aimed at abolishing existing administrative units.[36]

Since the collapse of the Soviet Union, the working relationship between Moscow and the regions has been both unclear and unstable. John Young identifies two main sources of confusion in early Russian federalism.[37] First is the asymmetry of the Russian Federation that allow different regions various degrees of power and authority. Autonomous republics possess rights and powers not afforded to other regions, such as the right to elect their own heads of

[34] Note that the term "region" refers herein to each of the eighty-nine subjects of the Federation, including republics.
[35] Sharlet, "The Prospects for Federalism."
[36] Gail W. Lapidus, and Edward W. Walker, "Nationalism, Regionalism and Federalism: Center-Periphery Relations in Post-Communist Russia," in Lapidus, ed., *The New Russia: Troubled Transformation* (Boulder: Westview Press, 1995), 79-114.
[37] John Young, "At the Bottom of the Heap: Local Self-Government and Regional Politics in the Russian Federation," in Larry Black, et. al., eds., *Beyond the Monolith: The Emergence of Regionalism in Post Soviet Russia* (Baltimore: Woodrow Wilson Center Press and John Hopkins University Press, forthcoming).

FIGURE 1-1

Map of Russia's Territorial-Administrative Structure and Natural Resource Endowments



1. Arkhangelskaia oblast
2. Nenetskii autonomous okrug
3. Republic of Karelia
4. Republic of Komi
5. Murmanskaia oblast
6. Vologodskaia oblast
7. St. Petersburg
8. Leningradskaia oblast
9. Novgorogskaia oblast
10. Pskovskaia oblast
11. Brianskaia oblast
12. Ivanovskaia oblast
13. Kaluzhskaia oblast
14. Kostromskaia oblast
15. Moskovskaia oblast
16. Moscow City
17. Orlovskaia oblast
18. Riazanskaia oblast
19. Smolenskaia oblast
20. Tverskaia oblast
21. Tul'skaia oblast
22. Vladimirskaia oblast
23. Iaroslavskaia oblast
24. Republic of Chuvash
25. Kirovskaia oblast
26. Republic of Marii-El
27. Mordovian Republic
28. Nizhniy Novgorod oblast
29. Belgorodskaia oblast
30. Kurskaia oblast
31. Lipetskaia oblast
32. Tambovskaia oblast
33. Voronezhskaia oblast
34. Astrakhanskaia oblast
35. Republic of Kalmykia
36. Penzenskaia oblast
37. Samarskaia oblast
38. Saratovskaia oblast
39. Republic of Tatarstan
40. Ulianovskaia oblast
41. Volgogradskaia oblast
42. Republic of Dagestan
43. Chechen Republic
44. Kabardino-Balkar Republic
45. Krasnodarskii krai
46. Republic of Adygeya
47. North-Osetien Republic
48. Rostovskaia oblast
49. Stavropolskii krai
50. Karachai-Cherkess Republic
51. Republic of Bashkortostan
52. Cheliabinskaia oblast
53. Kurganskaia oblast
54. Orenburgskaia oblast
55. Permskaia oblast
56. Komi-Permyatskaia autonomous okrug
57. Sverdlovskaia oblast
58. Udmurt Republic
59. Altaiskii krai
60. Republic of Altai
61. Kemerovskaia oblast
62. Novosibirskaia oblast
63. Omskaia oblast
64. Tomskaia oblast
65. Tyumenskaia oblast
66. Khanty-Mansiiskii autonomous okrug
67. Yamal-Nenets autonomous okrug
68. Republic of Buryatiia
69. Chitinskaia oblast
70. Aginskii Buryatskii autonomous okrug
71. Irkutskaia oblast
72. Ust'-Ordynskii Buryatskii autonomous okrug
73. Krasnoiarskii krai
74. Republic of Khakasia
75. Taimyrskii (Dolgano-Nenetskii) autonomous okrug
76. Evenkiiskii autonomous okrug
77. Republic of Tuva
78. Amurskaia oblast
79. Kamchatskaia oblast
80. Koriakii autonomous okrug
81. Khabarovskii krai
82. Jewish autonomous oblast
83. Magadanskaia oblast
84. Chukotskii autonomous okrug
85. Primorskii krai
86. Sakhalinskaia oblast
87. Republic of Sakha (Yakutia)
88. Kaliningradskaia oblast
89. Ingush Republic

Source: Richard M. Bird, et al., eds., *Decentralization of the Socialist State: Intergovernmental Finance in Transitional Economies* (Washington, D.C.: The World Bank, 1995).

executives, the right to a constitution rather than a simple charter (*ustav*), and preferential control over natural resources and budget revenues. This has inspired many oblasts and krais to campaign for the same rights as republics, or to be upgraded to the status of republic. An excellent example of this comes from President Yeltsin's native oblast, Sverdlovsk. In October 1994 regional leaders openly declared Sverdlovsk Oblast a sovereign republic.[38] The new republic was to be renamed the Urals Republic, and some neighboring regions, including parts of Tyumen' Oblast, were invited to join. Yeltsin's response was swift and harsh. Yeltsin issued presidential decrees that nullified Sverdlovsk's action and dismissed the regional chief executive. This demonstration of Moscow's authority served as a warning to other regional leaders with similar ambitions.[39]

During the first few years after the collapse of the Soviet Union, the issue of asymmetry in the Russian Federation generated fierce and passionate debate. On the one hand, oblast elites argued, and it was the "national elite's consensus," that asymmetry should be eliminated in favour of the political and economic equality of the regions.[40] On the other hand, many republic leaders insisted that the republics retain special status in a new constitution. Although no serious changes were made, "a positive outcome of the debate was that both groups of federation subjects agreed on the need for federalizing the Russian state. The central authorities, for lack of viable options, supported *de jure* devolution of authority, which was already being decentralized *de facto*."[41]

The second source of confusion in Russian federalism stems from the legal and constitutional status of the federal division of powers. Two main documents serve to define the existing arrangement of power between the centre and the regions. Although the republics of Tatarstan and Chechnya refused to sign it, the Federal Treaty, formally signed into law on 31

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[38] Sharlet, "The Prospects for Federalism," 122.
[39] Ibid.
[40] Ibid., 115-127.
[41] Ibid., 120.

March 1992, ameliorated some of the centre-regional tensions of the previous year. But the Federal Treaty was not an attempt to define and divide power between the centre and the regions and thus left many important issues unresolved. What was meant by the republics' ownership of land and natural resources was left unclear. The distribution of profits from exports between the centre and the regions, relative tax burdens, and the extent and distribution of subsidization of local budgets from the federal treasury were left to future negotiation or enacting legislation.[42] Consequently, studies such as this one is necessary to clarify how regions' ownership of land and natural resources is being defined and interpreted.

The Constitution of the Russian Federation did little more to clarify the federal division of powers. Belyakov and Raymond argue that unlike the Constitution of the United States, which "is vague and ambiguous and therefore broad enough to be interpreted in many different ways as expediency demands, the Constitution of the Russian Federation is specific down to the most minute detail ..."[43] However, in the Russian constitution the issue of the federal division of powers is certainly not "specific down to the most minute detail." In fact, Article 72 outlines fourteen areas that fall under the joint authority of the federal and regional governments. Section 1:j alone places under "joint authority" the authority to legislate on labour, family, housing, land, water, forests, environmental protection and, notably, mineral resources, so the number of "areas" is really much larger.[44] The lack of clarity regarding the intergovernmental division of powers has forced the central government to negotiate dozens of bilateral agreements with regional governments on these issues of joint authority.

This all suggests that Russian federalism is truly confusing. But if we bear in mind that Russia is in the early stages of the process of negotiating a federal division of powers, then this

[42] Walker, "Federalism --Russian Style."
[43] Vladimir V. Belyakov and Walter J Raymond, eds., *Constitution of the Russian Federation* (Lawrenceville, VA: Brunswick, 1994), 9.
[44] Ibid., 41-43.

confusion is less surprising. The federal division of powers is not a static phenomenon in any federally organized country, much less one trying to rebuild from rubble.[45] At the present time Russia probably satisfies some of the aforementioned conditions for federalism but not others. But rather than trying to conclude whether or not the Russian Federation is in fact federal, this thesis investigates two more specific aspects of Russian federalism: it seeks to determine whether the intergovernmental division of powers and the distribution of control in the Russian oil and gas sector reflects what would be expected in a federally organized country and how the redistribution of control over oil and gas is affecting Russian "federalization".

Research Design/Methodology

The process of federalization in Russia has clearly begun, but it remains debatable whether or not Russia is now a federation. How may we determine the nature and extent of Russian federalization? At this early stage of Russian federalization, "indirect approaches like fiscal federalism or comparative constitutional analysis may offer insights into distributional questions but reveal little about issues of jurisdiction."[46] By analyzing distinct issues of policy, the working division of powers can be more accurately assessed than with a purely constitutional analysis. This is especially true in the case of Russia because the Russian constitution is merely three years old and assigns many issues to the "joint authority" of the Russian Federation and the subjects of the Russian Federation. Thus, the manner in which joint authority is being interpreted in different policy arenas and the variation of interpretations between regions will be key indicators of the nature and extent of Russian federalization.

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[45] Martin Malia, "From Under the Rubble, What?," *Problems of Post-Communism*, 8: 3, 1992, 197-238. Malia uses the "rubble" metaphor aptly in reference to the what was left behind after the collapse of the USSR.
[46] Solnick, "The Political Economy of Russian Federalism."

A study of Russia's oil and gas sector serves to illuminate the nature and extent of Russian federalization. For several years now, Russia's federal centre has been involved in negotiations with oil and gas producing regions, as both sides are seeking to control the development of, and revenue from these extremely valuable commodities. And woven into these negotiations, of course, are the oil and gas industries. A study of the Russian oil and gas sector will also help generate some conclusions about the future of Russian federalism.

By analyzing the newly emerging distribution of control over Russia's oil and gas, we may better understand the processes of decentralization and federalization, particularly as they relate to the Russian Federation. The analysis has two main components. The first is an examination of the levers of control in the Russian oil and gas industries -- legislation and licensing, privatization and industrial organization, export quotas and pipeline access, prices, and taxation and rent -- to determine the extent of decentralization. As the oil and natural gas industries are of strategic importance and integral parts of Russia's future economic plans, they are key to federal state-building in the Russian Federation.

The second component is an analysis of decentralization in the Sakha Republic (Yakutia) and Tyumen' Oblast. From this analysis, it is argued that resource wealth is a considerable source of political power and may lead directly to greater regional autonomy.[47] Tyumen' Oblast and the Sakha Republic are good examples in the study of Russian federalism for several reasons. First, in terms of natural resources, Tyumen' and Sakha are two of Russia's wealthiest regions, yet they have some of the lowest standards of living in all of Russia. Second, they are, geographically, two of Russia's largest regions. Third, each is a northern region with a number of indigenous peoples.

[47] *Prima facie*, this is a common sense argument that regions with natural resources should be able to acquire greater political autonomy than regions without many resources. While it is beyond the limitations of this thesis to do extensive case studies of other regions, the case of the Tuva Republic is a good example of a negative case scenario to add validity to this central thesis. Tuva has republic status but few economic or natural resources, thus, the political autonomy derived from its status as a republic is severely diminished by its financial dependence on the Russian government in the form of federal subsidies.

Fourth, the Sakha Republic has been one of the most aggressive of the autonomous republics in challenging the authority of Moscow, while Tyumen' has been one of the most aggressive oblasts. Fifth, the presence of two autonomous okrugs within Tyumen' Oblast allows for an examination of another key aspect of Russian federalism, that is, the web of relations between the centre, a region, and "autonomous" regions within a larger region. Finally, in terms of autonomy (assuming of course that autonomy is a relative and not absolute term), Sakha is now one of Russia's most autonomous republics, while Tyumen' is one of the most autonomous oblasts. The thesis addresses how and why these two regions have secured more autonomy than others. Although a trip to Tyumen' was not possible, a three month visit by the author to Sakha yielded useful information about the region. Ideally, more regions would be included, but the aforementioned factors serve to make these two regions highly interesting and informative, if not optimal, examples in the study of Russian federalism.

Chapter 2

THE RUSSIAN OIL AND GAS SECTOR

Introduction

Oil and gas revenues are enormous in many of Russia's regions and a vital source of revenue for the central government. In 1993, approximately 20 percent of central government revenue came from special taxes on oil and gas and if all taxes had actually been paid, it is estimated that more than 30 percent would have come from the oil and gas industry.[48] Also, oil and gas exports consistently account for around 50 percent of Russia's foreign currency earnings. Oil and gas are unquestionably Russia's most valuable revenue sources. As Yuri Shafranik, Russia's Minister of Fuel and Energy, espouses, "oil and gas are the best wealth of Russia's today."[49]

The authority of the Soviet institutions that formerly managed the oil and gas industries was immediately challenged by the regions, and by others such as the mafia and the industry elite. As regional governments strive for more political power and authority, they must seek out new and greater sources of revenue to support new responsibilities. Decentralization of political power and authority is not particularly useful unless it is accompanied by sufficient decentralization of revenues and economic resources.

This chapter analyzes recent developments in the Russian oil and natural gas industries focusing on the economic *and* political decentralization of control, or rather the lack thereof. Since the collapse of the highly centralized Soviet system, some control over oil and gas resources

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[48] Matthew Sagers, et al., "Resource Rent From the Oil and Gas Sector of the Russian Economy," *Post-Soviet Geography*, Vol. 36, No. 7, 389-425, 390.
[49] Shafranik is quoted in Victor Kuznetsov, "Is the Gift of Nature Profitable?," *New Times*, July 1995, 1-3.

has shifted away from Moscow. But to what extent has the industry decentralized? How has it occurred? Who now controls Russia's oil and gas resources? And what are the consequences for Russian federalism?

The structure of ownership and control in Russia's oil and gas sector affords Russia's natural gas monopoly, Gazprom, and the major oil companies tremendous power and influence. These are some of the richest companies in all of Russia and they are beginning to diversify their portfolios, particularly with acquisitions in the Russian media. For example, the oil major, Lukoil, now owns 10 percent of the television channel "TV6" and 19 percent of *Izvestia*, arguably Russia's best all-round daily newspaper; Gazprom owns outright the television channel "ORT", and has recently bought 30 percent of the television channel "NTV" and 20 percent of *Komsomolskaya Pravda*, a top-selling middlebrow newspaper.[50] These purchases are testimony to the wealth and power generated from Russian oil and gas, and the strong presence of these companies in the Russian media makes them integral players in Russian politics and society.

Several key "levers" (*rychagi*) are used to control Russian oil and gas -- (1) legislation and licensing, (2) privatization and industrial organization, (3) export quotas and access to pipelines, (4) prices, and (5) taxation. Power in the Russian oil and gas industries rests with those people and institutions in control of these levers. An analysis of these levers will result in a better understanding of how control over Russian oil and gas resources, and revenues from them, are distributed. This chapter begins with an examination of the Russian oil industry, followed by a similar analysis of the Russian natural gas industry. The struggle for control over oil and gas resources remains a source of conflict in Russian politics, and this control (or lack of it) may determine whether the central, regional and local governments possess the funds necessary to operate effectively.

[50] "Russia's media: All the news that fits," *The Economist*, 15 February 1997, 50-51.

The Oil Industry

After years of astounding increases in production levels during the 1970s and 1980s, mostly as a result of rapid development in western Siberia (see Table 2-1), the Russian oil industry is in decline, though it remains one of the largest sectors of the Russian economy. Figure 2-1 shows Russia's main oil regions. During the final few years of the Soviet Union, the oil industry was pushed to the brink as oil export revenues were used in a desperate attempt by the Soviet elite to preserve the communist system. The Russian oil industry is still reeling, mostly due to the lack of key pieces of legislation, industrial reorganization, a lack of clarity concerning exports and pipeline access, pricing problems, and the confusing tax regime for the oil industry.

TABLE 2-1

Oil Production for Russia and West Siberia, Selected Years, 1980-1993 (in million b/d)

	Total for Russia	*West Siberia's Share*
1980	10.94	6.44
1985	10.84	7.32
1988	11.36	8.28
1993	7.08	4.40

Source: Robert Ebel, *Energy Choices in Russia* (Washington, D.C.: The Center for Strategic & International Studies, 1994), 9.

FIGURE 2-1

Map of Russia's Major Oil Regions

Source: Ebel, *Energy Choices in Russia*, 27.

Legislation and Licensing

Federal oil legislation has developed significantly over the past six years, as the central government has attempted to assert control over this critical sector of the economy, but some key pieces of legislation are still lacking. During this period of legislative development, many players -- notably the mafia, the oil industry elite and regional governments -- have been vying to usurp some of the centre's control over the oil industry. Oil producing regions are competing directly with the Russian government for the power to enact oil and gas legislation, and there are a number of issues which yet require much attention.

The legislation that has guided the entire natural resource sector since the collapse of the USSR is the Subsoil Act, adopted by the RSFSR in February 1991. The main feature of the Act is that it preserves central government ownership of all subsoil resources. The Act was intended to serve as an "umbrella" mineral resources law and was perceived as a general framework within which more detailed amendments could be made.[51] The oil and gas industry has thus far been forced to comply with the Act, but it is widely understood that a distinct Russian oil and gas law is essential, as this is the case for every oil and gas producing country in the world.[52]

On 10 September 1992, a draft energy plan entitled "The Conception of the Energy Program for the Russian Federation" was approved by the Russian government.[53] The plan's main proposal was to revive the fuel energy complex "by forming a regulated energy market, in which trade is based on world prices and the internal convertibility of the ruble, with indirect price controls exercised by the state through taxation and other means."[54] The scientists and engineers involved in the formulation of the plan agreed that state control over domestic energy prices was

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[51] P. Cameron, "Investing in Russian Oil and Gas: The Legal Factor," *Petroleum Review*, March 1993, 120-121.
[52] Ibid.; see also, Alan Jones, "Energy and Developing Law in the Russian Federation," *Petroleum Economist*, July 1992, 9-15.
[53] A. A. Makarov et. al., "The Conception of the Energy Policy for Russia in the New Economic Situation," *Thermal Engineering*, Vol. 40, No. 1, 1993, 1-6.
[54] Ibid., 3.

the chief problem for the energy sector, but prices continue to be held at artificially low levels by the state (see below). Although the plan was a step forward, the need for a distinct Russian oil and gas law remained.

