

# What the Papers Say. Part A

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## **PRESS EXTRACTS**

### **THE NEW BASES OF THE US ARE TIED TO THE REGIONS OF INSTABILITY**

#### **In the future they may become joint in the framework of Russia-NATO council**

*Nezavisimoe Voennoe Obozrenie, No. 31, August 20, 2004, p. 1, Pavel Zolotarev*

The meeting of the Russian Defense Minister and American Secretary of Defense caused an unusual reaction. This reaction was primarily connected with the rumors about possible arrangement of the US military bases along the Russian borders. The US is really revising the principles of deployment of American troops abroad. The US started reduction of its military presence in Europe right after the end of the cold war. In any case, the situation in the world that has changed in the last decade, as well as the content and geography of appearing threats require not only reduction of forces where they are not needed but also a possibility of their transfer and deployment to where it is necessary. Working out a new concept for deployment of troops abroad, the US is obviously guided by purely pragmatic motives.

It is obvious that creation of large military bases with many thousands of servicemen is not rational.

With regard to geography of location of new bases, most likely they will be tied to potential regions of instability, as well as to the regions rich with energy resources. That is why, first of all, it is necessary to expect arrangement of the bases along the arch of instability, or "Big Middle East." This means that these objects will be arranged near the Russian borders. With regard to Europe, in addition to reduction and liquidation of a number of existing bases it is logical to shift them to the southeast. Preserving of American bases in Europe is necessary because continuation of "Islamization" of European countries may have different consequences and Southeastern Europe will "digest" the Balkan crisis for a long time ahead. Relocation or creation of bases in Northeastern Europe is not ruled out, but it will belong to recurrences of the cold war and will be as "smart" as the urgent beginning of patrolling by NATO aviation in the sky of the Baltic neophytes.

What does this mean? How should Russia take this prospect?

Stability in Big Middle East belongs to our common interests with the US and other CIS countries and countries of the Western community. The current situation shows that neither the US nor Russia can cope with contemporary threats on their own. In any case, it is necessary to bear in mind the inevitably inclination of the US as the only present super power towards hegemony and independent actions proceeding from its own national interests and without any special respect to the interests of partners and allies. That is why it seems that

simultaneously with possible American military presence it is also necessary to use and develop the existing mechanisms of cooperation in the security arena. First of all, this is NATO and the Russia-NATO council. The option of creation of not American bases but NATO bases under the aegis of the Russia-NATO council would be optimal. NATO has started to gradually go out of the dead end of passiveness helping to solve security problems outside of the traditional zone of responsibility; for instance, in Afghanistan. Russia-NATO council also begins to play an important role in buildup of collective efforts in the security arena.

It is impossible to be sure that European countries will have an ardent wish to create such bases. Europeans are inclined to reduce military activities and cut military expenditures. We may have a situation already familiar to us. We have the example when the peacekeeping forces of the CIS or the base of the collective security treaty organization of the CIS are actually Russian due to passiveness of other member states of the commonwealth. That is why it is possible that these bases will consist mostly of American and Russian servicemen. There is nothing fantastic in this. We have the memorandum on opening of a joint center for exchange of information from the missile attack warning systems in Moscow, which makes provisions for watch duty of joint crews of American and Russian servicemen. At any rate, such option of the military bases near the borders seems the best. If the matter is about objects of the air defense system, arrangement of joint objects in Russian territory is not ruled out. We have failed to cope with the task of counteraction to nuclear weapons and proliferation of missile technologies; that is why pooling of efforts in the interests of costs minimization and efficiency of the missile defense system would be logical. Control over the missile-hazardous directions by radars from the southern borders of Russia is much more efficient from Eastern Europe.

It is also possible that in one region there will be both Russian - American bases and bases of the collective security treaty organization of the CIS. The main thing is that it is necessary to be guided not by the wish to divide the areas of influence but by the wish to pool efforts in the interests of security. The epoch of division of areas of influence inside of the countries of the Western community, into which Russia is being gradually involved, should remain in the past. Developing military cooperation either on bilateral base or through Russia-NATO council,

bases in one region should interact and not compete. In any case, for this purpose it is also necessary to be active in military diplomacy and in buildup of our own military power. The US is not the partner who can take into account and respect interests of a weak partner. The US has become hostage of its own super power status. The US needs an enemy and often seeks one where there is no enemy, acting like an elephant in a china shop incurring damage on global security. Russia should be able to act as a responsible partner of the US, like on the eve of the war in Iraq, but much stronger and more influential than now.

It is impossible to ensure equal partnership by diplomatic means alone. This also corresponds to the long-term interests of the US.

