
4. Domestic developments in Russia

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I. Introduction

The system of international relations is shaped by the totality of states' foreign policies. In the long run the foreign policy of each country is determined by the state of its home affairs at the particular stage of its development. The state of peace means reasonable and mutually acceptable compromise among the members of the world community—compromise that takes into account the diversity of domestic situations of different countries and dampens its explosive influence. This is why in analysing the foreign policy of any state it is vital to recognize the roots that feed it.

Russia, which is still in the early stages of the formation of its new statehood, is faced with the choice of the set of values that will determine its further evolution. Both inside and outside Russia there is heated controversy between the proponents of a 'Western' and an 'Asian' orientation. There are also voices which stand up for some 'special' Russian way of development which, to be more precise, can be defined as a special synthesis of separate elements of Western and Asian development models with the Russian 'soil', but they are few and far between and their voices are usually lost in the noisy chorus of adherents of extreme positions.

The international community, and especially the West, has not yet managed properly to comprehend Russian realities. This is not an easy matter. The dynamism of change in Russia—not only in the political sphere but also in the social and economic spheres—is so intense that sometimes even a native observer might fail to keep pace with it. It is even more difficult to follow the correlation between these inner transformations and the zigzags in foreign policy.

It is impossible to cover all the aspects of this interdependence within the framework of this chapter. It therefore focuses on a brief analysis of the most important changes in Russian public life which have produced new foreign policy actors and the consequences for the adoption of an 'Asian' direction of Russian foreign policy.

II. The nature of political power in Russia

There is a myth that after the unsuccessful August 1991 coup democracy was established in Russia. This myth is supported by the simplistic idea that the presence of such attributes as regular parliamentary and presidential elections, numerous political parties, and a press and other media representing different

points of view means the existence of democracy itself. Outward appearances, however, hardly ever adequately reflect real content. The world has always had and still has dozens of states that have arrayed their traditional 'body' in a democratic 'suit' borrowed from the West. To prevent this suit from falling apart they have stitched it with strong authoritarian thread.

That is exactly the case of Russia.

It is true that in 1990–91 a young democratic movement was at the vanguard of the struggle for the transformation of the USSR, but there was neither the social nor the economic basis necessary for it to establish itself in power; there were no appropriate traditions, no appropriate mass psychology or even a more or less developed civil society. That is why, objectively speaking, Russian democracy paved the way to power not for itself but for quite a different public force—the economic *nomenklatura* responsible for economic management.

Previously the ideological *nomenklatura* had held complete sway. The events of August 1991 eliminated it once and for all. During the short prime minister-ship of Yegor Gaidar in 1992, the economic *nomenklatura* was in confusion. When Viktor Chernomyrdin replaced Gaidar in December 1992 it began to recover from the shock and strengthen its position on the federal level. Its triumphant march into the Russian regions needed more time, entering its final stage only during the 1996–97 local elections, which were mostly won by pragmatic managers irrespective of party affiliation.

Russia's peculiarity and its trouble is that power, which is democratic in its form and authoritarian in its essence, is never strong. The power that emerged after the collapse of the Soviet Union has from the beginning been weak and unconsolidated. The society lacked social and political consensus both at the party level and in the very top power structures—between the executive and legislative branches and between factions and groups within the executive. Even President Boris Yeltsin, in spite of the deliberately cultivated image of a 'strong ruler', seemed unable to overcome the divisions within and between powers and the political elite. Instead he manoeuvred and set different forces against each other. As a result a peculiar phenomenon developed or revived—the court cabal or 'shadow cabinet' familiar from pre-Revolutionary Russia. The composition of the shadow cabinet changed from time to time. In late 1997 and early 1998 Tatyana Dyachenko, the president's daughter, Valentin Yumashev, the head of the presidential administration, and some of his deputies obtained special influence in the presidential circle. Owing to their closeness to the president some of them achieved importance disproportionate with their real abilities, while the president's mood, sentiments, whims and state of health were becoming a critical factor of Russian domestic and foreign policy.

The initial euphoria following the 'victory of democracy' and the proclamation of radical economic and political reforms (the stage of 'romantic democratism') was evidence of the complete disregard for Russian realities, social forces and economic interests of the radical democrats and liberals in Russia and those Western circles who supported them.

The implications for foreign policy

All these factors were reflected in Russia's foreign policy. In the early years after the collapse of the USSR, the urge to join the club of democratic Western nations immediately, establish Russia's equality in partnership with the Group of Seven leading industrialized countries (G7) and so on prevailed.