In 1994 Russia finally had a draft Law on Oil and Gas put before the State Duma (i.e. Russian parliament). There were six main provisions in the draft Law.[55] First, ownership rights for oil and gas were to be certified by licenses issued by the State Committee for Geology and the Use of Subsoil Resources, Roskomnedra. Second, "duly authorized government agencies" were to have the power to compile a list of projects that would be subject to licensing through closed tenders to which only Russian enterprises would be admitted. Third, in "exceptional cases," and by decision of the government of the Russian Federation, a development license could have been issued without holding a tender or auction. Fourth, licenses could have been assigned from one company to another with all the rights and obligations of the license, but only with the approval of Roskomnedra. Fifth, a "grandfather clause" existed which would have protected license holders from legislative or regulatory enactments adopted after the purchase of the license, save for changes relating to the protection of the environment and to labor safety.

Lastly, and most important to this thesis, the Law provided for the creation of a "federal fund" consisting of oil- and gas-fields that are considered to fall under the jurisdiction of the Russian government. These included fields for which no prospecting or development licenses have yet to be issued. According to Gennady Shalmanov, the chairman of the main joint board of legal and normative-legal support of the Ministry of Fuel and Energy, "the process of developing the list of fields to be included in the Federal Fund is very likely to create tension between Moscow and regional governments, which eventually may turn into major conflicts over some of

[55] "Nothing is Easy," *Russian Petroleum Investor*, June 1994, 26-27.

the more attractive deposits."[56] With the power to issue development licenses, Moscow would retain one of the most important levers of control over the oil industry. Regional governments, however, continue to fight for this power.

Given the importance of oil and gas in Russia's economy, it might be expected that passing an oil and gas law would be a serious challenge. Indeed, this has been the case. On 27 May 1994, the draft Law on Oil and Gas failed to pass the Duma.[57] Several parties boycotted the vote, thus, a mere 251 of the parliament's 450 deputies were present and, due to the low turnout, the measure received only 211 of the 226 votes needed for passage. Unfortunately, the latest draft of the Law on Oil and Gas also did not resolve the issue of joint ownership and jurisdiction over resources between Moscow and the republics.[58] It is certainly possible that very powerful interests are benefiting from legal uncertainty, and are working to ensure that it persists. But, after some amendments to the draft Law, Russia should have a Law on Oil and Gas in place in the not too distant future.

One piece of legislation which has passed is a production-sharing-agreement law (PSA) which became operative on 30 December 1995. The law is a "blueprint" for contracts between Russian and foreign oil companies, but it must be emphasized that the law applies to both foreign and domestic investors. The "primary purpose of any production sharing arrangement is to offer a stable, attractive tax regime fixed for the full term of the Agreement and operating outside the normal legislative framework in return for a share of production."[59] Investment in Russia's oil industry is still hampered by an unfavorable and unstable tax regime where taxes "change every day and are imposed retroactively." It was hoped that a production sharing law would provide a

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[56] Ibid.
[57] Ibid.
[58] Leslie Dienes, *Corporate Russia: Privatization and Prospects in the Oil and Gas Sector* (University of Washington: Jackson School of International Studies, 1996), 34.
[59] Chris Ferguson, "Russian Law - production sharing agreements," *Petroleum Review*, February 1996, 60-62.

mechanism to make taxes stable throughout the term of an investor's involvement. As one analyst suggests, the PSA "does not steal from the state - it bars the state from stealing."[60] Production sharing agreements are common in countries with unstable tax systems such as Russia.

The PSA also met several challenges before being enacted. The chairman of the Federation Council, Vladimir Shumeiko, personally led a campaign for the defeat of the PSA while conceding that the law is "very necessary for the country" and that with new amendments, the law would be passed by parliament. Shumeiko's spokesman, Yuri Algunov, suggested that this contradiction stemmed from the fact that the bill offered "no guarantee that the share in decision-making and the share of income for local [i.e. regional] governments was properly secured."[61] The bill failed in the Federation Council by a large margin on 3 October 1995, and on 27 October the Duma fell 12 votes short of the 300 necessary to override the veto. It was another three months before the PSA was passed by both houses of parliament and became operative. However, a reconciliation commission introduced highly restrictive amendments to the original version that will make the law completely unworkable -- disputes arising from the PSA must be resolved in Russian court, and the final version gives the state the right to unilaterally amend the terms of any agreement in the case of "drastic changes in market conditions."[62]

Thus, acting collectively via the Federation Council, Russia's regions were able to force amendments to guarantee a share of control at the regional level. However, this may not have been the only motive behind the amendments. Mikhail Subbotin, one of the bill's authors, maintained that Shumeiko was simply flexing "his political muscle." Shumeiko was implicated in

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[60] Yulia Latynina, "Absurdity: Adventures of the Law on Production Sharing, or a Dog in the Well," *Sevodnya*, 2 November, 1995, 3, translated in *Current Digest of the Post-Soviet Press*, Vol. XLVII, No. 44, 1995, 8-9.
[61] Steve Liesman, "Russian Oil Bill Still Alive," *Globe & Mail*, Friday, 6 October, 1995, B7.
[62] Dienes, *Corporate Russia*, 34.

several financial scandals and may have been trying to secure his position as chairman of the Federation Council, then an appointed body.[63] Furthermore,

> [w]hile it was publicly claimed that the late amendments were added to placate conservative elements opposed to Russia's strategic resources falling into the hands of rapacious foreigners, it is likely the real reason behind the amendments was to enable the legislature to wrest control of the process from unaccountable civil servants. In a country known for its corruption, where none of the normal constitutional checks and balances are in place, the legislature felt the need to oversee the agencies negotiating the Agreements.[64]

It is likely that taking power out of the hands of "unaccountable civil servants" was indeed an intended consequence, but the power of Russia's "conservative elements" should not be so easily dismissed or underestimated. Many communists and nationalists still favour full state control over oil, at both the national and regional levels.

Environmental legislation has a profound impact on the Russian oil industry, but it is still evolving and remains vague. There is little doubt that this is an area where stable, consistently enforced legislation is critical. Soviet oil production left a legacy of environmental abuse and post-Soviet Russia's lingering instability has done little to ameliorate the situation. Since 1991, accident rates at well sites and along pipelines have been increasing as a result of the overall aging of the capital infrastructure and a decrease in maintenance and safety practices.[65] That the power to protect the environment has yet to be vested at a single level of government has led to confusion and corruption, with oil producers often receiving conflicting information from federal, regional and local authorities.

Environmental protection is an area where regional control may be appropriate, as there are likely variations between regions as to what are acceptable environmental costs reflecting the

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[63] Liesman, "Russian Oil Bill Still Alive."
[64] Ferguson, "Russian Law," 60.
[65] James Peterson, "Russia's Environment and Natural Resources in Light of Economic Regionalization," *Post-Soviet Geography*, Vol. 36, No. 5, 1995, 291-309.

diversity of regional economies. Indeed, in a recent treaty on the demarcation of powers, Moscow for the first time went so far as to delegate to the Republic of Udmurtia "sole authority" over the environment, and similar treaties are on the table for Krasnodarskii Krai, Kaliningradskaya Oblast and Komi Republic.[66] Other powers demarcated under the Udmurtia treaty included the demarcation of state property ownership, the organization and management of customs affairs, and the possession, utilization and disposition of forest and petroleum resources, all of which affect the oil industry. Moscow may have simply downloaded some of these responsibilities, but the agreement does give Udmurtia considerable power and authority. As with other centre-regional agreements, the Udmurtia agreement should set a precedent for the other autonomous republics of the Federation and perhaps other regions as well. Whether delegating to regional governments the power to protect their environments will make enforcement more predictable for the oil industry remains to be seen; what is important is that that this power is beginning to be consolidated at the regional level.

As with many aspects of Russia's transition period, Russian oil legislation is characterized by instability. Enacted laws are still immature and some critical legislation is lacking (most notably the Law on Oil and Gas), which leaves the industry with some unresolved issues. Stability will be difficult to achieve without a comprehensive oil and gas law to serve as a "constitution" for the industry. And with the federal division of powers far from complete, the situation remains very fluid. Thus, although the Russian government is still the legal owner of all subsoil resources, regional governments have earned a measure of control and collectively Russia's regions have exercised power through the Federation Council, using the upper chamber of parliament to force amendments to critical pieces of oil legislation.

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[66] Nadezhda Bannikova and Dmitry Kamyshev, "Relations Between the Capital and the Regions: Special Relations Will Help the Capital Deal With Udmurtia," *Kommersant-Daily*, 18 October 1995, p. 3, translated in *Current Digest of the Post-Soviet Press*, Vol. XLVII, No. 42, 1995, 16-17.

Privatization and Industrial Reorganization

An intense struggle over the future direction of the Russian oil and gas industry began in early 1992. Victor Chernomyrdin, then Deputy Chairman of the Council of Ministers in charge of energy, was largely responsible for overseeing the reorganization of the industry. Positions on this issue ranged from complete nationalization of the oil industry to all out privatization. Months of discussion culminated with Presidential Decree No. 1403,[67] signed on 17 November 1992. The decree regulated the procedure for privatization and stock issuance of enterprises in the oil industry and it envisaged the creation of four large oil companies in which the federal government would hold a controlling stake.[68] Lukoil, Surgutneftegaz and Yukos were established as vertically integrated joint-stock companies (JSCs) while the fourth, Rosneft', acts as a holding company for the state throughout the industry. In 1993 these four organizations controlled over ninety percent of Russian oil output.[69] Since 1993, other vertically integrated companies have been established, including the Orenburg Oil Company (ONACO), Slavneft', the Eastern Siberian Oil Company (Vostok), and the Siberia Far Eastern Oil Company (Sidanco). Given the absence of a comprehensive state policy in the oil and gas sector, decree No. 1403 noted only general "outlines" of the process of privatization and left resolution of many issues "for the future."[70]

As the names of these "oil majors" suggest, each has carved out a geographic sphere for itself which has led not to increased competition but rather the creation of geographical oil monopolies controlled by oil "generals."[71] The lack of competition in bidding for development

[67] The decree is titled, "On Special Features of the Privatization and Transformation into Joint-Stock Companies of the State Enterprises, Production, and Scientific-Production Associations of the Oil and Oil Refining Industry and Petroleum Product Supply".
[68] Arild Moe and Valeriy Kryukov, "Observations on the Reorganization of the Russian Oil Industry," *Post-Soviet Geography*, Vol. 35, No. 2, 1994, 89-101, 90.
[69] Ibid.
[70] Ibid., 90-91.
[71] Robert Ebel, *Energy Choices in Russia* (Washington, D. C.: The Center for Strategic & International Studies, 1994), 25-26.

licenses makes it extremely difficult to make an accurate valuation of individual deposits or fields. From the outset, the oil majors were made responsible by the Russian state for supplying oil products to specific regions (although a few regions were not assigned a supplier). For example, Sidanco supplies oil products to the regions from Baikal to the Far East. V. V. Razuvaev argues that, by and large, "this circumstance has led specifically to the practice of combining the overt monopolism prescribed from above with the more covert competition between companies in the "non-assigned" regions."[72]

With the reorganization of the industry, the oil majors have usurped a great deal of power and influence and are in the middle of some of Russia's biggest political struggles. As an article in *The Moscow Times* reported,

> the major oil companies are already at the hub of all the country's basic domestic conflicts: those between the military-industrial complex, the agricultural sector, and the energy sector; between the center and the regions; and between political forces which favor protectionism and those which support an open economy ... [R]elations between the oil companies and the [central] government will remain tangled for the foreseeable future.[73]

The approach to privatization, or rather destatization, of the Russian oil industry had four basic features.[74] First, privatization of oil industry was unified in character, that is, differences in approach were determined not by the specifics of the entities, but by their degree of "readiness" for transformation -- companies were forced to demonstrate that they were prepared to privatize before they were permitted to do so. Second, the federal level played an active decision making role regarding the creation of independent companies and the dismantling of existing production associations. Third, Rosneft' was given a significant portion of shares in reorganized enterprises

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[72] V. V. Razuvzev, "The Oil Companies in Russian Politics," *Russian Politics and Law*, March-April 1996, 71-81, 75.
[73] Vladimir Razuvayev, "Managing Russia's Oil," in *The Moscow Times*, 12 March 1995, 25.
[74] Moe and Kryukov, "Observations," 90-91.

in the oil industry. Fourth, dividends from state shares and revenues from privatization were to be allocated to finance technical re-equipment, reconstruction, and expansion of the production capacities of oil-sector enterprises.

In appearance, privatization has decentralized the oil industry, but in practice power remains highly concentrated in the hands of the oil majors and in the federal Ministry of Fuel and Energy via Rosneft' and Roskomnedra.[75] There is no question that the central government supports the continued growth of the vertically integrated oil majors. A good example is the manner in which central authorities quashed the bid for regional independence by the production association, Permneft'.[76] In mid-1995, Lukoil acquired Permneft's refinery assets and subsequently the whole company. Lukoil acquired Permneft, and later eight more regional oil firms, through direct transfer from the Chernomyrdin government. The direct transfers increased Lukoil's reserves by one-third and its production by 29 percent. The move also gave Lukoil a virtual monopoly on exploration, development, processing, and transit routes from the upper Kama River to the Caspian Sea, except in the republics of Tatarstan and Bashkortostan. The political implications of the transfers, just as election campaigning was approaching, were only too obvious;[77] as the head of Lukoil, Vagit Alekperov, publicly supported President Yeltsin's re-election.[78]

The oil sector continues to be based upon the Soviet principle of a "single production and technological complex", within which *production associations* (PAs) are the core units. Many production associations hold regional monopolies, a situation which affords the presidents of PAs a great deal of power. In turn, within production associations, actual production is carried out by

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[75] Ibid., 94-97; see also Valeriy Kryukov, "Industry Profile. Siberian-based Oil Companies," http://solar.rtd.utk.edu/friends/siberia/eco_bus/f2_6.html, 1-2.
[76] The Permneft example is from Dienes, *Corporate Russia*, 32.
[77] Ibid.
[78] Robert Orttung, "Lukoil Head Backs Yeltsin," *OMRI Daily Digest*, 17 April 1996.

production organizations (POs), sometimes referred to as field directorates. While PAs manage almost all ancillary services -- supporting transport services, rig assembly and well maintenance, as well as preparation of tracts for drilling, management of drilling operations, exploration, etc. -- POs are normally engaged in only one or a few of these tasks.[79] As was the case in the Soviet oil industry, POs are highly subordinate to their respective production associations, particularly financially.

Production organizations are in a position similar to local governments; that is, most desire greater autonomy but lack the financial stability and independence to realize this goal. Superordinates (in this case PAs and holding companies) are reluctant to delegate power and continue to control the finances of POs. But there have been some tendencies towards economic pluralism. In 1987-88, under the Soviet "Law on State Enterprises", some POs were given a more independent status as state enterprises which enabled them to establish their own bank accounts and gave them more control over operational decisions, such as negotiating and paying service organizations; but by 1991, only 15 of 140 POs had received this status, most notably the POs of the largest production association at the time, Nizhnevartovskneftegaz.[80]

One PO from Nizhnevartovskneftegaz PA, however, successfully gained full autonomy, the only instance of such to date. In 1990 Chernogorneft' successfully "seceded" from Nizhnevartovskneftegaz, employing cleverly the Law on State Enterprises. The general director of Chernogorneft', S. Volkov, managed to take the PO completely private by transforming it into a "leased company" (*arendnoye predpriyatiye*). Such a risky entrepreneurial act could not have succeeded without the acquiescence of highly placed people in Moscow and it "was perceived by other POs that it would have been impossible to duplicate at the time;" Volkov, a former

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[79] Moe and Kryukov, "Observations," 92.
[80] Ibid.

Communist Party official, had connections in Moscow that "were simply too good."[81] Other POs aspiring for independence have not had similar success and remain under the "tutelage" of their respective PAs. Similarly, PAs remain subordinate to their respective holding companies, although there have been some exceptions in the autonomous republics.