Translated by Pavel Pushkin

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## **MISSILES A LA KIEV**

### **To whom does the Ukrainian mafia sell weapons?**

*Rodnaya Gazeta, No. 32, August 20, 2004, p. 1, Alexander Kondrashov*

The threat of Georgian President Mikhail Saakashvili to sink ships with Russian tourists near the coasts of Abkhazia caused a loud political scandal. On the contrary, many observers in Russia neglected the promise of the Georgian leader to down airplanes flying over Tskhinvali. Really, will the Georgian air defense units fire slingshots at the modern airplanes? Where will the Georgian air defense units get missiles?

From reliable sources in the Russian security agencies, Rodnaya Gazeta learned sensational details of hasty preparation for a new war in the Caucasus. Who supplies which weapons to this "hot spot?" Knowledgeable people advised us to seek an answer to this question in Kiev.

Since the Soviet times Ukraine was considered one of the largest armament forges. It concentrated 1,810 enterprises of the Soviet military industrial complex employing about 2.7 million people. Of course, many of them are on the decline. For example, the super secret missile plant Radar, formerly known only to a narrow circle of specialists as mailbox number one, produced very sophisticated equipment for the famous Buran shuttle orbiter in the past. It is Ukraine that supports combat duty of the missile systems of the Russian Strategic Missile Forces. Besides the newest Topol-M missiles, almost all old Russian missile systems have "Ukrainian" origin. In the past, officers of the Soviet Strategic Missile Forces were very happy with the missiles made in Kiev and Dnepropetrovsk. Ukrainian plants keep exporting systems for docking of spacecraft and elements for the proton and Soyuz delivery vehicles to Russia.

The entire Ukrainian military industrial complex is currently oriented at export. Ukrainian Armed Forces can pay only for 5% of all products of the local defense enterprises. Ukrainians try to export all the rest of weapons, sometimes at dumping prices. For example, businessmen from the Ukrainian military industrial complex allegedly sold four reconnaissance airplanes worth \$25 million each to Yemen at a price of a Mercedes car, or \$500,000. Criminal proceedings were instituted with regard to this deal. However, Ukrainian special services

failed to investigate this mafia dealing to the end.

Former Chair of the Ukrainian Security Service Vladimir Radchenko spoke about the Ukrainian armament trade right to the point, "The mental wish 'to do something shady' leads to no good." The most illustrative example is the notorious "Kolchuga scandal," the case about illegal sale of the Kolchuga passive radar system to Iraq. This was a real volcano of compromising materials that made many people shudder.

Officially, Ukraine earns \$530-550 million on armament and combat materiel export a year. However, in the armament business, the most profitable business in the world, there are two markets. This is a legal market where companies supported by the state are operating and a criminal market where mafia clans are operating. Alas, in practice they are often intertwined.

Nobody knows how much the Ukrainian mafia earns on armament trade. My competent sources in Kiev presume that these earnings are only slightly lower than the earnings of the state.

In the past, the Ukrainian armament mafia supplied rockets from the Grad multiple rocket launcher systems to the Caucasus. Chechen militants launched them from primitive launchers back during Dudaev's rule. Afterwards Ukraine started supplying the Igla portable air defense missile systems to Chechnya. These missiles downed a few dozen Russian airplanes and helicopters.

Now Georgian military receive these weapons from Ukrainian mafia along with the Chechen field commanders. According to special services, illegal supplies go through Bulgaria. According to the military counterintelligence service, one of the main participants of the shady armament trade was former commander of the military economic service of the Bulgarian Defense Ministry Colonel Khristo Stanimirov. It was Stanimirov who issued two false certificates allowing import of the Igla air defense missile systems and missiles for the Fagot antitank guided missile systems from Ukraine.

From Bulgarian Varna, Ukrainian missiles sail to the Georgian port of Poti. In July alone, Georgia received a batch of ammunition worth about \$5 million from Bulgaria

by sea. At the end of August, the Georgian port of Batumi expects another ship with military cargo worth about \$6 million. Ukrainian mafia may make the biggest revenue of approximately \$100 million from supplies of the medium-range missile defense systems to Georgian troops. By such missile Ukrainian air defense units downed a Russian passenger airliner flying from Israel over the Black Sea by mistake during the military exercises in the Crimea. Only in mid-August Ukraine finally found \$7.8 million in its budget to pay off damages to 132 families of the killed.

It will obviously be even more dangerous to fly over

the Black Sea and the Caucasus because Georgian air defense units can launch missiles a la Kiev no better than the Ukrainian ones.

Translated by Pavel Pushkin

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## **STRUGGLE AGAINST THE "TADPOLES"**

### **Nationalization of parties already started**

*Rodnaya Gazeta, No. 32, August 20, 2004, p. 4, Valery Khomyakov, general director of the national strategy council*

Against the background of political stagnation, Chair of the Central Election Commission Alexander Veshnyakov demonstrates enviable activeness. Recently he acquainted the public with new ideas on correction of the electoral legislation. The most important novelties are obviously the following.

First, Veshnyakov proposes abolishment of the existing mixed system of parliamentary elections and transition solely to the proportionate principle. In other words, all 450 deputies will be elected according to the party lists.

Second, Veshnyakov proposes significant reduction of the federal part of the party lists. Whereas now it may amount to 18 people, after implementation of the ideas of the Central Election Commission it will decrease to three.

Third, the Chair of the Central Election Commission also advocates return to the 5% barrier instead of the 7% barrier to be implemented from 2007.

It is interesting that explaining the need for the upcoming changes Veshnyakov has said that as a result "federal parties will not look like tadpoles whose head is located in the limits of the Garden Ring and who have nothing in the regions."

It is obvious that modernization of the electoral legislation creates new rules of the game for political parties, which will not only accomplish reformatting of the party system started after the defeat of the Rightist Forces Union and Yabloko at the latest elections but will also create more comfortable conditions for the pro-Kremlin parties.

The proportionate system which will dramatically increase centralization inside of the parties will increase weight of the federal governing bodies leaving the unenviable role of the secondary players to the regional branches. What regional development can we speak about in this case? On the contrary, there will be significant reduction of motivations for the regional activists.

With regard to reduction of the federal part of the party lists to three people and respective declared redistribution of deputies' mandates in favor of the regions, people who have some time seen how the party

lists are formed understand perfectly well what will happen in reality: the regional threes will be given to the same party "Garden Ring." It is quite obvious that liquidation of the institution of single-mandate constituencies will reduce the regional representation in the parties even more.

Thus, it is possible to see with a naked eye that the declared goals of modernization of the electoral legislation obviously contradict to the obvious results. What are the real goals of such hasty correction then?

First, behind the abolishment of elections in the single-mandate constituencies there is a new attempt to reduce influence of governors on the federal authorities. This will be especially noticeable for large regions that elect three and more deputies.

If we bear in mind the words of Alexander Veshnyakov about the need for transparency of financing of the elections and abolishment of sponsor contributions from non-profit organizations, it is possible to say that abolishment of the institution of single-mandate constituencies will seriously reduce political opportunities for business. As a result of the obvious reduction of the number of centers of influence on the deputies, the deputies will be more controllable and dependent on the Kremlin.

Second, return to the 5% barrier should be taken as granting of chances for the future party projects of the Kremlin. In the leftist flank this is Motherland. With regard to the other part of the political spectrum, information about beginning of buildup of a new party has already leaked to mass media and by the end of the year we will obviously see the first organizational steps in this direction.

If all this is implemented, by 2007 we will receive a practically complete "nationalization" of the system of political parties. This construction may have the following configuration. United Russia or other pro-presidential party will be the basic party, Motherland will be to the left and a new rightist party will be to the right. Leftists and probably LDRP will be in the future Duma as exceptions and their role in the legislative process will be seriously reduced.

With regard to Yabloko and the Rightist Forces Union,

their prospects are directly connected with results of the elections to the regional parliaments to be held in 2004. It is impossible to rule out that in case of the failure the project entitled the Rightist Forces Union will be finally closed and Yabloko will continue its further marginalization.

President Vladimir Putin has frequently spoken about the need to form independent political parties, about the need to seek new stability on the basis of stable system of political parties. So far it seems that everything is done to move the country further from fulfillment of these tasks.

Making the parties supplements to the state mechanism, the initiatives of the Central Election Commission only aggravate the situation.

Translated by Pavel Pushkin

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## **THE AUTHORITIES PREPARE A NEW DEFAULT**

### **The money for this is being accumulated in the stabilization fund**

*Rodnaya Gazeta, No. 32, August 20, 2004, p. 1, Alexander Krivtsov*

The current unprecedented growth of world oil prices is very bad for the financial authorities. The growth makes fulfillment of the task of simultaneous hindrance of inflation and strengthening of the real ruble exchange rate set for the government and the Central Bank much more difficult. Sooner or later, the authorities may be tempted to "socially orient" the economy at expense of the surplus of the stabilization fund. There is no other money for additional expenditures in the budget for 2005, and this money cannot be taken from anywhere else.