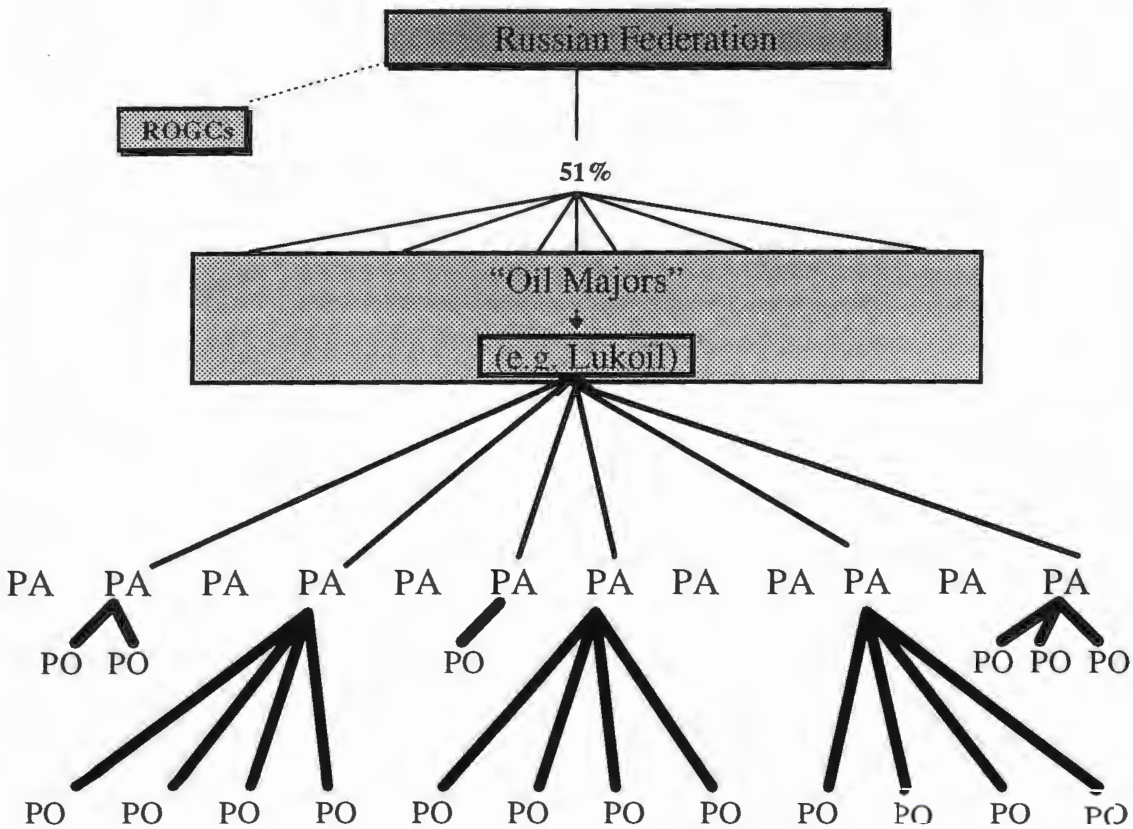
It is largely the structure of ownership that has perpetuated centralization in the Russian oil industry (see Fig. 2-2). The major Russian oil companies have been established as holding companies, amalgamating existing PAs and having a 38 percent stake in each. It is important to note that a 38-percent share is a controlling share, since 25 percent of all shares are non-voting shares distributed to employees.[82] While in decree No. 1403 of 17 November 1992, the relationship between holding company and subsidiary is represented as primarily financial, and on paper the arrangement appears to support the independence of subsidiaries, as long as the vertically integrated companies hold controlling shares they will retain tight control over their subsidiaries, regardless of their status as joint-stock companies or state enterprises.

As most production associations operate in a given region, they tend to have close ties with regional governments. Just as autonomous republics have secured a relatively high degree of autonomy from the federal government in the political arena, republican governments have also earned a significant degree of control over their oil and gas resources by establishing republic-owned oil and gas companies. For example, the autonomous republics of Komi, Tatarstan, Bashkortostan and Sakha (Yakutia) have all formed their own oil and gas companies, Komineft', Tatneft', Bashneft' and Sakhaneftegaz, respectively. These are all former PAs that

[81] Bruce Kellison, "Siberian Crude: Moscow, Tiumen, and Political Decentralization," in Stephen Kotkin and David Wolff (eds.) *Rediscovering Russia in Asia: Siberia and the Russian Far East* (Armonk, N. Y.: M. E. Sharpe, 1995), 193-206, see 200-203.
[82] Moe and Kryukov, "Observations," 94.

FIGURE 2-2

Organizational Structure of the Russian Oil Industry



PA=Production Association
PO=Production Organization
ROGCs= (Autonomous) Republic Oil and Gas Companies

have been appropriated by regional governments since 1991. While most PAs tend to hold regional monopolies in their geographic domain, none have earned outright independence from their holding companies as is the case with these republic-owned companies.

The Russian Federation maintains a 45 percent stake in new vertically integrated holding companies. Of the remaining 55 percent, 40 percent was sold at investment auctions and 15 percent to employees and residents of the producing area. But again, 25 percent of the non-government shares are non-voting shares, leaving the Federation with a controlling share.

> This allocation of shares in the new oil companies would appear to give federal authorities decisive influence in their operations. This impression is strengthened by a provision that grants the federal government the authority to appoint directors in these companies, and that stipulates that members of the companies' management board have to be approved by the government.... Government-appointed members of the respective boards of directors shall vote as a bloc according to government instructions. This set-up resembles companies in other countries where the state holds a majority of the shares. In these countries, the government does not interfere in daily operations of the companies, but can influence major strategic decisions that are brought before the board of directors or the general assembly.[83]

Thus, the oil majors are afforded a degree of independence, but the Russian government is not prepared to lose control over an "industry that poses an implicit threat to the government, since oil supplies are so vital to the stability of the economy and thus the society."[84]

Lukoil has been the most liberal of the Russian oil majors in terms of privatization, restructuring and foreign investment. When Lukoil was established in April 1993, the joint-stock company (JSC) had a book value of $29 million US. By mid-1994 its market value had reached $850 million US.[85] In a second phase of privatization, shares totaling 20.4 percent of the company's registered capital were offered to Russian investors and another 15 percent were

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[83] Ibid., 94.
[84] Ibid., 97.
[85] *Oil & Gas Journal*, 25 July 1994, 38.

offered to foreign investors. A further 10 percent of Lukoil shares, then owned by the state, were earmarked for sale through a voucher auction.[86] Lukoil's short term strategy involves stabilizing oil production, increasing refining capacity, doubling the number of retail outlets in Russia from the current 1,300, and expanding activities abroad. Lukoil has already exhibited a degree of independence from the federal government, but it remains to be seen whether the state will relinquish its controlling shares.

Rosneft' has also made shares available on the Russian market. A 1995 Presidential decree enabled the changing of Rosneft' into a JSC. As with the other oil majors, the state retains a 51 percent interest with remaining shares sold on the stock market.[87] While it is unlikely that the state will relinquish control of Rosneft' any time soon, shareholders may be able to exert pressure, and they may be able to influence the state on important strategic decisions.

The oil majors and some PAs have earned a degree of independence, but Moscow still controls key elements of the industry and retains ultimate decision making power with its controlling share in the major holding companies. It seems evident that from the beginning, the central government "intended to exert a large measure of influence over [production associations] through substantial ownership of stocks in the newly created holding companies. This influence, in fact, borders on control."[88] Production associations have significant control over daily operations and, due to their size, many continue to operate as geographical monopolies; but most remain subject to the strategic decisions of the holding companies. Finally, as with local governments,[89] many POs are being given more responsibilities without the requisite financial resources.

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[86] Ibid.
[87] *Oil & Gas Journal*, 17 April 1995, 28.
[88] Dienes, *Corporate Russia*, 10.
[89] See, for example, John Young, "At the Bottom of the Heap: Local Self-Government and Regional Politics in the Russian Federation," in Larry Black, et al., *Beyond the Monolith: The Emergence of Regionalism in Post Soviet Russia* (Woodrow Wilson Center Press and John Hopkins University Press, forthcoming).

Given the volatility of oil markets, the capital intensity of the industry and the high degree of risk involved, vertical integration of the Russian oil industry should not come as a surprise as it has proven to be a time-honored strategy worldwide. Russia's Fuel and Energy Minister, Yuri Shafranik, is confident that large, vertically integrated oil companies, as the basis for the organization of the Russian Federation's fuel-and-power complex, will guarantee the security of the domestic market and participate in the division of spheres of influence in the world market.[90] Vertical integration in oil industries is generally deemed necessary for efficiency, security and stability -- three things that are certainly in short supply not only in the Russian oil and gas industry, but in Russia's economy, politics, and society as a whole.

Export Quotas and Access to Pipelines

Given the instability of the Russian transition, the central government has taken measures aimed at protecting domestic oil producers and consumers. The wide differential between world prices and Russian domestic prices forced the central government to use a quota system in order to restrict the amount of oil being exported. Acting as agents for producers, "special exporters" (normally producers or trading companies) were the only legal entities legally authorized to export. The quota system was "a major policy instrument in regulating the oil industry, especially in maintaining the low internal price level," however, under intense pressure from the IMF and World Bank, the quota system was abolished.[91]

Initially, the Ministry of Economics set an aggregate quota based on expected production volumes and consumption requirements. The export quotas were then desegregated into assignments for producers by the Ministry of Fuel and Energy, but with assistance from the

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[90] Pyotr Zhuravlyov, "Government Decides to Manage Oil Complex," *Sevodnya*, 21 September 1994, translated in *Current Digest of the Post-Soviet Press*, Vol. XLVI, No. 38, 1994, 21.

[91] *Energy Policies of the Russian Federation: 1995 Survey* (Washington, D. C.: International Energy Agency, 1995), 131.

Ministry of Economics, the Ministry for Cooperation with CIS Nations and the Ministry for Foreign Economic Relations. The export quota system, however, was plagued by a problem typical of Soviet economic planning - that is, "problems in developing realistic forecasts for energy consumption resulted in a bottling up of too much oil on the domestic market."[92] This forced quotas to be repeatedly adjusted. While export quotas were designed to ensure domestic supply would be sufficient to meet consumers' (mostly refineries') needs, the actual result was a situation where refineries often had oil in excess of their capacity. In December 1994, a system of domestic quotas was proposed, but, since this would have jeopardized future IMF and World Bank loans, the plan was scrapped.

The oil export quota system was finally dismantled with a 31 December 1994, resolution, issued by Prime Minister Victor Chernomyrdin, which called for the liberalization of oil exports and "stipulated that the volumes of exportable oil envisaged for each producer should vary with the amount of oil produced."[93] The resolution was followed by a 6 March decree from President Yeltsin "that fully relaxed foreign trade and disbanded the institution of special exporters. It also revoked the many tariff concessions enjoyed by selected enterprises and regions, and explicitly prohibited the restriction of exports through a mandatory domestic sales target."[94] In lifting export quotas, the federal government has released its grip on one of the important levers of control over the oil industry.

As most oil pipelines are operating at or near capacity, a key issue has been pipeline regulation and access. This will be an even greater issue now that export quotas have been lifted because there will be increased attempts to export crude oil and petroleum products. The agency responsible for the overall pipeline system's operation is Transneft', which includes twelve

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[92] Ibid.
[93] Ibid., 132.
[94] Ibid.

regional pipeline associations organized as "daughter" JSCs.[95] As a natural monopoly wholly owned by the Russian government, Transneft' is "nominally a regulated common carrier operating under several existing laws (notably the Law on Natural Monopolies)" and is required "to offer nondiscriminatory pipeline services to all customers, including equal access to the network by all accredited shippers and nondiscriminatory tariffs."[96] When pipelines are operating at capacity, rules call for prorationing, but they do not specify precisely how this is to be done. Of course, this makes it difficult to be "nondiscriminatory." An independent regulating agency, known as the Federal Service, was established in March 1995, but its position remains weak.

Transneft' is a significant vehicle for the central government in maintaining central control over the oil industry:

> The pipeline monopoly has long ranked among the most immovable and impenetrable of Russian enterprises. It earned about $450 million US in profit for the government [in 1996]. But, to the frustration of its customers, little was re-invested in the pipeline system, which Transneft operates but does not own. ... Exporters have to wheedle quotas for pipeline use out of an opaque bureaucracy operated jointly by Transneft and the federal energy ministry. Pipeline charges are high, yet users are denied the stability of long-term contracts.[97]

Pipeline access and regulation are issues that will remain omnipresent in the oil industry as the desire to export increases and, at the same time, pipeline infrastructure continues to age and deteriorate.

Pipeline access is an issue which has a direct effect on Russian federalism because it transcends regional borders. With pipelines being centrally controlled by the Transneft' monopoly, disparities may result, even when the system is run honestly. Producers that are denied sufficient access to the pipeline network may be discriminated against. Nevertheless, if regions

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[95] Ibid., 125.
[96] Ibid., 128.
[97] "Russia's energy monopolies: Giving an inch," *The Economist*, 1 February 1997, 66.

controlled pipelines they could demand exorbitant prices, thereby denying producing regions precious revenues, leaving consumers helpless, and disrupting federal interests. Also, the Russian government must play a leading role because a lack of *interregional* regulation will undercut attempts at *intraregional* regulation. With Transneft', central control over oil transport remains secure.

Prices

The dilemma of oil prices is that while it is necessary, economically, for Russia to have a domestic oil price that is at or near world market value, it is currently almost impossible socially, and thus politically, to raise the price to such levels. Oil consumers are already having a difficult time paying their bills and rapid price hikes would bankrupt many Russian enterprises and leave millions of residential consumers without heat and power. Such a situation would leave Russia with a cold, unemployed, and thus angry electorate, and support for nationalist and communist parties would probably increase.

Prices tend to be the most difficult problem for the Russian oil industry. At the time of the collapse of the USSR, while the world price fluctuated around $20 US per barrel, the Russian internal price could be calculated in cents per barrel.[98] This was one of the principle causes of waste and inefficiency in the Soviet oil industry. Although the domestic price for Russian oil has now risen substantially, it remains state-controlled below the world market price. Presidential decree No. 23 of 17 February 1992 allowed enterprises to dispose up to 40 percent of their produced oil and gas at free prices (i.e. negotiated between buyer and seller), but these "free" prices are still well below world market prices.

[98] Cameron, "Investing in Russian Oil and Gas."

There are three serious problems that have arisen from artificially low prices. First, oil is often exported illegally by producers trying to get a better price for their product. These clandestine exports generally avoid taxation which allows the illegal exporter to capture virtually all of the resource rent (see below). In September 1992, the Department for Economic Crimes in the Russian Internal Affairs Ministry reported that the illegal export of unlicensed oil to Europe, most of which flows through the Baltics, cost the federal government 190 billion rubles (about US$950 million).[99] The so-called "oil mafia" has capitalized on new laws designed to encourage joint ventures in the once-restricted energy sector. In one case, a new joint venture, "approved by the government after presenting a detailed drilling schedule, never drilled a single well, even though it managed to conclude contracts for the sale of seven hundred thousand tons of oil. Its crude actually came from supplies already produced by government wells, and siphoned off with the collusion of officials."[100] Also of consequence, the murder of two western Siberian oil company presidents "has been widely interpreted as a manifestation of the effort of organized crime to take over parts of the oil industry."[101]

Regional authorities appear to be involved in clandestine oil sales as well, taking advantage of "market" prices. By decree No. 151 of the President of the Russian Federation, regional authorities were given the right "to establish regional trade and raw material "funds" through the purchase (at government-regulated prices) of up to 10 percent of the oil produced within their territory, and to sell part of this volume (up to 40 percent) at "free" prices."[102] Revenue from these sales were to be transferred directly to regional budgets. For 1992, however, it is estimated less than 2 percent of production (6.7 million tons) was sold on the commodity

[99] Stephen Handelman, *Comrade Criminal: The Theft of the Second Russian Revolution* (London: Michael Joseph, 1994), 226.
[100] Ibid., 114.
[101] Dienes, *Corporate Russia*, 35.
[102] Sagers et. al., "Resource Rent," 401-402.

exchanges, and overall, 20-30 percent of oil production was believed to have been disposed of outside state channels, so most of the increase in "free" oil sales occurred outside the exchanges.[103] Therefore, a good portion of oil was still being sold at government-regulated prices or through informal channels and much of the revenues never found their way into regional budgets.

A second major problem resulting from artificially low oil prices is that the price of almost every other domestically produced product is being distorted. The Russian oil price must eventually rise to world levels even though this will lead directly to further inflation. Full economic recovery and stabilization will be extremely difficult without raising domestic oil prices. And third, even with controlled prices, oil consumers owe the oil industry staggering amounts of money. Inter-enterprise debt is a huge problem for the Russian economy, but particularly for the energy industry, to which the bulk of these arrears are owed. Hence the economic necessity, but political difficulty, of allowing oil prices to rise to world market levels.

Inter-enterprise debt in the energy industry has been exacerbated by the aforementioned regional dimension of industrial organization, with selected companies supplying specific regions. Higher energy prices have led to acute energy crises in some regions. Some oil and gas suppliers have reduced or cut supplies to regions that have accumulated large debts. Without a choice among oil and gas suppliers, regions may be held hostage by their oil and/or gas supplier. In the city of Tver, for example, despite freezing temperatures in October 1996, heating stations were not being turned on because of the city's 210 billion ruble ($40 million US) debt to Gazprom.[104] Although mayor Aleksandr Belousov complained that two thirds of the debt was owed by federal institutions within the city, Gazprom still cut supplies to the city by 45 percent. A similar crisis

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[103] Ya. Ruderman, "Oil in Russia has still not become a stock market commodity," *Biznes-MN*, 4, 1993; cited in Ibid.

[104] Peter Rutland, "Cold War in Tver," *OMRI Russian Regional Report Part II*, Vol. 1, No. 6, 2 October 1996.

arose in Samara Oblast when the local power company, Samaraenergo, could not afford to pay its 1.5 trillion ruble (US$283 million) debt to its gas supply company, Samaratransgaz.[105] The problem stems the inability of residents and enterprises to pay their electricity and heating bills, which in turn makes power companies unable to pay the oil and gas companies. However, artificially low prices will simply allow this problem to fester into the foreseeable future.

With the authority to set prices, the central government holds one of the critical levers of power in the oil industry. Some regions, however, are being delegated more authority in setting oil prices. For instance, the legislature of Tyumen' Oblast, Russia's most important oil and gas producing region, has reserved for itself the right to set oil prices in the oblast.[106] But this does not include the vast majority of Tyumen' oil, which is sold to other parts of Russia or exported abroad.

Taxation and Resource Rent

Resource rent represents income generated in excess of what a producer would normally receive in terms of returns on investment (i.e. capital and labor). This type of income is possible because of low costs of production and/or transportation which, in turn, reflects favorable geological conditions and/or geographic location. Resource rent may accrue to producers as residual profit or surplus, to employees of producing firms in the form of higher wages, or to consumers as a result of lower prices. In most countries, however, "governments, as owners of the land or mineral resources in their states, attempt to capture most, if not all, of this resource rent through various means, usually through special taxes."[107]

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[105] Penny Morvant, "Energy Crisis Threatens Samara Oblast," *OMRI Russian Regional Report Part II*, Vol. 1, No. 3, 11 September 1996.
[106] Bruce Kellison, "Siberian Crude: Moscow, Tiumen, and Political Decentralization," in Kotkin and Wolff, eds., *Rediscovering Russia in Asia: Siberia and the Russian Far East* (Armonk, N.Y.: M.E. Sharpe, 1995), 193-206, 199.
[107] Sagers et al., "Resource Rent," 390.

Although Soviet enterprises were not subject to market relations, some still generated a type of rent because of favorable operating conditions leading to lower costs. In the Soviet oil and gas sector, low domestic prices led to a rent type income for some producers, regardless of whether they were exported or not, and "it appears that oil and gas rent alone were equal to about 40 percent of total budget revenues."[108] Of course, in the centrally-planned economy, virtually all resource rent was captured by the central government.

> Thus, the "rent" generated from the exploitation of the country's natural resources was largely directed toward the maintenance of the state-political system and the international expansion of the former USSR, and use was made of the levers of a planned centralized economy for its accumulation. The centralized state structure made it possible to subordinate the exploitation of resources in the territory of any geographic unit (including union republics and autonomous republics) to the common goals and interests of the dominant political system.[109]

Since the breakdown of the Soviet Union's "centralized state structure", lower levels of government have been scrambling to capture greater shares of resource rent. The oil industry is a prime target for many regional and local governments, particularly those with exporting producers within their territory.

The implementation of market relations in Russia has necessitated significant tax reforms. Much of the tax reform effort has been *ad hoc*, driven by the need to minimize budget deficits. For the oil industry, taxation has been unstable and oppressive, as the number of taxes and payments collected from oil enterprises for the federal, regional and local budgets is around 30, or even greater in some regions due to the relative power of regional and local governments to assess and collect taxes.[110]

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[108] Ibid., 395.
[109] Ibid., 393.
[110] Ibid., 414.

In the oil industry, four main taxes apply. First, the *export tax*, introduced in January 1992, was devised as a wedge between foreign and relatively lower domestic prices. Such a tax was necessary for the security of the domestic oil market. As world prices remained substantially higher than domestic prices, without the export tax the incentive to export would have been too intense, leaving domestic consumers with unaffordable oil, or no oil at all. This tax, in accordance with the Law "On Export Tariffs", is levied in rubles and paid directly into the federal budget.[111]

Second, the *excise tax*, introduced in August 1992, is levied as a percentage of sold product for all enterprises and varies according to individual enterprises' production costs. The excise tax is "the pre-eminent mechanism of collecting resource rent because of its variable, profit-sensitive character."[112] Proceeds from this tax normally go to the central government, however, their assignment to regional and local budgets is possible under certain arrangements between the federal government and its regional counterparts. For example, such an arrangement was concluded between the Russian government and Samara Oblast, where 50 percent of the excise taxes on oil produced in the oblast is transferred to the oblast budget for developing fuel sources.[113] However, the central government has been less accommodating with other regions. Dienes' account of a situation in Bashkortostan is a good illustration of this point. On 3 August 1994,

> Bashkortostan's government set a new excise tax on oil that is to be remitted to Moscow. The Bashkir action flatly contradicts the resolution of the federal government on a new excise tax. The federal government quadrupled the per ton tax payment and would have bankrupted Bashneft' in short order. (Maintaining a slim 3 percent profit rate would have required a selling price of 110,000 rubles per ton, impossible for refineries to pay). Bashkortostan's new excise tax amounts to only 39 percent of that previously paid and a mere tenth now demanded by Moscow.[114]

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111 Ibid., 416.
112 Ibid.
113 Ibid., 417.
114 Ibid., 34.

Thus, some regional governments have been successful in capturing all or a portion of this important source of revenue, but only through special deals with the Russian government.

Third, *royalties and bonuses*, introduced in mid-1992, are two other examples of rent-capturing mechanisms. Royalty (i.e. payment for use of the subsoil) rates have varied between 6 percent and 16 percent of the value of product sold (low-cost fields being subject to higher rates). A bonus, also payment for the use of the subsoil, is a one-time payment negotiated as part of the license bid and subject to minimums set by law. Revenues from royalties and bonuses go to all three levels of government -- 40 percent federal, 30 percent regional and 30 percent local -- although for "regions occupied by minority peoples and ethnic groups, some of the payments entering the federal budget are to be used for the socioeconomic development of these peoples and groups."[115]

Fourth, a *geology fee* is applied to all oil fields that have been explored by the Geology Committee or its Soviet predecessor. The geology fee is assessed as an *ad valorem* rate that has typically been 10 percent of the domestic sales price, with proceeds going to a special extrabudgetary fund used to pay for the geological exploration activities of the Geology Committee.[116] However, on 30 December 1993, the geology fee was changed under Government Resolution No. 1359. With the change, varying "rates by region and by enterprise were introduced to reflect the fact that enterprises are increasingly financing geological exploration themselves."[117] Thus, the geology fee is not a direct contribution to government budgets at any level, though the Geology Committee is a federal agency.

Not surprisingly, the system of taxation in the oil industry appears to favour the federal government. However, as this tax system evolves, some regional and local governments are

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[115] Ibid., 418.
[116] Ibid.
[117] Ibid.

challenging Moscow's position. On the one hand, the export tax continues to be paid entirely into the federal budget and the geology fee supports state-funded geological exploration. On the other hand, the regions are gradually achieving some control over revenues derived from royalties, bonuses and, most importantly, the excise tax. This is particularly the case for autonomous republics that have established republic-based oil and gas companies (see Chapter three). More time is needed before a clear and stable tax regime is established for the Russian oil industry.

Analysis of the Russian oil industry shows that the central government holds many of the important levers of control. The Subsoil Act states that the Russian Federation is the owner of all Russia's natural resources, although this conflicts with the Federal Treaty which granted natural resource ownership to the autonomous republics. Unless bilateral agreements have been concluded that allow for a region to be the legal owner of its oil, the Russian Federation remains one hundred percent owner. Also, the manner in which the oil industry was reorganized leaves the Russian Federation with decisive influence. The oil majors have close ties with the Russian government and have really only been quasi-privatized. The regions have some authority with respect to taxes, and to a lesser extent pricing, but the Russian government is still the dominant player in the oil industry.

The Natural Gas Industry

Natural gas is quickly becoming Russia's most important fuel. Beginning in the late 1970s the Soviet Union initiated a massive "gas campaign" that substantially increased natural gas production. Figure 2-3 shows Russia's gas producing regions. As with oil, the bulk of the increase was derived from development in western Siberia. In 1970 Soviet gas output was 197.9 billion cubic metres (bcm), but in 1988 output had reached 770.0 bcm; and from 1970 to 1988,

FIGURE 2-3

<u>**Map of Russia's Major Natural Gas Regions**</u>

Source: Ebel, *Energy Choices in Russia*, 50.

Soviet gas output as a percentage of Soviet primary fuel output increased from 19.1 percent to 37.7 percent.[118] Due to declining oil and coal production, natural gas now accounts for about 54 percent of Russia's energy balance, an all time high not only for Russia but for anywhere in the world.[119] Moscow's leading energy specialists have predicted that natural gas, not oil or coal, will pull Russia out of its fuel production slump by the end of the century.[120]

As natural gas output has increased rapidly, so has the power of the gas industry. The former head of the Soviet gas industry, Victor Chernomyrdin, has since become the first gas company chairman ever to be appointed Prime Minister of a country.[121] Chernomyrdin's promotion was largely a reward for running the only significant Russian enterprise that continued to operate more or less according to plan -- natural gas is the only primary Russian fuel that has not suffered a large decline in production over the past ten years. But Chernomyrdin is perhaps the only person with the ability to successfully coordinate the affairs of the energy sector with those of the rest of the economy, for his experience and contacts in the oil and gas industries are unparalleled in Russia. As Prime Minister, he is also very much responsible for many of the special deals that the gas industry has concluded over the past few years. Chernomyrdin's elevation is evidence of both the importance of the gas industry in Russia, and his tremendous personal power and influence.

In the Soviet Union, natural gas production was entrusted to the monopoly producer, Gazprom. Gazprom has survived the collapse of the Soviet Union and continues to hold a virtual monopoly over natural gas production, transmission and sales. In 1993, Gazprom produced 95 percent of Russia's natural gas.[122] The value, or more importantly, the *potential* value of Russian

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[118] Thane Gustafson, *Crisis Amid Plenty: The Politics of Energy Under Brezhnev and Gorbachev* (Princeton, N.J.: Princeton University Press, 1989), Table 5.1, 138.
[119] *Oil & Gas Journal,* 7 September, 1992, 18.
[120] Ibid., 17-20.
[121] Patrick Heren, "Prices Become the Paramount Factor," *Petroleum Economist,* August 1993, 7-11.
[122] "Gazprom Pressured to Sell Shares Freely," *Moscow News,* No. 47, 25 November-1 December 1994, 8.

natural gas is enormous and through Gazprom the central government maintains almost complete control over the industry. With sales of 123 trillion rubles ($30 billion US) in 1995, Gazprom ranks among the world's fifty largest companies, it is the world's largest monopoly, its output is equal to eight percent of the entire Russian GDP, and some suggest that Gazprom has displaced the central bank as the most important source of credits in the Russian economy.[123] Furthermore, Gazprom controls two-thirds of the world's confirmed gas reserves and, in 1993 Russia accounted for 27 percent of world natural gas extraction.[124]

As for the reorganization of the Russian gas industry, the situation is much different than in the oil industry. In 1993, Gazprom was reorganized as a joint stock company, but the privatization of Gazprom has been far from simple. Shares of the corporation were made available in a privatization process that began in the spring of 1993, with residents of gas-producing regions having preferential access to the auctions. The regionally based privatization scheme of closed auctions, however, lead to "tremendous distortions in access to the shares. It also provides the cover of legitimacy to misappropriation and fraud on a colossal scale."[125] The 3,156,000 inhabitants of sparsely populated Tyumen' oblast were offered 25 percent of the 68 million Gazprom shares, or 10 times more than those living in Russia's densely populated Central Black Earth Region which is well served by pipelines and therefore has a good portion of Gazprom's assets. An resident of Tyumen' was given access to 73-83 times more shares than a resident of Moscow Oblast; the territory east of the Kuzbas, which accounts for 12 percent of Russia's population, was excluded from the auctions entirely.[126]

There are indications of high-level intervention in the privatization of Gazprom. By restricting participation in voucher auctions to individual investors, and by excluding both

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[123] Peter Rutland, "Gazprom Issues Annual Report," *OMRI Daily Digest*, 5 June 1996.
[124] "World Natural Gas Market for 1993," *Moscow News*, 9-15 September 1994, 8.
[125] Dienes, *Corporate Russia*, 18.
[126] Ibid.

professional and foreign buyers, Gazprom "came out of the auction with a valuation of under $228 million[US], which is roughly one thousandth of the value put on it by foreign investment banks."[127] Furthermore, Gazprom, with the support of the Russian government, placed "every possible kind" of limitations on the movement of shares on the stock market, and as early as 1994, it was "practically impossible" to buy Gazprom shares on the stock market.[128] At any rate, as with the oil industry, the Russian government retains forty percent of Gazprom shares which amounts to a controlling interest in the Russian gas industry. Gazprom chairman, Rem Vyakhirev, insists that centralized control over gas production and distribution is essential to Gazprom's efficient operation in Russia,[129] but this is debatable.

Gazprom has concluded special deals with respect to the excise tax and export duties, and was allowed to form a tax-exempt investment or "stabilization" fund. Previously, Gazprom had been exempt from virtually all taxes and customs duties, but the gas sector is now subject to an excise tax, royalties and the geology fee. The excise tax, extended to the gas sector in mid-1993, was initially set at 15 percent and has subsequently been increased to 25 percent.[130] A 6-16 percent royalty (the same as for oil) now applies to gas production (it was previously set at 2.8 percent). As of August 1993, the 10 percent geology fee was applied to gas production, up from 2 percent. The gas sector has been largely exempt from the export tax. Not surprisingly, Gazprom's favorable tax status has continued to come under fierce attack by the Ministry of Economics as the Russian government is looking for additional revenues to close the budget deficit. Yevgeny Yasin, Minister of Economics, considers it possible to increase Gazprom's taxes and to rescind its tax-free investment fund.[131] Indeed, in March 1996, as one of the conditions for

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[127] Maxim Boyco, et. al., *Privatizing Russia* (Cambridge, MA.: MIT Press, 1995), 109.
[128] "Gazprom Pressured to Sell Shares Freely," *Moscow News*, 25 November-1 December 1994, 8.
[129] *Oil & Gas Journal*, 7 September 1992, 18.
[130] Sagers, et al., "Resource Rent," 419.
[131] Aleksandr Bekker, "Gazprom Could Become a Source of Revenue," *Sevodnya*, 1 August 1995, 2, translated in *Current Digest of the Post-Soviet Press*, Vol. XLVII, No. 31, 1995, 8-9.

a US $10.1 billion IMF loan, Gazprom's tax-exempt "stabilization fund" was merged with the federal budget; however, President Yeltsin compensated Gazprom by cutting the duty on pipe imports and lowering the excise duty.[132]

The Russian natural gas industry remains highly centralized under the Gazprom monopoly. Privatization thus far has been limited and mostly cosmetic, as Gazprom tries to quiet critics like the IMF and Russian Ministry of Economics, and the privatization that has taken place was heavily skewed in favour of producing regions. With Gazprom, it appears as though the future of the potentially lucrative Russian gas industry is entirely in the hands of the Russian government, much more so than in the oil industry.

Conclusion

Analysis of the Russian oil and gas industry has revealed a visible attempt to maintain central control, but also a less visible trend of decentralization. The creation of joint stock companies has diversified ownership and has allowed managers more freedom in enterprise operations. Nevertheless, ultimate decision making power tends to remain in the hands of the central government, and preserved by the structure of ownership in the industry. That the central government retains the power to issue development licenses via Roskomnedra should prove to be a significant vehicle for maintaining central control over the oil industry. The current tax regime also allows the central government to capture a considerable portion of the economic rent derived from the oil industry -- assuming, of course, that these revenues are successfully collected. The export tax should prove to be a substantial source of central government revenue, and is an issue which will inevitably cause friction between the central and regional governments, as regional initiatives clash with central government attempts to retain control.

[132] Peter Rutland, "Gazprom Loses Tax Privilege," *OMRI Daily Digest*, 9 April 1996.

In the natural gas industry, although Gazprom shares have been made available and the company is technically a joint-stock company, its monopoly position does not appear to be threatened on any front for the time being. As for the oil industry, it is possible that the major oil companies will push for greater independence, but their close relationship with the central government is serving their interests for the time being. While the Russian state may not be willing to part with its controlling shares, but rather keep them in defense of the "national interest" or protection of the domestic market, it is possible that once a Law on Oil and Gas is in place the oil majors will be "set free." But this may simply set the stage for more pointed battles between the oil majors, the Russian government, and regional governments, as the federal division of powers remains ill-defined.

The distribution of control over Russia's oil and gas is being shaped largely by negotiations between the central government, relevant regional governments, and the oil and gas companies. The system of joint authority, entrenched in Article 72 of the constitution, has led to numerous bilateral agreements between the central and regional governments in an effort to set the parameters for joint authority over oil and gas. This is not an ideal way to establish a federal division of powers in this policy arena, but it is perhaps the only realistic way that this could be accomplished in Russia -- a country that is geographically large, ethnically diverse, and where endowments of oil and gas vary considerably from region to region.

Chapter 3

RUSSIAN FEDERALISM AND OIL AND GAS: EXAMPLES OF THE SAKHA REPUBLIC AND TYUMEN' OBLAST

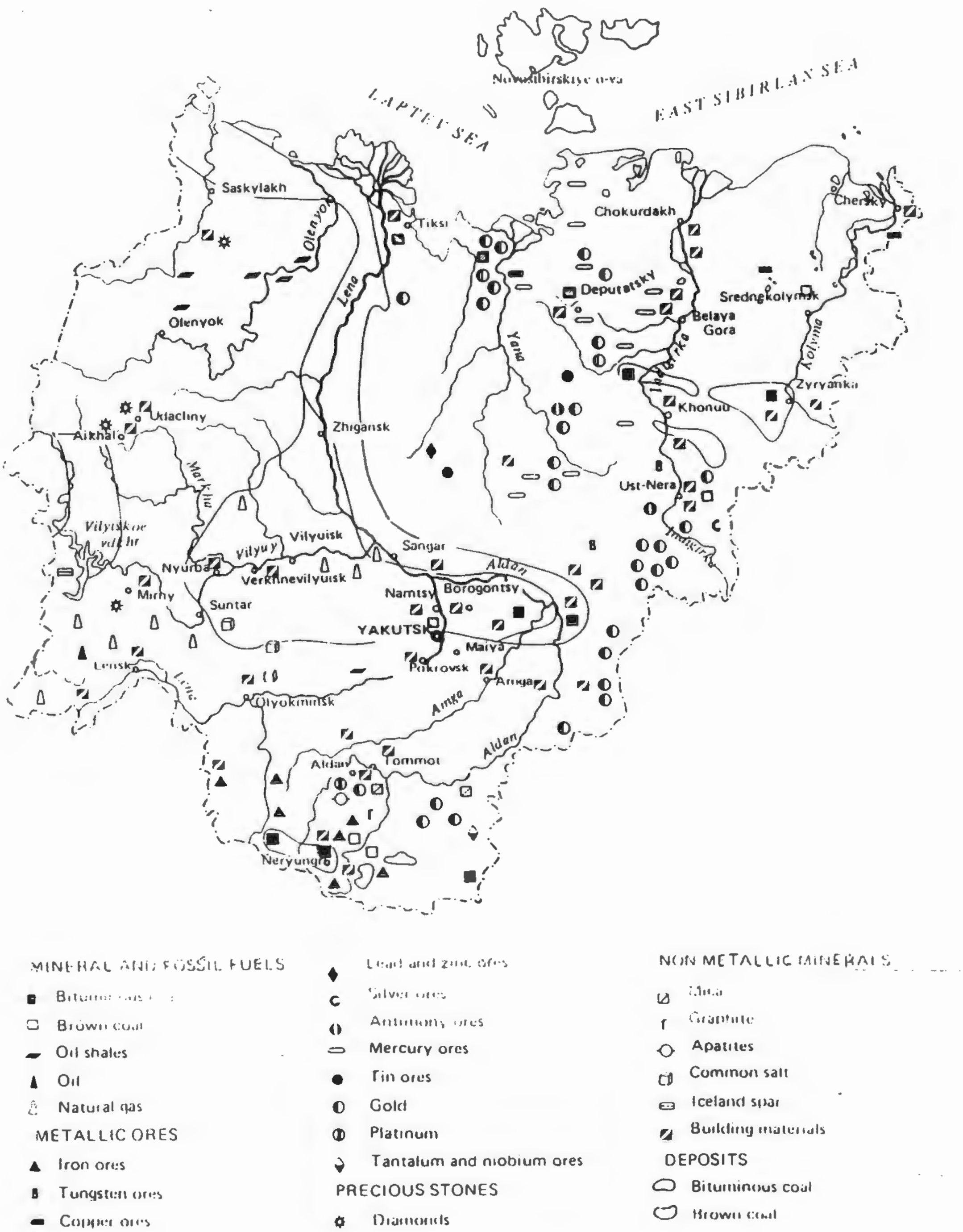
Introduction

This chapter investigates decentralization and the rise of regional power in Russia, focusing on the centre-regional distribution of control over natural resources (but particularly oil and natural gas). The Sakha Republic (Yakutia) and Tyumen' Oblast are used as examples. Such an investigation serves a dual purpose. First, it demonstrates that natural resources are substantial sources of political power and outlines the relationship between natural resource control and federalism. By controlling natural resources and their revenues, regions may become less dependent on the central government. Natural resource revenues add to a region's autonomous revenue pool and may allow regional governments more freedom in budget formation. Second, such an investigation illustrates the importance of a region's status in the Russian Federation. Republics appear to be in privileged positions vis à vis other regions in the Russian Federation and some have taken advantage of the situation by seizing significant control over their natural resources, including oil and gas, while most oblasts and krais seem to be having less success.