With increase of the petrodollars' flow into the economy the budget stabilization fund became a real magic wand for the Finance Ministry. So far, the stabilization fund has saved the government from direct accusations of incompetence. Surplus of ruble supply on the market goes to the stabilization fund. This explains, according to leading expert of the Center for Development Oxana Osipova, the speed of growth of the gold and currency reserves decrease in the first half of 2004 to 0.6% from 24.4% in the first half of 2003. Capital flight also helps the government to combat inflation. Only according to the latest official projections of the ministry of German Gref, net capital flight from the country until the end of 2004 will amount at least to \$8 billion. According to independent estimates, the net capital flight will be even bigger.

In his interview to the correspondent of Rodnaya Gazeta, director of the analytical department of bank of Moscow Kirill Tremasov said that unplanned social payments would lead "to a serious shift of all macroeconomic parameters." Tremasov is convinced that by the end of 2005 the stabilization fund will accumulate already about 1 trillion rubles "if the government keeps accumulating the money not used in the economy and oil prices do not fall below \$30 per barrel."

The oil prices are not going to fall yet. Officials of the Finance Ministry and Economic Development and Trade Ministry keep saying that strengthening of the national currency is an objective process connected with natural growth of economy. That is why it is reportedly a very difficult but noble task to prevent ruble strengthening.

Without the hotbed conditions maintaining the weakness of the national currency the commodities economy of Russia will allegedly collapse. Independent experts agree that this is possible. However, in reality, this is the most important aspect; ruble strengthening will lead to actual growth in the labor costs. State officials somehow prefer to keep silent about this obvious axiom of the economic theory. After ruble strengthening people will actually earn more, if we presume that the sums of wages are not reduced and at least remain the same. In this case for the money paid by the employer it will be possible to buy more goods of better quality. Hence, the "natural ruble strengthening" registered by officials of the Economic Development and Trade Ministry and Finance Ministry is nothing more than natural brake for inflation process. On the contrary, artificial slowing down of the growth in the value of the national currency that the monetary authorities set as the super task only contributed to acceleration of the inflation flywheel.

The most astonishing thing is that fulfillment of the killing "one-in-two" task of inflation hindrance and ruble strengthening prevention contradicts to the main priority of the state, namely building of a socially oriented economy. This happens because the new course of the Central Bank and "anti-inflation measures" of the Finance Ministry finally lead to decrease of real revenues of every Russian family. The "dry residue" of the economic strategy of Fradkov's cabinet pursued allegedly in the interests of "domestic manufacturers" remains on accounts of the oligarchic groups or, in the best case, in the stabilization fund.

Nobody knows what to do to the stabilization fund and gold and currency reserves, which have become bloated without justification. Top-ranking state officials even do not discuss this question. The stabilization fund as the main regulator of the optimal quantity of real money in the economy growing proportionately to the oil price on the global markets may finally become time bomb, about which economists warn us, and may ruin the financial system of new Russia. It is not necessary to remind who will suffer as a result of a new default.

Translated by Pavel Pushkin



## **THE DRAWN-OUT END-GAME**

*Expert, No. 30 (430), August 16, 2004, pp. 22-25, Alexander Koksharov*

The current result of the turmoil of the "YUKOS affair" in mid-August is the following: YUKOS still has to pay off 99.4 billion rubles (\$3.4 billion) of tax arrears to the Tax Ministry for 2000. YUKOS should pay off these debts until August 29. At the beginning of August, the company paid only 30% of this sum. Shares of Yuganskneftegaz and Tomskneft, accounting for 80% of YUKOS' oil production, are still frozen. The Tax Ministry already set the bill of tax arrears for 2001 worth 98 billion rubles and announced beginning of a tax check for 2002. The overall sum of the tax arrears for 200-2003 may vary from \$8 billion to \$12 billion.

Despite everyone's interest in the "YUKOS affair," Russian authorities keep the market, investors and analysts in complete ignorance about their plans. The science of "Kremlinology" blossoms in these circumstances.

Due to absence of open information about the strategy and tactic of the Kremlin with regard to the "YUKOS affair" and oil and gas sector in general analysts have to be content with fantasies and asking questions.

Until the beginning of August, many people doubted the resolution of the Russian authorities to liquidate YUKOS. After the arrest of shares of the main production assets these doubts disappeared. Julian Lee, senior analyst of the London Center for Global Energy Studies (CGES), told *Expert*, "For a long time I remained optimistic and believed that Russian authorities were trying to struggle personally against Mikhail Khodorkovsky and there might be scenarios for preserving of YUKOS as a company. Now it is clear that the reason is not Khodorkovsky but the company itself." On August 6, a bailiff arrested property of Yuganskneftegaz and Tomskneft as "property that does not belong to capital assets (machinery and equipment and so on) and belonging to the first turn of enforcement in accordance with the debt enforcement legislation." Thus, its holding structure played a dirty trick on YUKOS. From the point of view of the Ministry of Justice, YUKOS turns out to be a shell company that is not involved in production operations. As a result, not the share of Sibneft acquired by YUKOS in 2003 but shares of the main production assets become the first candidates for sale for repayment of debts to the state.