The chapter begins with an analysis of decentralization of power and authority from Moscow to the Sakha republic since 1990. Included is a discussion of the success Sakha has had in gaining control over its oil and gas resources and the actions Sakha has taken since gaining this control. This is followed by a similar analysis of decentralization from Moscow to Tyumen' Oblast. Again, emphasis is on the Tyumen' oil and gas sector, but also of importance is the

FIGURE 3-1

Map of the Sakha Republic



Source: *Republic of Sakha: Yakutian Business Guide*, 31.

relationship between Tyumen' and the two autonomous okrugs within Tyumen' -- Khanty-Mansiisk and Yamal-Nenets.

There are several similarities and differences between Sakha and Tyumen'. In terms of similarities, they are both large, sparsely populated regions with significant indigenous population and substantial amounts of natural resources. With Sakha's diamonds and Tyumen's oil and gas, these two regions account for about half of Russia's foreign currency earnings, yet they have some of the poorest standards of living in Russia. Both are northern regions, and as Greg Poelzer argues, no part of Russia "has experienced the consequences of the collapse of the former Soviet Union more than the Russian North," because federalization raises some unique issues in the Russian North.[133] In particular, the differences in the ownership of natural resources may lead to enormous variations in regional wealth. The most glaring difference between the two regions is that Sakha is an autonomous republic, while Tyumen' is an oblast. Another major difference is the presence of two autonomous okrugs within Tyumen'. Given the many similarities, however, we may isolate somewhat the variable of status to determine its importance in building regional autonomy.

The Sakha Republic

Background

The Sakha Republic in the Russian Far East (RFE) covers more than 3.1 million square kilometres, or about one-fifth of all Russian territory (see Fig. 3-1).[134] This makes Sakha 5.5 times the size of France, 10 times larger than Italy, or 13 times as large as Great Britain. At a

[133] Greg Poelzer, "Devolution, Constitutional Development, and the Russian North," *Post-Soviet Geography*, 36, No. 4, April 1995, 204-214, 204.
[134] *Respublika Sakha (Yakutia): Special Issue of Deloviye Lyudi*, November 1994, 5.

distance of 2,500 kilometres from its westernmost to easternmost points, the republic spans three time zones, 6, 7 and 8 hours ahead of Moscow. Sakha is one of Russia's northernmost regions and much of it lies within the Arctic Circle.

With just over one million residents, 18 percent (or 200,000) of which live in the capital city of Yakutsk, it is a very sparsely populated region. The average age in 1989 was 27.6 years, which makes Sakha a relatively young region in Russia.[135] The past thirty years or so has been a period of intensive natural resource development which drew a large influx of people to Sakha from across the former Soviet Union. But after several decades of immigration, Sakha is now experiencing some emigration from the republic, mostly because some Russians, Ukrainians, Belorussians and other immigrants to the region are returning to their places of origin.

Half of Sakha's population is Russian, one-third is Sakha (or Yakut), and the remaining nationalities of numerical significance include Ukrainians, Tatars, Belorussians, and the indigenous Evenks, Evens and Yukagirs.[136] Russian colonization and migration over the past few centuries has left the Sakha people a minority in their own land.[137] Cultural freedom has increased in Russia since the mid-1980s, allowing Sakha nationalism to grow somewhat, but it is not as yet radical. There have been instances of conflict between Russians and Sakha,[138] but the situation is certainly not critical. Diplomatic avenues have been used effectively to handle Russo-Sakha disagreements, thanks in part to president Mikhail Nikolaev's ability to tactfully arbitrate serious disputes. Sakha boasts an abundance and wide variety of valuable natural resources, in particular, gold and diamonds, but also oil, gas and coal. Gold mining began in the region in the 1920s, and mining of

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[135] Ibid.

[136] *Republic of Sakha: Yakutian Business Guide* (Yakutsk: The Ministry of Foreign Relations of the Republic of Sakha, 1995).

[137] For an excellent account of Russian colonization of Sakha and Siberia see James Forsyth, *A History of the Peoples of Siberia: Russia's North Asian Colony 1581-1990* (Cambridge, U. K.: Cambridge University Press, 1992).

[138] Marjorie Mandelstam Balzer and Uliana Alekseevna Vinokurova, "Nationalism, Interethnic Relations and Federalism: The Case of the Sakha Republic (Yakutia)," *Europe-Asia Studies*, Vol. 48, No. 1, 1996, 101-120.

both alluvial and ore deposits continue to this day. Sakha's diamond industry is forty years old and so far almost one thousand diamond-bearing kimberlite pipes have been discovered, 15 of which are suitable for commercial development. Sakha produces about 99 percent of Russia's diamonds and 25 percent of the world supply. Sakha produces 60 percent of Russia's tin and all Russian antimony. Over one-third of Sakha territory is believed to contain oil and gas. Sakha also possesses coal reserves in excess of ten trillion tons, most of which is located in the world's largest coalfied, the Lena basin.[139]

Decentralization

On 27 September 1990 Yakutia declared its "sovereignty within the Russian Federation," the declaration coming on the heels of similar declarations by the Republics of Tatarstan, Komi and Udmurtia.[140] In 1992 Sakha exercised its right as an autonomous republic to enact a constitution, one of the first republics to do so.[141] The Constitution of the Republic of Sakha (Yakutia) expanded republic authority in some key areas. For example, Article 9 of Section 1 states that Sakha is an "independent participant" in international relations and has the authority to conclude international treaties; while Article 6 states that the "land, resources and its wealth, waters, forests, vegetable and animal kingdoms, other natural resources, air space, continental shelf in the Republic of Sakha (Yakutia) are the property of the people of the Republic of Sakha (Yakutia)."[142] Article 6 in particular, though consistent with the Federal Treaty, is in direct conflict with Article 72 of the Constitution of the Russian Federation.

There are two main goals which motivate Sakha's regional authorities to push for more regional autonomy. First, some are motivated by Sakha nationalism. Balzer and Vinokurova

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139 These numbers are from *Respublika Sakha: Special Issue*, 7.
140 In Russian parlance, "sovereignty" is generally a relative rather than absolute term.
141 The Sakha constitution was revised in 1994.
142 *Constitution of the Republic of Sakha (Yakutia)*, 1994.

take this social anthropological approach in explaining Sakha's bid for sovereignty.[143] Cultural revival is an important goal of many Sakha and with the end of Soviet ideology, it has become a realizable one. Second, regional authorities are motivated by the desire to control Sakha's wealth of natural resources. Cultural freedom and the authority to implement and administer such things as social programs would be small consolation if they were not accompanied by more authority in the regional economy. If Moscow controls the finances of the region, then very little tangible power has decentralized. Control over Sakha's natural resources is also directly related to regional authorities' cravings for personal power and influence.

With these motivations in mind, we may begin to look at the means by which Sakha has increased its autonomy. Three of these means are studied here: (1) the expanded authority of Sakha's regional government institutions; (2) bilateral agreements concluded with Moscow; and (3) Sakha's ability to control the Russian voucher privatization process in the republic.

First, as with most of Russia's regional government institutions, Sakha's government institutions have been reformed and their authority has increased since 1991. On the legislative side, members of Sakha's parliament (known as the "Il Tumen") are democratically elected. On the executive side, Sakha has a democratically elected president, Mikhail Nikolaev. It is Nikolaev's executive branch which appears to possess the bulk of power and authority in the republic.

Nikolaev was formerly the chairman of the Yakutian Supreme Soviet before being elected president of Sakha on 20 December 1991, and re-elected to a second term of office in 1996. He has strong ties with Boris Yeltsin dating back to their years together in the Soviet bureaucracy. Nikolaev supported Yeltsin in his campaign against former Soviet president Mikhail Gorbachev, and channeled the republic's diamond revenue to the Russian Federation rather than the Soviet

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[143] Balzer and Vinokurova, "Nationalism, Interethnic Relations and Federalism."

government during the months leading up to the collapse of the Soviet Union. Nikolaev's popularity is based largely on his strong connections in Moscow, but he is also seen as a guarantor of political stability, the person most capable of solving the republic's socio-economic problems, and a buffer against inter-ethnic conflict in the republic.[144] Riding this wave of popularity, Nikolaev successfully amassed considerable power and authority in the executive branch of the Sakha government. From 1991 to 1994 he essentially ruled the republic by decrees in much the same way as Yeltsin's executive branch governed Russia.

President Nikolaev's strong base of power in Sakha has allowed him to challenge Moscow's power and authority on several fronts. In 1992, he advocated Sakha's secession from Russia, arguing that Sakha ought to conduct relations with Moscow on the basis of international treaties. However, he relented only after an agreement was reached which allowed Sakha to keep 20 percent of the profits from the republic's mined gem diamonds and all of its industrial diamonds. Upon achieving this concession from the central government, Nikolaev subsequently became a "firm advocate" of allowing Sakha to develop as a part of the Russian Federation.[145] Under Nikolaev, "Sakha leads virtually all the other Russian republics in the pursuit of sovereignty, and even has the right to its own military."[146]

A second example of Sakha's increased autonomy is the success Sakha has had in negotiating bilateral agreements with Moscow. On 29 June 1995, Sakha signed a series of bilateral agreements with Moscow,[147] which in terms of political and especially economic freedoms even surpassed other similar agreements with the republics of Tatarstan and

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[144] Robert Orttung, "Sakha President Relies on Moscow Ties and Diamond Revenues to Secure Re-election," *OMRI Russian Regional Report Part II*, 17 January 1997.
[145] Ibid.
[146] Ibid.
[147] All of the 29 June 1995, Russian Federation-Sakha Republic agreements are found in *Respublika Sakha*, 5 July 1995.

Bashkortostan.[148] The agreements consolidated Sakha's control over its natural resources in three key ways. First, Sakha became the legal owner of 30 percent of its gold resources and slightly less of oil and gas (see below). Second, Sakha was made 30 percent owner of Yakutugol', the republic's coal company (30 percent is owned by the Russian Federation and 40 percent by Yakutugol employees).[149] Third, and perhaps the most important part of the agreement, Sakha became a full fledged owner of 32 percent of its mined diamonds under the closed joint-stock company, Almazy Rossii-Sakha (Diamonds of Russia-Sakha, hereafter ARS). Fourth, Sakha was given the right to sell cut stones in addition to rough diamonds, which satisfied Sakha's need and desire to diversify economically by developing a lapidary industry. All of this came at a time when world diamond mining had dropped by 6 percent from the previous year, whlie Sakha mining had grew by 9.2 percent.[150] Previously, in March 1991, the Sakha government launched Tyumaada Diamond to spawn Sakha's diamond cutting industry. By 1994, Tyumaada had opened six cutting plants and employed 900 people; and with future plants in the works, it is expected that Tyumaada will employ about 2000 cutters, many of whom are taking a required, year-long training course.[151] The agreements simply provided legal recognition of, and official support for a Sakha diamond cutting industry.

Natural resources in general, but specifically diamonds, are Sakha's main economic resources. In 1995, ARS generated gross returns of US$721 million and profits of US$250 million. Seeing as taxes on the diamond industry make up 80 percent of the republic's budget,[152]

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[148] Vladimir Yemelyanenko, "Yakutia Wins Rights to its Own Diamonds," *Moscow News*, 30 June-6 July 1995, 1. For more on bilateral agreements between Moscow and Tatarstan see, for example, Peter Rutland, "Tatarstan: A Sovereign Republic Within the Russian Federation," *OMRI Russian Regional Report Part II*, Vol. 1, No. 5, 25 September 1996.

[149] The ownership structure of Yakutugol was outlined in the 29 June 1995, bilateral agreement "On Cooperation in the Fuel-Energy Complex," *Respublika Sakha*, 5 July 1995.

[150] Yemelyanenko, "Yakutia Wins Rights to its Own Diamonds."

[151] Daniel R. Kempton, "The Republic of Sakha (Yakutia): The Evolution of Centre-Periphery Relations in the Russian Federation," *Europe-Asia Studies*, Vol. 48, No. 4, 1996, 587-613, 593-594.

[152] Orttung, "Sakha President Relies on Moscow Ties."

this is an area where regional authorities are no doubt seeking as much regional control as possible. Kempton suggests that there were three keys to Sakha increasing its control of the diamond industry and a greater share of diamond profits.[153] First is Nikolaev's strong relationship with Yeltsin. Second, during Yeltsin's struggles with Soviet president Gorbachev, Nikolaev withheld diamond shipments to the Soviet government after Yeltsin promised Sakha greater control over its resources. Then, when it appeared as though Yeltsin was not going to keep his promise, rumours of a diamond boycott resurfaced. Third, Nikolaev cleverly played Yeltsin off against the Russian parliament to get a better deal for Sakha. In the end, "this three-part strategy proved useful not only in the diamond war but also in Nikolaev's more general efforts to maximize Sakha's political and economic autonomy."[154]

Bilateral agreements have also allowed Sakha to gain more control over its regional budget and matters of taxation. In 1993 the Russian government faced a serious budget crisis. The central government was having a difficult time collecting taxes, and the value of what was collected was rapidly eroded by inflation. Russia and Sakha had come to agreements in 1992 on dividing federal property and tax receipts, but Sakha did not receive its agreed upon subsidies from the central government. Faced with a severe cash shortage, in 1993 Sakha threatened "to introduce its own gold-backed currency if disputes over federal budget subsidies were not resolved."[155] Lacking cash needed to pay wages, Sakha issued its own temporary legal tender worth millions of rubles.[156] This type of action occurred in numerous other regions throughout Russia, but considering Sakha's wealth of gold and diamonds, the action may have been a more

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[153] Kempton, "The Republic of Sakha (Yakutia)," 594.
[154] Ibid.
[155] Darrell Slider, "Federalism, Discord, and Accommodation: Intergovernmental Relations in Post-Soviet Russia," in Theodore H. Friedgut and Jeffrey W. Hahn, eds., *Local Power and Post-Soviet Politics* (Armonk, N. Y.: M. E. Sharpe, 1994), 239-269, 247.
[156] Ibid., 251.

realistic threat to Moscow than in most other regions. While prompted by the severe fiscal crisis of the central government, it still represents an attempt to increase regional power.

Sakha ultimately found an answer to the subsidy disputes with Moscow. Many regions advocated a "one channel system" of taxation whereby federal taxes would be eliminated in favour of voluntary sharing of locally raised taxes. Such a system was unacceptable in the eyes of the Russian government, but the centre failed to prevent its implementation as Sakha (along with the republics of Tatarstan, Bashkortostan, Chechnia and Ingushetia) virtually stopped paying taxes to federal authorities. The Russian government eventually conceded, allowing Sakha to retain all its tax revenue, but on the condition that Sakha fund all federal programs directly from the republic's budget.[157]

Sakha now has more freedom in the realm of international relations thanks in large part to bilateral agreements. The 29 June 1995, bilateral agreements consolidated and expanded Sakha's areas of sovereign power by giving the republic the right of diplomatic representation in the world,[158] a power which Sakha had already been exercising to a certain extent. For instance, in February 1994, Nikolaev headed a Russian delegation that traveled to Japan and South Korea for meetings with authorities from the two Asian nations. The meetings produced several key agreements on political and economic cooperation between Sakha and South Korea; and, as Nikolaev was in fact representing not only Sakha but all of Russia, several documents were signed paving the way for further cooperation between Russia and South Korea in industry, energy and natural resources.[159] The legal right of diplomatic representation will allow Sakha to explore

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[157] This compromise was part of the 29 June 1995, agreements; the relevant agreements are "On Budget Relations" and "On the Realization of Federal Programs on the Territory of the Sakha Republic (Yakutia)," *Respublika Sakha*, 5 July 1995.

[158] "On the Division of Powers in International and Foreign Economic Relations," *Respublika Sakha*, 5 July 1995.

[159] "Podpisano Soglasheniye," *Respublika Sakha*, 1 March 1994, 1; "Koreskoye Chudo," *Respublika Sakha*, 8 March 1994, 1-2.

more international trade opportunities, particularly in the growing markets of the Pacific Rim nations.

Sakha is now able to attract foreign investment with less interference from central authorities and has used this opportunity to develop its social infrastructure. Projects in the republic financed with foreign investment include an addition to the university, an airport terminal, a surgical hospital and a "model village" for musically gifted children.[160] Sakha also has the power to draw foreign loans, using as collateral security its gold and diamonds.

Sakha's ability to persuade the Russian government that it might be able to survive on its own, combined with real or perceived threats of secession from Sakha and other republics, compelled the Russian government to give up a good deal of control over Sakha's natural resources in the agreements. Nikolaev's friendship with Yeltsin was also a definite asset for Sakha in concluding the bilateral agreements.

A third example of Sakha's increased power vis à vis Moscow is the manner in which the massive Russian voucher privatization process was manipulated by regional authorities. In 1992 Russia initiated the largest, most comprehensive privatization program in history.[161] The aim was to dismantle the former Soviet centrally-controlled economy and move towards a market or mixed economy. This required building and legitimizing a private sector, basically from scratch. As the privatization program was conceived, the process was to follow guidelines imposed by the Russian government on all of Russia's regions and municipalities. But, as Darrell Slider has shown, this clearly did not happen as many regional governments, particularly the republics, took control of the privatization process on their territories.[162] By the official end date of the voucher privatization program, on 1 July 1994, the extent of privatization varied greatly from region to

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[160] *Respublika Sakha (Yakutia): Special Issue*, November 1994.
[161] For a comprehensive look at the Russian privatization program see Maxim Boyco et al., *Privatizing Russia* (Cambridge, Massachusetts: The MIT Press, 1995).
[162] Darrell Slider, "Privatization in Russia's Regions," *Post-Soviet Affairs*, Vol. 10, No. 4, 1994, 367-396.

region, with the republics generally having created much smaller private sectors than the rest of the regions. In Sakha for instance, by May 1994 the ratio of privatized enterprises to prior total of state enterprises was a mere .10, one of the lowest in all of Russia.[163] This has much to do with the immense power and authority of Sakha president, Mikhail Nikolaev, whose economic views "tend toward the authoritarian -- he backs state regulation of the economy, arguing [curiously] that it creates conditions that stimulate business and entrepreneurial activity."[164] Thus, it was the Sakha executive branch that was able to defy federal legislation and prevent a good deal of privatization in the republic.

Sakha found a unique method of using the voucher privatization process to gain control over its substantial economic resources. On 28 September 1992, with decree No. 243 of the President of the Sakha Republic, a state-owned investment fund, SakhaInvest, was created.[165] According to the decree, SakhaInvest was created "for the purpose of accelerating the privatization process, ..." and to "guarantee the security of Sakha citizens."[166] The fund bought privatization vouchers from Sakha citizens and used them to buy stocks in enterprises not only within the republic, but throughout Russia. Table 3-1 shows SakhaInvest's holdings by industry. In a bold maneuver, President Nikolaev also ordered all enterprises in the republic, including federally owned ones, to contribute 10 percent of their shares to SakhaInvest without compensation.[167] With SakhaInvest, "republic authorities attempted to coopt the process of voucher privatization to retain some degree of control over the republic's larger enterprises."[168]

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[163] Ibid., Table 3, 388-389.
[164] Robert Orttung, "Sakha President Relies on Moscow Ties."
[165] The decree, "On the Creation of the Republican Investment Fund *SakhaInvest*," is published in *Sbornik: Ukazov I Razporyazheniy Prezidenta Respubliki Sakha (Yakutia)*, July - September 1992, 27.
[166] Ibid.
[167] Ibid.
[168] Slider, "Privatization in Russia's Regions," 390.

TABLE 3-1

SakhaInvest's Holdings By Industry

Metallurgy	30%
Gold and Diamonds	17%
Machine Building	15%
Chemicals	13%
Construction	7%
Oil and Gas	5%
Others	13%

	100%

Source: *SakhaInvest-Servis,* July 1995

Sakha had one other organization which impeded privatization in the republic. The privatization of most small enterprises was not possible because virtually all of them were owned by a cooperative society called Kholbos.[169] As Kholbos was not state-owned, there was very little that federal authorities could do, despite the fact that the situation conflicted with the directives of the Russian State Committee for the Administration of State Property (*Goskomimushchestvo*, or GKI).[170] But holding companies such as Kholbos enjoyed the support of GKI's main opposition, the Russian Federal Property Fund, which saw holding companies "as a transitional stage between state ownership and full privatization."[171] By October 1993 a mere four percent of Sakha's "small" enterprises were privatized, the third lowest percentage of all Russian regions.[172] Thus, Kholbos obstructed the privatization of small enterprises while SakhaInvest enabled the state to retain control over most of the republic's largest enterprises and industries.

The Sakha Republic has become more independent than it was at any time during the latter half of the Soviet period. The power of president Nikolaev's executive branch and his close

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[169] Author's interview with Semyon Lamber, Vice-President of the Sakha Committee on State Property, 14 August 1995.

[170] Ibid.

[171] Slider, "Privatization in Russia's Regions," 371.

[172] Ibid., Table 2, 384-385; only the Yamal-Nenets and Taymyr Autonomous Okrugs had lower percentages of privatized enterprises than Sakha, and seven of the nine regions with the lowest percentages were republics.

relationship with Boris Yeltsin have helped Sakha's pursuit of autonomy. Sakha's response to the cash shortage and unpaid subsidies, and the decision to quit paying federal taxes demonstrated that considerable political power lay in the hands of the Sakha government. Sakha's ability to control the privatization process in the region, despite the central government's objections, is yet another example of increased regional power. Natural resources, however, are the backbone of the Sakha economy, and Sakha's independence from Moscow may be measured largely by its degree of control over natural resource industries in the republic.

The Sakha Oil and Gas Sector

This section outlines the way in which the Sakha Republic took control of the levers of power in the Sakha oil and gas sector, and goes on to discuss some of the steps Sakha has taken since it assumed control of its oil and gas industries. While the oil and gas sector in Sakha is not as large as in some of Russia's other regions, oil and gas are valuable resources and Sakha has tremendous potential for development.

Hydrocarbon exploration in Sakha began in 1935. Since that time, over 1000 wells have been drilled, about 500 of which are located in thirty discovered natural gas fields. Of these thirty fields, four are under production, six are prepared for commercial development, fifteen are under exploration/appraisal, and five are under conservation.[173] Sakha has yet to develop any of its eleven discovered oil fields, but more than half of Sakha's 3 million square kilometres are considered to be prospective for oil and gas.[174]

At present, Sakha is not even energy self-sufficient and is forced to import about 15 million barrels (bbl) of oil each year. But this is not to say that Sakha lacks energy resources. In

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[173] Keun Wook Paik, *Gas and oil in Northeast Asia: Policies, Projects and Prospects* (London: The Royal Institute of International Affairs, 1995), Table 3.9.
[174] Steve Thompson and Vladimir Matveev, "Exploration opportunities, 30 fields dot eastern Russia's Sakha Republic," *Oil & Gas Journal*, 15 August 1994, 98-102.

1994 gas production was 53 billion cubic feet (bcf), all for local consumption. Recoverable reserves from discovered fields are estimated to be 35 trillion cubic feet (tcf) for gas and 15 billion bbl for oil, making Sakha an exploration frontier with great potential for development and growth.[175] With its relatively low carbon dioxide emissions, natural gas is quickly becoming the fuel of choice in much of the developed world, and Sakha gas may be marketable in the energy deficient countries of the Pacific Rim if the difficult job of erecting the necessary infrastructure is accomplished.

During the Soviet period, Sakha's natural resources were owned and administered by Moscow. As owner of all Soviet natural resources, the Soviet government captured virtually all natural resource rents. Sakha used to put one hundred percent of its profits from precious metals mining at the disposal of the Soviet government. The Russian government still holds a stake in most of Sakha's natural resource industries, but many key decisions regarding Sakha natural resource development are now made by republic, rather than federal, authorities.

The Sakha government has successfully taken considerable control over the management of the republic's oil and gas industries. On 17 January 1992, decree No. 19 of the President of the Sakha Republic, M. Nikolaev, spawned the creation of a Sakha national oil and gas company, Sakhaneftegaz.[176] Sakhaneftegaz brought all of Sakha's geophysical, geological, production and trade organizations in the oil and gas sector under the control of a single organization (see Fig. 3-2). The Sakha Republic owns 51 percent of Sakhaneftegaz, which in

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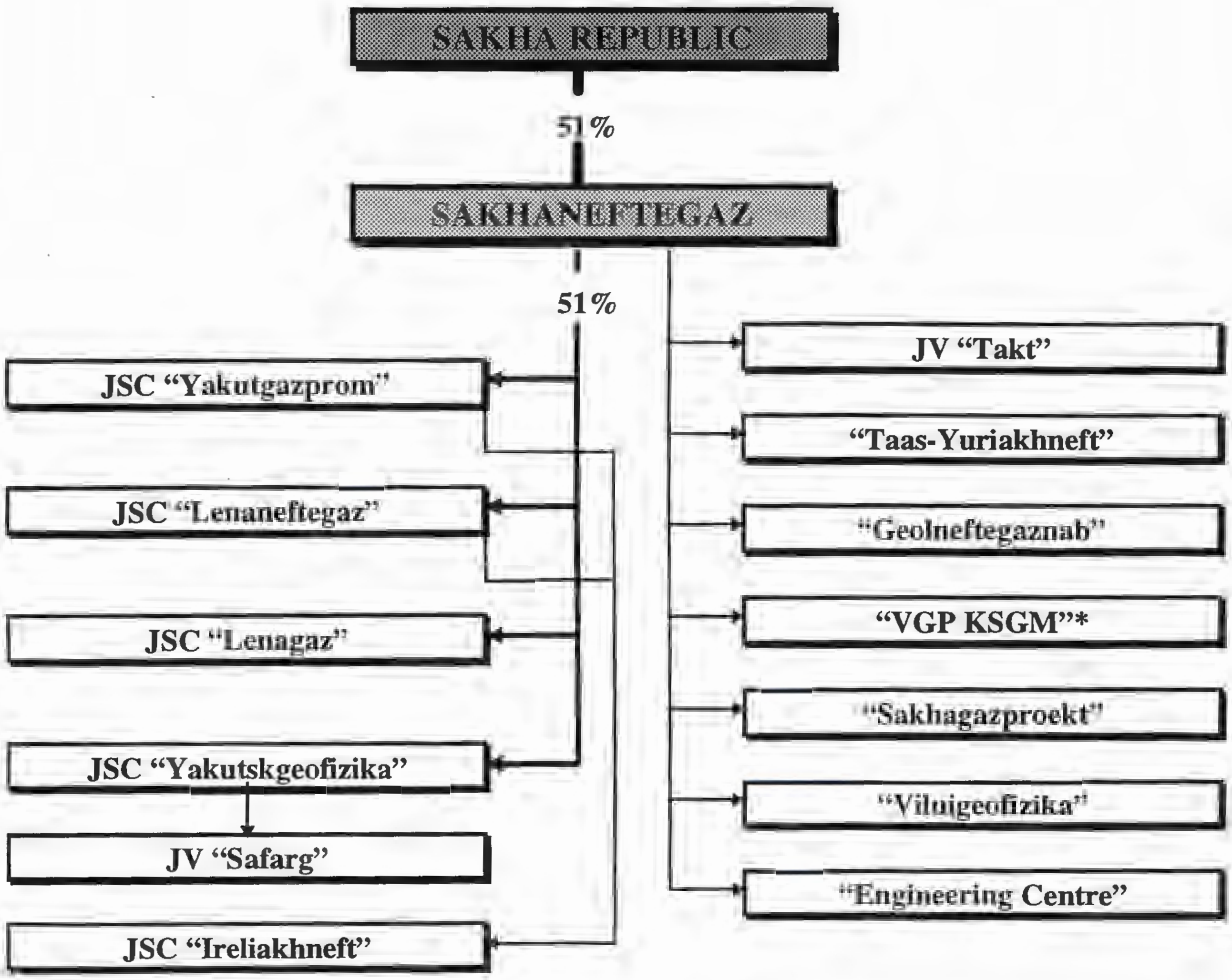
[175] Steve Thompson and Vladimir Matveev, "Sakha Republic of Russian Far East looks like new exploration frontier," *Oil & Gas Journal*, 8 August 1994, 70-72.

[176] The formative decree is "On the Creation of the National Company of the Republic Sakha (Yakutia) *Sakhaneftegaz*," *Sbornik*, January - March 1992, 30; it was amended slightly with the 4 September 1992, decree "On Changes and Supplements to the Decree "On the Creation of the National Company of the Republic of Sakha (Yakutia) *Sakhaneftegaz* from 17 January 1992, No. 19," *Sbornik*, July - September 1992, 39.

FIGURE 3-2

Organizational Structure of Sakhaneftegaz



* Viluiskoye Enterprise on Control of Gas-Field Preservation
JSC=Joint-Stock Company
JV=Joint Venture

Source: *Sakhaneftegaz National Oil and Gas Company* turn holds 51 percent of shares in each of its main subsidiary organizations. The largest of these, Yakutgazprom, had already severed its ties with Gazprom of Russia a year earlier, making the creation of Sakhaneftegaz somewhat easier.[177] This break was unusual, as Gazprom has a virtual monopoly on Russian gas production, transport and sales. Sakha's remoteness and the small size of its oil and gas sector relative to regions such as Tyumen' and Tatarstan facilitated Sakhaneftegaz's consolidation process.

Sakhaneftegaz is formally an open joint-stock company (JSC) with shares in the company available to Russian investors on stock markets in Yakutsk and Moscow. In 1994, 8,730 investors bought 855,000 shares in Sakhaneftegaz at a price of 17,000 rubles per share. Shortly thereafter, by decree of President Nikolaev, the share price was reduced to 3,000 rubles for "social defense purposes," though the meaning of "social defense" was never made clear. In Moscow, shares continued to sell for 14,000 rubles. By 1995, ten percent of Sakhaneftegaz had been sold to private investors. This represents only a small fraction of the shares that were to be made available to private investors, and it was expected that Sakhaneftegaz will also accept foreign investment in the future.[178]

Although Sakha has successfully secured the right to manage its oil and gas industries, the Subsoil Act still protects the Russian government's legal ownership of Russia's natural resources. With the Russia-Sakha treaty of June 1995, Sakha became the legal owner of 20 percent of its oil and gas. So long as Sakha did not export any oil or gas, this was not particularly contentious. However, this will likely change within a decade or two as Japan and South Korea are keenly interested in the possibility of developing Sakha gas for export. For this reason, Sakha may seek

[177] Author's interview with Konstantin Fyodorov, General Director of Yakutgazprom, 25 July 1995.
[178] Author's interview with Mikhail Tsikel', Vice-President of Sakhaneftegaz, 18 July 1995.

more legal ownership, but Moscow may be reluctant to cede it as future revenues may be enormous.

Several proposals to develop Sakha gas have been prepared over the past few decades, but none have come to fruition. During the late 1960s and early 1970s, various proposals were tabled that purposed to have Sakha gas exported to Japan (see Fig. 3-3).[179] The projects all failed, however, partly due to a lack of capital but also because the parties involved could not agree on a pipeline route that would have ultimately transported the gas to market.