It is clear that without these assets YUKOS will cease to exist in the old form. Yuganskneftegaz accounted for 70% of the proven reserves of YUKOS and 62% of production, Tomskneft accounts for 20% of production and Samaraneftgaz accounts for 12% of production. CEO of YUKOS Steven Theede says that in case of loss of Yuganskneftegaz and oil produced at its fields, bankruptcy

of YUKOS will happen in three weeks.

The verdict of the arbitration court on August 6, which abolished arrest of Yuganskneftegaz shares, did not change the situation. On the same day, the Ministry of Justice arrested the shares again. Craig Kennedy, analyst of Morgan Stanley, told *Expert*, "Persistence of Russian authorities in imposing of arrest shows that these assets will be sold first of all in the near future." In late July, the bailiff service of the Ministry of Justice estimated Yuganskneftegaz at \$1.75 billion. According to YUKOS, the American geological company DeGolyer & MacNaughton estimates proven reserves of Yuganskneftegaz at \$30.4 billion in current prices. Russian and foreign investment banks estimate the market value of Yuganskneftegaz (taking into account production costs and discount) at \$15-17 billion.

Why does the state estimate this asset so cheaply? James Neil, analyst of the London branch of Citigroup, says "There are two answers to this question. The first answer is that Russian authorities wish Yuganskneftegaz to be sold to an oil company loyal to the Kremlin. The second answer is that they may wish YUKOS to have insufficient money from this sale for return of the past tax arrears, which means company's bankruptcy."

A kind of change occurred in the fate of the assets last Thursday. On August 12, the Ministry of Justice announced that for assessment of Yuganskneftegaz it would hire the investment bank Dresdner Kleinwort Wasserstein (DrKW). From the foreign bank valuing its reputation analysts expect an assessment being as close to the market one as possible. This circumstance confuses the fate of the assets but so many pieces of controversial news have been in the "YUKOS affair" in the last few weeks that it is possible to take all of them in good faith.

In the last few weeks, analysts persistently mention the state-run company Rosneft as the most likely buyer of Yuganskneftegaz and probably other assets of YUKOS. The unanimity is explained by the recent personnel reshuffles. On July 25, Deputy Director of the Presidential Administration Igor Sechin was appointed on the post of CEO of Rosneft. Previously this ally of Vladimir Putin and professional agent of the special services was not noticed to have any special interest in the economy, nor in the oil industry. Christopher Weafer, chief strategist of the analytical department of Alfa-bank, told *Expert*, "Igor Sechin is one of the key political allies and proxies of Putin; that is why his appointment to present-day Rosneft, a small oil company, is a serious lowering. His appointment is obviously connected with the new role assigned to Rosneft by the Kremlin."

In the last 12 years, Rosneft has been an obvious outsider of the Russian oil sector. At first, this state-run served as a pool of production assets, from which other vertically integrated oil companies were separated. These were TNK, Sibneft, VNK, ONACO and other companies, which were privatized later. By the end of the 1990s, Rosneft became the smallest of the vertically integrated oil companies with assets scattered all over the country, low production (even purely regional company Tatneft produced more oil) and low efficiency. Many analysts presumed that after privatization of Slavneft in 2002 Rosneft will be privatized very soon and the entire Russian oil industry will go to private owners.

This did not happen due to growth in oil prices. The state evidently understood that it was not worth getting rid of all oil assets. Rosneft has remained state-run and is currently being strengthened politically. It is difficult to interpret Sechin's appointment as anything other than preparation of the company for reception of a large oil asset. Because tax checks of YUKOS were started after the statement of Sergei Bogdanchikov, who was President of Rosneft then, it seems that this company is the first candidate for assets of drowning YUKOS.

Analysts can only guess what the plan of the Kremlin regarding the future of Rosneft is. If the state decides to give up services of DrKW in assessment of Yuganskneftegaz, this asset may be sold to Rosneft for a small sum. If the price of the asset reaches at least \$10 billion, the state will have either to invent sophisticated schemes (including reorganization of Rosneft into a joint stock company and cross exchange of shares) or to attract other loyal companies like Surgutneftegaz. According to analysts, Surgutneftegaz accumulated about \$6 billion in cash.

If Rosneft receives only Yuganskneftegaz, it will immediately become Russia's second largest company according to oil production (75 million tons) and will be inferior only to LUKoil. If Rosneft establishes control over all the remaining key assets of YUKOS, it will be oil company number one in Russia.

In their fantasies some analysts go even further. With a high probability they predict a merger of new enlarged Rosneft with Gazprom and Surgutneftegaz. Such merger may seem to be incredible but the current events related to YUKOS would seem absolutely unrealistic 18 months ago.

One way or another, it is now possible to speak about the end of existence of the system of the oil and gas sector that appeared in Russia in the 1990s. Demonopolization and privatization were the main directions for development of the sector at that time. Now many members of the political elite presume that bearing in mind importance of the oil industry for the national economy the oil industry should be under state control. In any case, trying to strengthen its influence the state will not necessarily give up the marketing institutions entirely. Rosneft may be reorganized into a joint stock company and a part of company's shares may be brought to the market. Nonetheless, the situation in the oil industry will change radically.

In case of transition of capital assets of YUKOS to the state-run company a significant part of the oil and gas sector that accounts for about 55% of the export revenue of Russia will remain under direct control of the state. Naturally, the remaining companies of the sector like LUKoil, Surgutneftegaz, Sibneft and even TNK-BP will remain loyal to the state sector to the maximum extent. LUKoil and Surgutneftegaz have always had friendly relations with the state. Sibneft, which was passing a phase of aggressive growth on account of internal reserves and takeovers 18 months ago, suddenly disappeared from the information field. The British-Russian TNK-BP, establishment of which was approved by the Kremlin according to sources of Expert, has also acted as a company very loyal to the authorities in the last 18 months. Incidentally, this is TNK-BP that is negotiating with YUKOS on buyout of a 53% stake in Rospan. This fact shows that TNK-BP feels itself quite comfortable in Russia.

If control over the oil industry goes to the state, the rules of the game for those private companies loyal to the state will change significantly. Christopher Weafer from Alfa-bank presumes, "Most likely, they will have to pay more taxes, a more stringent natural resources use regime will be implemented, observance of the license terms will be controlled more stringently, etc." This is already taking place. Taxation of oil industry was increased in spring. On August 12, the Natural Resources Ministry announced that together with the Federal Security Service, Interior Ministry and customs services it would check oil companies with regard to correspondence between the real and declared production volumes. The Natural Resources Ministry is currently accelerating passing of amendments to the law on natural resources that will abolish participation of the regions in licensing and will implement more stringent procedures of natural resources use. Natural Resources Minister Yury Trutnev hopes that the Duma will pass these amendments already this autumn.

Laza Kekic, senior economist of EIU, told Expert, "Optimism that some people have retained about YUKOS is already gone. Now everyone is waiting for the final destruction of the company and beginning of any kind of stability in the oil and gas sector of Russia." One way or another, this stability will be connected with strengthening of state positions in the oil industry. One of the most important questions for our economy is how will the state manage it. Analysts cannot say according to which scenario the state development will go, according to Venezuelan (fully state-run model) or Norwegian (allowing private ownership).

Julian Lee from CGES presumes, "Although in both countries the oil and gas sector was in the hands of the state, different political cultures lead to different results. State-run companies usually work in circumstances of dictatorship of the state; private companies in circumstances of dictatorship of the market. If the state chooses populist goals, like this has happened in Venezuela, the state-run companies suffer financially."

Political culture in Russia is obviously different from the political culture of Norway. In the post-Soviet history of Russia state-run companies were inefficient. Throughout

the 1990s, state-run Rosneft and semi-state-run Slavneft were inferior to their competitors practically according to all parameters. In mid-2003, full production costs of a barrel of oil (including delivery to terminals and administrative costs) amounted to \$6.50 in YUKOS, \$7.50 in Sibneft and almost to \$12 in Rosneft.

In any case, the oil industry was not very efficient in the Soviet times too. Due to inefficient management in the 1980s investments in the oil industry decreased and production growth stopped in 1987. Russian oil industry started growing rapidly since the end of 1999 (since then, production grew by 52%) and this growth was conditioned by dictatorship of the market.

Craig Kennedy from Morgan Stanley presumes, "It is quite possible that the state has decided to use the oil and gas sector as a "cash cow" for modernization of the economy. This is probably a good idea but due to absence of efficient banking system it is not realistic. The most dangerous may be the worst-case scenario when the state neglects the interests of the oil and gas industry that requires significant investments, \$10-12 billion a year."

The matter is primarily about investments in new fields located outside of the current zones of interests of the state. If YUKOS is destroyed, only old oil provinces will remain under direct or indirect state influence. These are Western Siberia (70% of production) and Urals and Volga area. The new oil provinces like Eastern Siberia, Timan-Pechora or Sakhalin require significant investments for which it is necessary to make daring decisions. Our state has become used to considering itself very poor and makes strategic decisions with difficulty.