In early 1991, a very ambitious plan for accelerating Russian Far East (RFE) gas development was devised.[180] This was a report entitled the "Concept of Developing Yakutian and Sakhalin Gas and Mineral Resources of Eastern Siberia and the USSR Far East," commonly known as the "Vostok (East) plan." Figure 3-4 shows the planned pipeline routes for the Vostok Plan. The plan was prepared by the USSR Ministry of Geology, the Russian Republic's Committee on Geology and Utilization of Energy and Mineral Resources, the USSR Ministry of Oil and Gas Industry, the State Gazprom Concern, the USSR Academy of Sciences and the Russian Technological Academy.[181] According to the Vostok Plan, by 2005 the Sakha Republic and Sakhalin oblast together would produce about 15.7 million tons per year (mt/y) (54 percent) for RFE consumption and 13.3 mt/y (46 percent) for export -- 6.0 mt/y to South Korea, 6.0 mt/y to Japan, and 1.3 mt/y to North Korea. The key elements of the plan were the construction of a 3,230-km gas pipeline from Sakhalin Island across Russian territory and North Korea to South Korea, and a 3,050-km line from Yakutsk to Khabarovsk. But the projected cost of the project was colossal. Based on the official exchange rate of the time (1.8 rubles to one US dollar) the total cost was estimated to be US$20.7 billion, and on the commercial rate (30 rubles to one US

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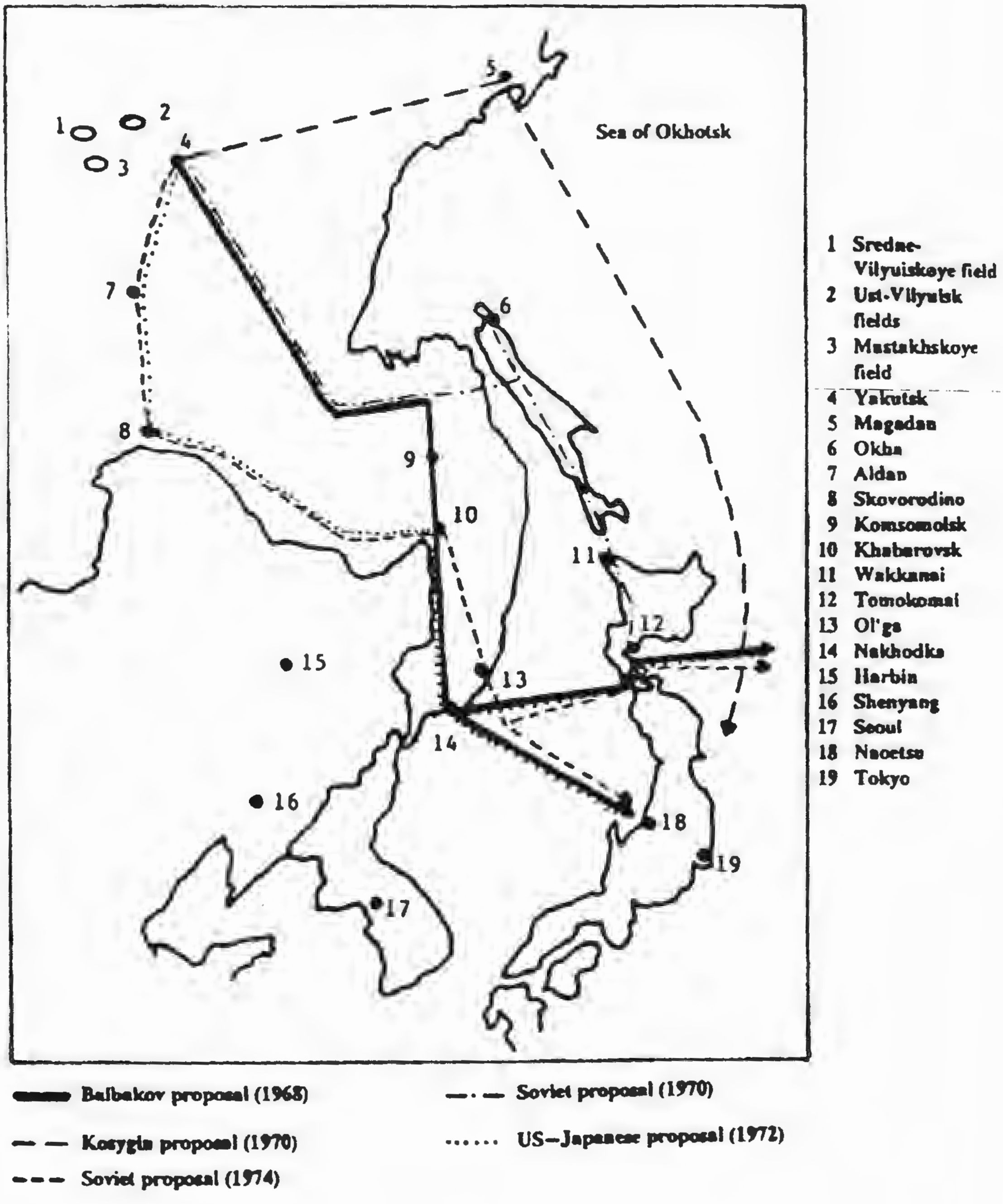
179 Wook Paik, *Gas and oil in Northeast Asia*, 227-235.
180 Ibid., 231-233.
181 Ibid., 231; see also, *Oil & Gas* Journal, 23 March 1992, 121.

FIGURE 3-3

<u>Yakutian Gas Pipeline Proposals, 1968-1974</u>



Source: Wook Paik, *Gas and oil in Northeast Asia*, 228.

dollar), US$7.4 billion.[182] Another estimate, from Allen S. Whiting, sets the total at US$15 billion with delivery beginning ten years after the start of feasibility studies.[183]

The Vostok plan was essentially dead until November 1992. At that time, an agreement was reached to undertake a preliminary feasibility study for the development of Sakha gas, and construction of a gas pipeline connecting the Sakha Republic with South Korea. Fig. 3-4 shows the planned pipeline route for the Vostok project. But disputes over financing meant that nothing was accomplished on the preliminary feasibility study until June 1994 when Russia and South Korea agreed to invest $20 million in the study, with a twelve month working period.[184] The study has thus far involved three consortiums to assess the economic and geological feasibility of the project.[185] South Korea is providing capital for feasibility studies and to assess its potential domestic demand. The Sakha Republic is conducting a resource evaluation to prove that enough gas exists to make the project worthwhile; this is being carried out by Lenaneftegaz, a subsidiary of Sakhaneftegaz.[186] Gazprom, representing the Russian consortium, is responsible for geological and engineering studies to determine the obstacles that exist for the extraction and transportation of Sakha gas to market. No construction will begin until these studies demonstrate the feasibility of the project.

Another party that is indirectly involved in the Vostok plan is the joint venture (JV), Safarg, one of the only geophysical JVs in all of Russia. Safarg was established in 1991 as a five year corporate agreement between Yakutskgeofizika and Fairfield Industries of Houston, Texas.[187] With computer equipment provided by Fairfield, Safarg's computer department went

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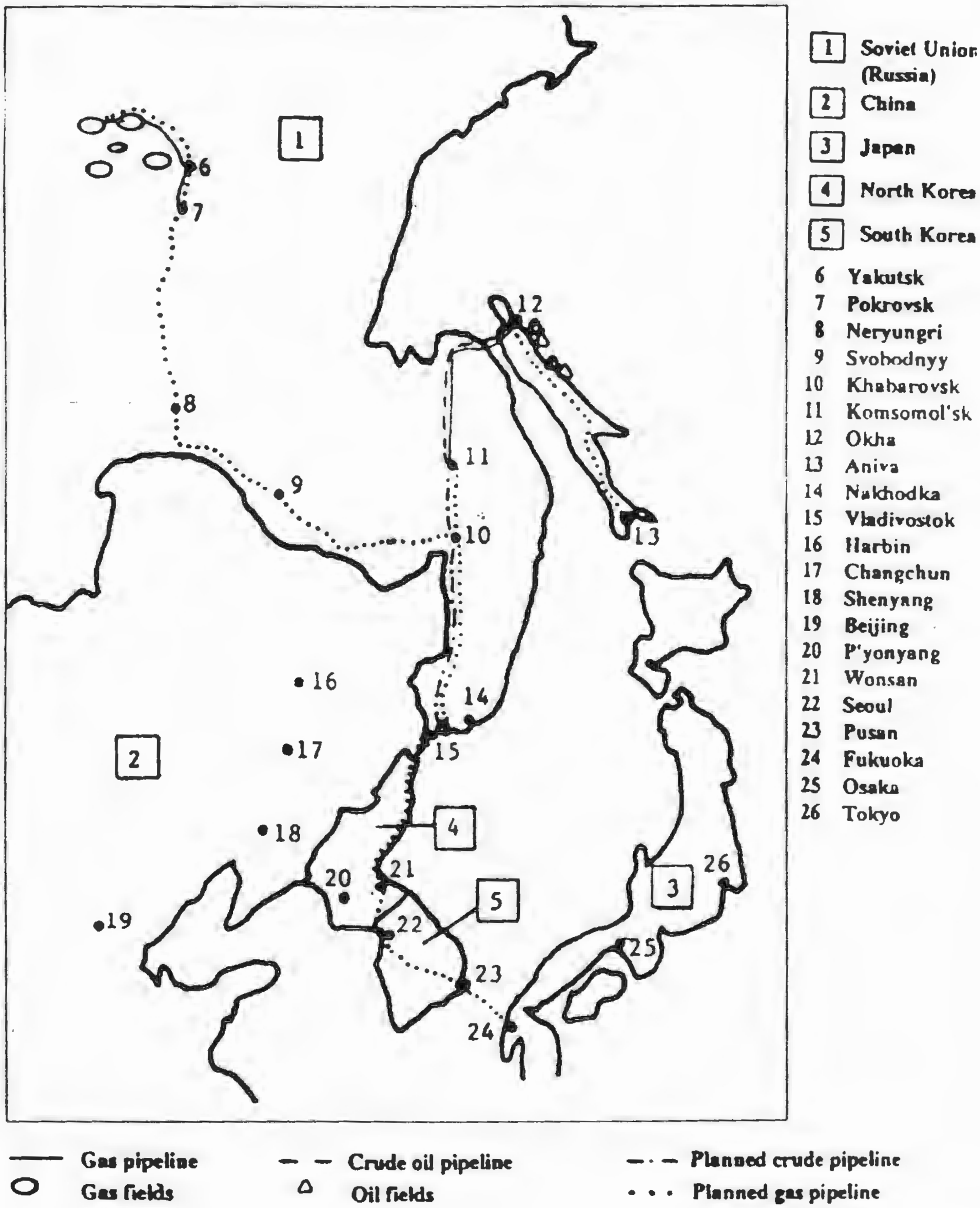
[182] Wook Paik, *Gas and oil in Northeast Asia*, 232.
[183] Allen S. Whiting, "Yakutiya Gas," in Mark J. Valencia, ed., *The Russian Far East in Transition: Opportunities for Regional Economic Cooperation* (Boulder, CO: Westview Press, 1995), 111-124.
[184] *Respublika Sakha*, 8 June 1994; the June agreement also dealt with future Sakha coal exports to South Korea.
[185] Author's interview with Mikhail Tsikel', Vice-President of Sakhaneftegaz, 18 July 1995.
[186] Interview with Konstantin Fyodorov.
[187] Author's interview with L. L. Popova, General Director of Safarg, 4 August 1995.

FIGURE 3-4

Planned Pipeline Routes for the "Vostok" Plan



Source: Wook Paik, *Gas and oil in Northeast Asia*, 230.

from 300 down to 4 employees and still accomplishes more. The JV's main work involves processing seismic data, and it has been entrusted with that task in the feasibility study for the Vostok plan. Safarg is 45 percent Sakha, 45 percent American and 10 percent Japanese and is another example of Sakha's increased power in foreign economic relations.[188]

During President Nikolaev's February 1994 visit to Japan, he hosted a briefing in hopes of generating more interest in the Sakha gas project. Representatives from over 70 Japanese companies attended, but despite the high turnout, the Japanese remained lukewarm on the idea and South Korea continued to be the active foreign partner. Nevertheless,

> South Korea's initiative on Sakha gas development embarrassed Japan, which knew only too well the importance of its commitment to the development. Four Japanese organizations -- the Ministry of Foreign Affairs, JNOC [Japan National Oil Company], Institute of Energy Economics of Japan and Keidanren -- have undertaken studies on the Sakha Republic's gas project, and Japan will not become an idle onlooker. It continues to be interested in Sakha gas development and is only waiting for the best moment to become actively involved.[189]

With or without Japan's involvement, the next steps in the Sakha gas project would be to amass the enormous sums of money required to finance the project and to tackle the formidable engineering obstacles associated with the daunting climatic and physical conditions.

These geographical and financial obstacles are now being addressed and the important point regarding any plans to develop and export Sakha natural gas is that the republic appears to be in control of the process. South Korea and Japan are interested as potential consumers and as sources of necessary capital, and Gazprom of Russia is conducting feasibility studies that Sakha is probably incapable of undertaking due to a lack of experience and inadequate technology. But Sakha has the power to control the process -- the decision to develop is entirely in the hands of the republic. Although it is too early to tell how future revenues from Sakha gas exports might be

[188] Ibid.; see also "<<Safarg>> ishchyot i nakhodit", *Respublika Sakha,* 6 May 1995, 1-2.
[189] Wook Paik, *Gas and oil in Northeast Asia*, 233.

divided between Sakha and Moscow, with Sakhaneftegaz, the Sakha republic has an established institution with which to control the current and future development of its oil and gas resources.

Tyumen' Oblast

Background

Tyumen' Oblast is situated just east of the Ural mountains in western Siberia. The oblast covers 2,296 square miles, which makes it twice the size of Texas, and Russia's largest oblast. Tyumen' has a population of about 3 million residents, 600,000 of which live in the oblast capital, Tyumen' City. The majority of residents are Russian, but indigenous inhabitants include Khantys, Mansis and Nenets. Tyumen' City is reputed to be the first Russian city in Siberia.[190] The Tyumen' region is best known for its abundance of oil and gas resources -- it is the source of about two-thirds of Russia's oil and natural gas.

Decentralization

Much has changed in Tyumen' Oblast since the collapse of the Soviet Union. As with all of Russia's region's, Tyumen' has become more independent, both politically and economically. Tyumen' is regarded as a pro-reform region,[191] which has kept it in favour with the Yeltsin administration. For instance, the process of appointing an oblast governor -- a good indicator of the extent of conflict or cooperation between the centre and a region -- was a Herculean task in some regions, but was accomplished with relative ease in Tyumen'. In 1991 the oblast soviet and President Yeltsin promptly agreed upon Yuri Shafranik as governor and Shafranik later became

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[190] Forsyth, *A History of the Peoples of Siberia.*

[191] Tyumen's pro-reform stance is well documented in Josephine Andrews and Kathryn Stoner-Weiss, "Regionalism and Reform in Provincial Russia," *Post-Soviet Affairs*, Vol. 11, No. 4, 1995, 384-406.

Russia's Minister of Fuel and Energy when Victor Chernomyrdin left the post to become Prime Minister. Shafranik's replacement was Leonid Roketski whose relationship with Chernomyrdin is quite strong. That there exists a degree of trust and agreement between Tyumen' and Moscow likely facilitates decentralization. However, the office of governor in an oblast is not nearly as powerful as that of president in a republic. Oblast governors remain largely subordinate to the executive branch of the Russian Federation, and in several cases Yeltsin has appointed regional governors regardless of regional sentiments, or removed existing governors not loyal to him.

As a resource-rich region, Tyumen' has actively sought to achieve greater control over its oil and gas industries and this control is now more decentralized than at any time during the Soviet period. As early as 1991, the Tyumen' oblast soviet (i.e. legislature) reserved for itself the right to enact laws that could not be rescinded by Moscow, including the right to set prices on oil, gas and wood products.[192] Much of this is a result of, and justified by, "marketization" and the breakup of the centrally-controlled Soviet economy, a professed goal of President Yeltsin.

Challenges to the power and authority of the Tyumen' government come not only from Moscow, but also from the Yamal-Nenets and Khanty-Mansiisk autonomous okrugs, which are themselves subjects of the Federation, but lie fully within Tyumen'. The okrugs' pursuit of autonomy has a direct impact on Tyumen's own pursuit. The challenge from within may prove to be a more serious one for the Tyumen' administration than the one from above. In particular, members of both the legislative and executive branches in Tyumen' have argued that "the threat to local oblast-level control over resources and authority to tax lay not with Moscow but with the autonomous okrugs."[193]

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[192] Bruce Kellison, "Siberian Crude: Moscow, Tiumen, and Political Decentralization," in Stephen Kotkin and David Wolff, eds., *Rediscovering Russia in Asia: Siberia and the Russian Far East* (Armonk, N.Y.: M.E. Sharpe, 1995), 193-206, 199.
[193] Ibid.

The process of decentralization in Tyumen' is made eminently more complex by the presence of the two autonomous okrugs within its territory. There exists an interesting web of relations between the central government and each of these three regional governments, but also between Tyumen' and the two okrugs. Khanty-Mansiisk and Yamal-Nenets were largely subordinate to Moscow and Tyumen' under the Soviet system, but they have recently secured considerable independence from both the central government and from Tyumen'. For instance, Presidential decrees giving the okrugs "fair compensation for the extraction of natural resources and the adverse consequences of the extraction, ... put the Tyumen region into a "one against all" situation."[194]

The situation of the Khanty-Mansiisk and Yamal-Nenets autonomous okrugs in the Russian Federation is a peculiar one. Under Russia's federal structure, they are subordinate to the Tyumen' administration, but are also themselves subjects of the Federation. Of course, this creates much jurisdictional confusion. Going back to 1992, there was great hope that the okrugs could continue their previous relationship with Tyumen', but the parties are now realizing the problems of dealing with each other in governing such a large territory.[195]

Yamal-Nenets is far and away Russia's most important natural gas-producing region, for the present and the future, while Khanty-Mansiisk is Russia's main oil-producing region. Together they account for almost all of Tyumen's wealth and a good portion of Russia's wealth. This wealth affords them considerable economic and political resources that put them in positions of strength in federal negotiations. On some issues, the okrugs have been dealing directly with Moscow, much to Tyumen's dismay. For the Tyumen' government, a loss of control in the

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[194] Alexei I. Ivandaev, "The Struggle for Power Allocation Between the Central Government in Moscow and the Administration of the Tyumen Region," in James E. Hickey Jr. and Alexej Ugrinsky, eds., *Government Structures in the U.S.A. and the Sovereign States of the Former U.S.S.R.: Power Allocation Among Central, Regional, and Local Governments* (Westport, CT: Greenwood Press, 1996), 222-229.
[195] *Rossiskaya Gazetta*, 11 July 1992.

okrugs represents a serious threat to its power. In particular, lost revenues would be enormous if the okrugs were to become independent of Tyumen'.

A recent example of increased independence in Yamal-Nenets and Khanty-Mansiisk, and their threat to Tyumen's power, comes from the Tyumen' gubernatorial election of 22 December 1996. Khanty-Mansiisk and Yamal-Nenets elected their own governors in October 1996 and both okrugs threatened to boycott the Tyumen' election.[196] Khanty-Mansiisk relented but only managed about 15 percent turnout (which basically amounts to a boycott), well below the 25 percent required by okrug law for a valid election. Yamal-Nenets, however, flatly refused to participate in the Tyumen' election. Despite presidential decrees, visits from Kremlin emissaries, and warnings from First Deputy Presidential Chief of Staff Aleksandr Kazakov and Gazprom chairman Rem Vyakhirev to the Yamal-Nenets legislature, the okrug was not deterred. Kazakov suggested that the Yamal-Nenets boycott represents a "serious challenge" to Russia's political structure.[197] Indeed, although the Yamal-Nenets boycott does not threaten Russia's territorial integrity in the same way as the actions of the independence-minded Chechen Republic, it does have potentially serious implications for Russia's federal structure as it currently exists.

Yamal-Nenets was able to successfully boycott the Tyumen' election partly because its abundance of natural gas is a valuable political resource. Yamal gas is one of the vital components of Russia's future economic plans, thus Yamal may use this as leverage in negotiations with the centre and with Tyumen'. Russia is anticipating massive revenues from gas exports to western Europe. The Russian government, wary of jeopardizing both present and future gas development in the okrug, must proceed cautiously in its relations with Yamal-Nenets. Although it has not been stated publicly, it is quite possible that the Russian government would

[196] "Tyumen Election Held, but Okrug Follows Through on Boycott Threat," *OMRI Russian Regional Report*, 17 January 1997.
[197] Ibid.

like to leave Tyumen' out of the loop and share gas revenues directly with Yamal-Nenets. This might leave a larger portion of gas revenues in the hands of the Russian Federation at the expense of Tyumen'.