If the old oil provinces are fully divided among Russian companies, Western companies will try to come to the new regions even despite the significant costs. Julian

Lee presumes, "Of course, Western oil companies will have bigger apprehensions about doing business in Russia but they cannot ignore it. Russia is the last undeveloped territory. Of course, political risks will be higher but oil companies have got used to working with even bigger risks in such countries like Nigeria and Venezuela." That is why coming of such companies as ExxonMobil or ChevronTexaco to Russia and not only to the Sakhalin seabed is just a matter of time.

Thus, foreign capital may form an external ring around the Russian nucleus of the oil and gas sector. A part of this ring is represented by undeveloped reserves of Eastern Siberia and correspondingly the Asian direction of the oil and gas export with a huge multiplication effect for Russian trade and economy in general.

Changing of configuration of the oil industry and uncertainty about the long-term infrastructure projects create a risk of loss of strategic prospects of Russia on the global oil market. While the global demand for oil keeps growing very fast, re-division of property and/or control continues inside of the country and solving of strategic problems is postponed. The new structure of the industry will not necessarily provide the necessary volume of investments for the oil sector. As a result, Russia loses time, money and opportunities and risks remaining a regional oil power with very limited ambitions.

Translated by Pavel Pushkin



## **ON THE OUTCOME OF THE "YUKOS AFFAIR"**

*Expert, No. 30 (430), August 16, 2004, p. 12, Valery Piven, Alexander Savelyev, Bakhur Andrei Borisovich*

The outcome of the "YUKOS affair" left no doubts from the very first procedures of the prosecutor's office against the corporation.

It is possible to argue about legality and substantiation of the tax accusations, charges according to clauses of the Criminal Code and other legislative acts and opinions may differ. However, the following peculiarities attract our attention.

1. Repression mechanism was used against the corporation being the leader of not only oil industry but also the economy in general. Whereas not only YUKOS used the tax avoidance schemes, it is possible to presume that the corporation occupied its place due to a more successful choice of managers and method of managerial methods used. Leadership of YUKOS on the stock market among other oil companies proves that investors considered the mechanism of the corporation's functioning optimal for Russia's circumstances and did not wish to add any corrections to it. A wise state would settle the problems of tax and other problems in the ex-court

manner and allowing of bankruptcy of a company being one of the pillars of the national economy is an unprecedented case for the international practice. If the authorities and the new owners desired by it (we know how tenders of all kinds are organized in Russia) possess unique methods for making of corporations super successful, it would be necessary to test these novelties in the companies being in decline or not valued by the market as high as YUKOS.

It is quite clear that the argument that "we will simply pay more" is not a sufficient reason for such serious interference. Here is a small detail: collapse of the stock market together with its deprivation of one of the most attractive tools for investments buries the pension reform at the earliest stage of its development and leads to removal of not even the biggest capital from active circulation.

2. The whole Russian business elite brilliantly demonstrated its insolvency as a serious public and political force. It is obvious that the naive hopes that the

process of property re-division ends with the "YUKOS affair" will not come true. From historic practice it is known that if an aggressor is not stopped at the earliest stage of its predatory activity, the aggressor gets the taste of this action. Nobody also abolished the old rule that power is in unity but instead of being united around Khodorkovsky and others oligarchs suddenly turned to comprehensive philosophizing about the essence of the state system. These philosophical thoughts were expressed at the level of epoch of Nicolas I; that is with complete absence of any dissidence. In the current situation businessmen had to remind the Kremlin about a bigger range of unsolved problems being much more important than the tax arrears and that given the non-eradicated corruption redistribution of property is doomed for lawlessness and that the authorities elementary did not grow up to such direct interference into economy. They needed to say that unlike business, which this way or the other started developing and determined direction of this development, the state could not dare to take any serious step practically in any area of its competence. They needed to remind that the state did not do anything to improve conditions for existence of business and that it finally owed its survival to the businessmen who supported Yeltsin in 1996, who were making money themselves and were allowing others to earn money lowering the degree of social tension. In other words, since 1991 business has coped with its activity much better than the state and has the right for a totally different attitude.

3. There is no doubt that such actions of the state will result in suppression of private initiative. There is a feeling of some enormous chaos in the authorities.

Throughout the entire course of the "YUKOS affair" I advocated the actions that reduced influence of YUKOS,

Khodorkovsky and large business on state policy even on not quite legal grounds. Oligarchs should not determine state policy because other groups of society and social groups have no influence comparable to that of large business now, of course, leaving apart the corporation of bureaucrats and security agencies officers.

I have been and remain a supporter of tight control of the state over large business. If large monopolies control 60% of revenues of the federal budget, the state is simply obliged to control them stringently. Russia should be governed from the Kremlin and not from Jersey Island. But I am definitely against destruction of large business by the state. To receive the aforementioned 60% of revenues large business needs to work and not lay in ruins. Putin is absolutely right: we should not make YUKOS bankrupt.

For me coming of Gerashchenko to YUKOS was a sign of normalization of the situation from the point of view of national interests. Only a cynic can say that Gerashchenko is a person of non-statehood mentality. However, Gerashchenko complains that he cannot establish contact with the state.

We can only presume that bureaucracy of the authorities remains stronger than the authorities. The tail is wagging the dog. Tails are fond of wagging dogs and the most important thing is that the dog should not allow this.

Translated by Pavel Pushkin

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## **CHECHEN RUBICON**

### **The border between chaos and order goes through it now**

*Rossiyskie Vesti, No. 28, August 19, 2004, p. 1, Alexei Titkov*

It turns out that it is possible to abolish the elections in Chechnya and to introduce direct rule of a super plenipotentiary of the Russian President in some regions. According to Rossiyskie Vesti, this good idea was born in the staff of currently dismissed Kvashnin. The other extreme was proposed by Berezovsky. The essence of the idea pinned up to the topic of presidential elections in Chechnya is simple: to correct Yeltsin's slogan "Take as much sovereignty as you can" for "Give up as much sovereignty as you do not grudge." It is clear for any sober-thinking person that implementation of both the first and the second model means inevitable destruction of the Russian state.

Incidentally, arguments of the hardliners are more than serious. For example, if in 1998 there were only 279 pieces of small arms in search in the USSR, the overall number of small arms pieces that remained on hands of the population after breakup of the USSR amounted to

8-10 million. The major part of this quantity still remains in the regions and republics of North Caucasus. In the course of Vikhr-Antiterror operation in 1999, law-enforcement agencies confiscated more than 300 tons of explosives illegally stored by private individuals. The major part of these explosives was stored in the south of Russia. The context of these figures frequently laid on the table of the President was obvious: the federal center was pushed towards implementation of the regime of state of emergency in some regions of North Caucasus and south of Russia.

In case of application of the regime of state of emergency to Chechnya, Ingushetia, Dagestan, North Ossetia, Kabardino-Balkaria, Karachaevo-Cherkessia and Stavropol Territory a significant part of the country's population and, what is the most important, its population will be removed from the constitutional environment. This will actually mean that the central authorities recognize

their inability to govern the state in the framework of commonly accepted civilized norms.

It is interesting that the idea of state of emergency was discussed in the Kremlin in 1996. If we continue these unpleasant recalls of the future, we recall that the model of state of emergency was replaced with the Khasavyurt agreements prepared by Berezovsky and Co. The principle dear to the heart of the "London exile" was actually implemented. The Ichkeria enclave shared sovereignty with the central authorities in accordance with the well-known proverb "Oh Lord, take what I do not need." We are still disentangling the consequences of those decisions. Like in case of the forceful option, the oligarchic scenario makes provisions for direct and uncontrollable access to resources of the country bypassing the federal center. The essence of the matter does not change from the fact that in one case we speak about absolute access to power and in the other case we speak about access to money.

It is obvious that now the intrigue is connected with the upcoming presidential elections in Chechnya. Coming of a new strong leader actually undermines the interests of both the first and the second groups of the "interested persons." Alarm of the opponents of the elections scheduled for August 29 is primarily connected with the personality of Alu Alkhanov. Alkhanov is actually a representative of the group of the Chechen Society that was at the steering wheel in the Soviet time when northern clans formed the basis of both the state power bodies and security agencies in the region. It was the northern Chechens, primarily representatives of the Interior Ministry of the republic, who offered the most serious resistance to Dudaev and Basaev. It is for them that the militants are still hunting.

At the end we present the data of the sociological poll held in early August. Between August 1 and 5, the Moscow Center of Political and Business Communications polled 630 residents of Grozny. In the course of the poll 63.3% of respondents gave a positive answer to the question "Will you take part in the elections?"; 17.4% of respondents answered negatively and 19.1% of respondents did not make up their mind yet. According to the poll, 59.1% of respondents know for whom they will vote, 23.4% of respondents did not make up their mind yet and 26.7% refused to answer the question "Do you know for whom you will vote?" If the elections were held at the moment of the poll, 39.7% of respondents would vote for Alu Alkhanov, 6.9% would vote for U. Abuev, 6.3% would vote for M. Aidamirov, 6.3% would vote for A. Bugaev, 2.3% would vote for M. Khamidov, 1.5% would vote for V. Visaev, 0.4% would vote for M-KH. Aksakov and 21.8% refused to answer.

Translated by Pavel Pushkin

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