Plans to further develop Yamal-Nenets gas for delivery to Russian and European markets involve some of the most ambitious natural resource development projects in the world. Russia has already signed some export deals, in particular with Germany, in anticipation of further gas development in the okrug.[198] Potential revenues from Yamal-Nenets gas exports are enormous and would give the struggling Russian economy a tremendous boost. With its small population, Yamal-Nenets could conceivably become a "Kuwait" in the Russian north if it were to gain more control over revenues from gas produced in the okrug.

To briefly summarize, as an oblast, Tyumen's regional autonomy does not yet match that of the Sakha Republic. But, with its pro-reform stance and tremendous oil and gas resources, Tyumen' has become one of the more autonomous oblasts. Political decentralization from Moscow to Tyumen' has been facilitated by the close relationship between central and regional authorities. However, decentralization is complicated by the craving for increased power and authority in Yamal-Nenets and Khanty-Mansiisk. At the heart of all of these struggles for power and authority is the desire for greater control over West Siberia's oil and gas resources.

The Tyumen' Oil and Gas Sector

During the Soviet period, Tyumen' City was home to most of the Soviet economic planning institutions that directed investment in the region's oil and gas sector. As many as nine

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[198] See, for example, Gennadiy Yastrebtsov, "Rurgaz -- Gazprom: Konkurentam tesno, partnerram -- prostorno," *Trud*, 21 June 1995, 2.

Soviet ministries, overseeing everything from exploration and production to refining and distribution, had offices in Tyumen'.[199] Moscow's control over a large part of the Soviet oil and gas industries was directed through Tyumen' city and extended throughout the oblast.

As noted in the previous chapter, privatization in the Russian oil industry has resulted predominantly in regionally-based joint-stock companies (JSCs) which now wield enormous power in their respective areas of operation. The power that is being secured by the "oil generals" that manage these companies is an example of economic decentralization and an important part of Russia's federalization process. Although some of these JSCs may be regional monopolies or even managed by regional governments themselves, their mere existence indicates that a degree of power has passed from Moscow and that the old Soviet centrally-controlled economy has been further eroded. As Russia's main source of oil and gas, much of this process has occurred in Tyumen' oblast.

Tyumen' appears to have some legitimate reasons for wanting more control over oil and gas. For a region so rich with oil and gas, living standards are dismal.

> Tens of thousands of Tyumen oil workers still live in temporary houses that are not equipped with any utilities. No more than 69% of the oil workers in the region have proper housing, which is 12.4% less than the number for oil workers in other areas of the country.... Tyumen's crude oil did not make the people in the region rich. The standard of living in this oil capital is lower than in the capital of any other region in the country. Tyumen is 62nd in housing development, 67th in development of schools and hospitals, 74th in telephones. Crude oil from the Tyumen did not enrich either the country or its oil and gas industry.[200]

Much of the blame for this situation must be placed on the Soviet government. For two decades, the Soviet economy rode on the shoulders of Tyumen' oil and gas, yet the residents of the region

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[199] Kellison, "Siberian Crude."

[200] Ivandaev, "The Struggle for Power Allocation."

were not rewarded with even average living standards. A dramatic decline in oil production since 1989 has made socio-economic development still more difficult.

In the foreseeable future, Tyumen' can entertain little hope of gaining legal ownership of its oil and gas. The Subsoil Act made the central government the owner of all subsoil resources, most of the hundreds of oil and gas companies in Tyumen' are controlled by one of the major holding companies, and Tyumen's oil and gas resources are of such enormous value to the Russian state so as to make regional ownership highly implausible. Furthermore, most of Tyumen's oil and gas resources are situated in the autonomous okrugs which have similar visions of legal ownership.

Under these circumstances, Tyumen' has opted to strive for greater control over the management of and revenues from its oil and gas. In this endeavour Tyumen' has had some success. For instance, Presidential decree No. 93 of 17 February 1992 gave the Tyumen' executive the power to buy up to ten percent of the total volume of the extracted crude oil and sell up to forty percent of it to domestic buyers at free market prices.[201] However, the main powers of management which Moscow and Tyumen' are struggling to control are the authority to set quotas, to issue drilling and export licenses, and to draw foreign investment into the oil and gas industries; and in these areas Tyumen' has had less success.[202]

Conclusion

The analyses of the Sakha Republic and Tyumen' Oblast offer two main conclusions. First, the status of autonomous republic gives Sakha an advantage over Tyumen' in relations with

[201] Ibid.
[202] Kellison, "Siberian Crude."

the centre. More power and authority have been delegated to the Sakha government, largely because Sakha is an autonomous republic. Sakha's executive branch possesses more power and authority than those of oblasts and krais, and has used this asset to aggressively challenge the Russian government on many issues of jurisdiction. Second, natural resource wealth is a considerable source of political power in centre-regional negotiations. The regions of Sakha and Tyumen' derive substantial power from their right to independently market fixed shares of their natural resources -- a right granted by Presidential decree, not by constitutional principle.[203] The political power derived from natural resources is also evident in the gas-rich Yamal-Nenets and oil-rich Khanty-Mansiisk autonomous okrugs. The okrugs have successfully challenged the power and authority of both the Russian and Tyumen' governments. In boycotting the Tyumen' gubernatorial elections, the okrugs have made it clear that they are not satisfied with the current arrangement of power and are striving to usurp power and authority from the Tyumen' oblast administration.

The increased power of resource-rich regions, however, creates some problems for Russian federalism, particularly fiscal federalism. By gaining the right to retain all republic-raised taxes and fund federal programs in the republic, a right delegated to very few regions, Sakha earned a good deal of autonomy. The share of taxes being collected by oblasts and krais that went to the federal budget ranged from 29 percent to 72 percent.[204] Thus, there are wide discrepancies from region to region, and the procedures for sharing central government tax revenues with the regions are changing frequently and unpredictably.[205] Naturally, these circumstances seriously limit the Russian government's ability to reduce economic inequalities among the regions and demonstrate Moscow's lack of control over federal taxation and finances.

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[203] Solnick, "The Political Economy of Russian Federalism," 17.
[204] Slider, "Federalism, Discord, and Accommodation," 246-251.
[205] Christine I. Wallich, "Intergovernmental Fiscal Relations: Setting the Stage," in Christine I. Wallich, ed., *Russia and the Challenge of Fiscal Federalism* (Washington, D. C.: The World Bank, 1994), 64-95.

The executive branch in Moscow has proven to be weak when confronted by the regions, most notably by the republics. The centre "has no political recourse when subnational governments refuse to allow tax revenues to be remitted to the federal government."[206] A reasonably equitable distribution of resource rents among regions is something that may be expected from a federal state, but a sound system of revenue redistribution does not currently exist in the Russian Federation.

The main observation to be gleaned from examinations of the oil and gas industries of the Sakha Republic and Tyumen' Oblast is that negotiations with the centre over joint authority, as specified in Article 72 of the Russian constitution, have produced different outcomes. Specifically, the ownership structures that have emerged in the oil and gas sectors of these two regions are markedly different. Sakha has consolidated republic control over its oil and gas in one organization -- Sakhaneftegaz; while the bulk of Tyumen's oil and gas sector is controlled largely by the Russian government via the vertically-integrated oil majors.

There are several explanations for the different ownership structures that have emerged in the Sakha and Tyumen' oil and gas sectors. First, Sakha's oil and gas sector is very small in relation to Tyumen's. As of yet, Sakha does not export any oil or gas, while revenues from Tyumen' oil and gas exports are a critical to the strength and stability of the Russian economy. Second, as an autonomous republic, Sakha has more legal power and authority with which to control its natural resource industries. The Federal Treaty paved the way for aggressive republics such as Sakha to gain greater control over their natural resources. Oblasts were not granted similar rights and powers under the Treaty. And third, Tyumen' is forced to deal with two independence-minded okrugs, thus further complicating any oblast efforts to increase control over

[206] Ibid.

oil and gas resources. These two okrugs appear to be assuming, or at least attempting to assume, a status akin to that of republics.

It is also important to reiterate the value of natural resources in the Russian economy in general, but especially in Sakha and Tyumen'. In 1992, Sakha, Yamal-Nenets, and Khanty-Mansiisk had the three highest per capita revenues of all Russian regions; and in terms of per capita expenditures, Sakha ranked first, Yamal-Nenets fourth, and Khanty-Mansiisk fifth.[207] That resource wealth may be readily converted into a considerable political resource is evinced by the success these three regions have had in negotiations with the Russian government, and by the success of the two okrugs in their struggles with Tyumen'.

[207] Wallich, *Russia and the Challenge of Fiscal Federalism*, Appendix E.

Chapter 4

CONCLUSION

This thesis examined the changing distribution of control over Russia's oil and natural gas resources, and how this is affecting the nature of post-Russian federalism. The evidence suggests that Russian "federalism" is still very much in flux, as the instability resulting from the collapse of the Soviet Union has yet to subside. Although many new institutions have emerged to guide a fledgling market economy and a young democracy, many more are needed. In particular, a concrete system of federal revenue redistribution is lacking. In the meantime, the nature of Russian federalism is being determined as intergovernmental relations are being resolved, and they are being resolved, for the most part, with bilateral agreements between the centre and the regions. One of the principle powers that is being addressed by bilateral treaties is the power to control natural resources, particularly Russia's lucrative oil and gas resources.

Thus, in assessing the nature of Russian federalism, Friedrich's concept of federalism as a "process" and Riker's theory of federalism as a "bargain" seem very appropriate. Constitutional analysis sets the framework of the bargaining process, but does not reveal the complexity of the situation. A sociological approach helps in understanding the dynamics involved when building federalism in a multi-ethnic environment, but does not address all dimensions when dealing with natural resources. Conceptualizing Russian federalism as a "bargaining process" is useful at this time because, on the one hand, Russia is engaged in processes of differentiation, from highly centralized to more decentralized economic and political systems; and, on the other hand, since the Russian constitution is still young and obviously conflicts with many republic constitutions and the Federal Treaty, the federalization process is best characterized by persistent centre-regional bargaining. Russian federalism may be defined, then, as an ongoing process of political bargaining between the central government and each of the regional governments, as is the case in any federation.

What Russia clearly lacks, however, are effective, stable institutions through which to conduct the bargaining process. In terms of control over oil and gas resources, the most pressing need is a federal system of revenue redistribution. At present, if regions were to gain full control of their oil and gas, Yamal-Nenets, Khanty-Mansiisk and other oil- and gas-rich regions could conceivably become "Kuwaits." This type of situation would not encourage Russia's continued federalization. However, this by no means implies that oil and gas regions do not deserve to reap the benefits of their resource wealth. For its last ten to twenty years, the Soviet system was sustained largely by oil and gas export revenues, while oil and gas producing regions were rewarded with dismal, below-average living standards and serious environmental degradation. In a true federation, these regions that drive the Russian economy ought to be compensated with, at the very least, living standards equal to the Russian average.

At any rate, the Russian government has retained decisive influence in Russia's oil and gas industries. In the oil industry, the Russian Federation continues to hold a controlling bloc of shares in the vertically-integrated joint-stock companies, or oil majors, which dominate the industry. The Russian government has the authority to appoint directors in these companies and members of the companies' management boards must be approved by the central government. Although central authorities do not interfere in day-to-day operations, they have the power to influence major strategic decisions in the oil industry. As for natural gas, the industry is still owned and managed by the Gazprom monopoly which has strong ties with the Russian government, in particular with the company's former general director, now Prime Minister, Victor Chernomyrdin. Under pressure to increase competition in the gas industry, especially from the

Minister of Economics, Yevgeny Yasin, Gazprom recently insisted that it is planning to regroup its operations into separate divisions for production, transport and sales, though it remains unclear whether such a move will increase competition or simply create a clearer corporate structure for the continuation of the monopoly.[208]

The preeminent form of control over oil and gas, and the one which creates the most tension between the federal and regional governments, is ownership. While the Subsoil Act established the federal government as the legal owner of all subsoil resources, this situation has been successfully challenged by some regions. Several intergovernmental agreements have awarded regions substantial *de jure* ownership rights, which in many cases were already being assumed *de facto*. For example, the republic of Tatarstan, which now draws up its own budget independently, has also won the right of ownership of its land and subsoil resources and the right to do as it wishes with a third of the oil it produces.[209] But the constitution of the republic of Tatarstan, in direct violation of the Russian constitution, had already made the republic legal owner of its land and subsoil resources, so the federal-regional agreement was simply an official concession of these rights.[210]

In some cases, however, ownership may not be enough, for Moscow possesses various means by which to trespass on the domain of its *sub''ekty*. For example, through its pipeline company, Transneft', the central government can seriously limit or completely undermine the flow of oil into or out of a region. Moscow has also prevailed in some centre-regional disputes over oil and gas taxation. The conflict between the Republic of Bashkortostan and Moscow over excise taxes is evidence of the central government's authority over taxation in the oil industry.

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[208] "Russia's Energy Monopolies: Giving an Inch," *The Economist*, 1 February, 1997.
[209] Sanobar Shermatova, "Mintimer Shaimiyev's Big Game," *Moskovskiye Novosti*, 24-31 March 1996, 8, translated in *Current Digest of the Post-Soviet Press*, Vol. XLVIII, No. 12, 1996, 15-16.
[210] Leslie Dienes, *Corporate Russia: Privatization and Prospects in the Russian Oil and Gas Sector*, Paper No. 5 (University of Washington: Jackson School of International Studies, 1996), 11.

It is obvious that the struggle to control oil and gas is at the heart of many centre-regional negotiations, and, in some instances, it appears as though the intergovernmental struggle to control oil and gas is shaping Russian federalism. Natural resources in general, but specifically oil and gas, translate into valuable political assets. Accordingly, regions such as Sakha, Yamal-Nenets and Khanty-Mansiisk that are rich in natural resources are among the leaders in the pursuit of regional autonomy.

The other principal asset available to some regional governments is the administrative status of autonomous republic within the Russian Federation. The "layered" territorial-administrative structure of the Russian Federation gives republics an advantage in intergovernmental negotiations, although it is not clear whether it is a decided advantage -- oblasts such a Tyumen' have had greater success challenging the central government than some republics.[211] Still, oblasts and republics do not begin the bargaining process with the centre on equal footing -- the Federal Treaty granted autonomous republics rights and powers that the rest of Russia's regions simply do not possess.

Asymmetry is one of the more conspicuous aspects of Russian federalism. Most of Russia's autonomous republics enjoy relations with the federal centre that resemble federalism, while most oblasts, krais and okrugs remain largely under the tutelage of the centre, embedded in a unitary system of intergovernmental relations. Continued challenges to central authority by the republics should push Russia closer to federalism, but unless oblasts and krais begin to win rights and powers comparable to the republics, Russia will continue to operate under a system of "marble cake" or "matrioshka" federalism, with varying degrees of power and authority in each of the eighty-nine regions; this will be exceedingly difficult to sustain over the long-term.

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[211] Steven Solnick, "The Political Economy of Russian Federalism: Problems of Measurement and Analysis," prepared for the 1995 Annual Meeting of the American Political Science Association, Chicago, Ill., 31 August - 3 September, 1995, 31-32.

The hypothesis that republics have more control over their natural resources is supported by the evidence from Tyumen' Oblast and the Sakha Republic. According to the Federal Treaty, mineral resources are the possessions of the republics, and Sakha used this right to secure control over its oil and gas industries, and its lucrative diamond mining industry. Although it has some authority in terms of oil and gas pricing and taxation, Tyumen' does not control the levers of power in its oil and gas sector to the extent that Sakha does. But the hypothesis that resource-rich regions have earned a relatively high degree of autonomy also appears legitimate, although research on more regions is necessary to validate it with more conviction.

An important factor which prevents Tyumen' from gaining more control over oil and gas is that Tyumen's oil and gas resources are not really in Tyumen', but rather in the Yamal-Nenets and Khanty-Mansiisk autonomous okrugs which are fully within Tyumen', but are themselves subjects of the Russian Federation. The okrugs have similar visions of controlling their natural resources and their outright secession from Tyumen' Oblast now appears to be a real possibility. Should the okrugs be successful in their bids for independence, it would be testimony to the political power generated by their natural resource wealth.

Russian federalization will continue to be an arduous, complex process, but the wheels are certainly in motion. Federalism is beginning to take shape in Russia, and that shape is peculiarly Russian, as it well should be. Decentralization of economic and political power has already been extensive enough so as to make a recentralization of Soviet proportions extremely difficult, as both domestic and international resistance would be stanch. As with any federal state, Russian federal state-building will depend on the continued cooperation between centre and regions.

The challenge for future research in this field of study seems quite obvious: at this stage, assessing the nature of Russian federalism requires direct examinations of jurisdictional divisions. It is insufficient to simply suggest that republics are in privileged positions vis à vis other regions without investigating and analyzing the true division of powers in specific regions. This thesis shows that natural resource wealth also puts regions in privileged positions in intergovernmental relations and that, in some cases, natural resource wealth may indeed be of more consequence than administrative status. Again though, for this to become a firm conclusion more regions would have to be studied. Direct examination of jurisdictional divisions in a greater number of regions would also enable us to address deeper questions, such as: Is the Russian Federation really a federal state? Is the Russian Federation sustainable, or is it destined for disintegration or re-centralization?

This thesis is a contribution to this endeavour. With direct examinations of the Russian oil and gas industries, the Sakha Republic, and Tyumen' Oblast, it further clarifies the nature of Russian federalism by highlighting the manner in which the intergovernmental struggle to control oil and gas is shaping Russian federalism. In doing so, it also promotes a greater understanding of the forces which give rise to and sustain federal states.

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