Andrey Kozyrev, Russian Foreign Minister from January 1992 to January 1996, was ready to pay for formal great-power status by patiently following the lead of US foreign policy. For this reason Russia broke off practically all cooperation with developing countries, instead of placing those relations on a mutually beneficial commercial basis. Even the countries of the Commonwealth of Independent States (CIS), and especially the Central Asian and Transcaucasian republics, began to be seen as a burden, and Russian foreign policy blocked all integrationist tendencies on their part. The direct consequence of that one-sided orientation to the West was that cooperation with Asian countries, vitally important for Russia, was ignored. The emphasis was placed on obtaining financial aid from the West—from official sources and through private investment. Development aid, however, came to little. The West shifted the function of financial support to Russia to the international financial organizations such as the International Monetary Fund (IMF) rather than to official development aid. Multinational corporations and private Western businesses have been in no hurry to invest in Russia, fearing instability, the lack of clear and reliable legal infrastructure, the corrupt bureaucracy and so on.¹

Kozyrev's foreign policy did not correspond to the fundamental interests of the state. A reversion to a more pragmatic and more balanced foreign policy was inevitable.

III. The formation of bureaucratic capitalism and the emergence of new foreign policy actors

Bureaucratic capitalism is a specific form of capitalism during the catching-up phase. In fact it is a special version of 'primitive accumulation', initiated by the state bureaucracy and carried out with its active participation. It is especially typical for states with strong traditions of bureaucratic rule. The best-known examples in modern history were Kuomintang China (initially on the mainland and later on Taiwan), Indonesia from the mid-1950s and South Korea from the early 1960s. In the USSR the first elements of bureaucratic capital were already appearing at the end of the presidency of Mikhail Gorbachev² but the liberalization policies of Gaidar gave the impetus to the mass, practically unlimited

¹ Foreign direct investment (FDI) in Russia amounted to \$538 million in 1994, \$1710 million in 1995, \$1707 million in 1996 and \$3752 million in 1997. Astapovich, A. *et al.*, *Obzor Ekonomicheskoy Politiki v Rossii za 1997 god* [Survey of economic policy in Russia in 1997] (Bureau of Economic Analysis: Moscow, 1998), p. 422.

² The author warned of the danger of this development already at the beginning of 1990. Simonia, N., 'Gosudarstvo, kooperatsiya i byurokraticheskii kapital' [State, cooperation and bureaucratic capital], *Moskovskiy Novosti*, no. 9 (4 Mar. 1990).

formation of bureaucratic capitalism in all its manifestations. There was no malicious intent behind this. Most probably it was evidence of basic naivety and schoolboy dogmatism. Gaidar and his associates simply failed to take into account the obvious fact that no significant business stratum existed, so that only two social groupings could take advantage of the opportunities presented by a policy of unlimited liberalism in its classic form. The principal group was the economic *nomenklatura*, equipped with the necessary connections and know-how. The second included the representatives of illegal business (the 'shadow economy') who were already being widely cultivated during the period of Soviet General Secretary Leonid Brezhnev.

An important feature of the development of this form of capitalism in Russia was the fragmentation of bureaucratic capital resulting from the lack of a strong, consolidated state power. The serious antagonism between its various factions was in fact the essence of Russian politics in 1994–98 and found its reflection in changes and zigzags in foreign policy. It was typical that the presidential staff, the government and the media (both the pro-government media and most of the opposition) carefully disguised this fact, although for different reasons, deliberately overemphasizing the division between democracy and communism instead. For serious observers, however, it had become obvious long before that the process of commercialization of Russian society, including that of the greater part of the left-wing opposition, had gone so far as to be irreversible and that the real choices now were not between communism and democracy but between different options for further capitalist development.

This kind of social–economic development created the preconditions for: (a) the strengthening of authoritarian tendencies at the state political level; (b) the growth of statist sentiment in public opinion; and (c) the rejection of the earlier 'romantic' perception of the West in foreign policy and a search for strategic partnership in Asia and other regions. However, because of the factionalism of the bureaucratic bourgeoisie and the contradictions between its different groups, those changes proceeded unevenly and with varying success.

The factions of bureaucratic capitalism

Initially the factions grouped according to economic sector. The three main sectors were export-oriented raw materials, financial–trading, and industrial.

The first was the richest and most influential as it included the oil and gas industries and other extractive industries such as non-ferrous metals. The oil industry alone provides about half of the country's foreign currency revenues and 40 per cent of budget receipts.³ It had the strongest representation in the executive branch—Chernomyrdin, Prime Minister from December 1992 to March 1998, and Yury Shafrannik, Minister of Fuel and Energy from February 1993 to August 1996. This faction has its own commercial banks, created, like

³ Lapina, N., *Rossiyskiye Elity i Natsionalnye Modeli Razvitiya* [Russian elites and national models of development] (Institute of Scientific Information in the Social Sciences (INION), Russian Academy of Sciences: Moscow, 1997), p. 6.

the corporations themselves, on the basis of former Soviet ministries and departments. Some corporations (Gazprom, Lukoil, Rosneft and others) came to act as autonomous foreign policy actors, first within the CIS framework, in both oil-importing and oil-extracting republics, but also in some more distant countries in Eastern and Southern Europe, the Middle East and South-East Asia.⁴

The financial–trading faction presents a more motley, less consolidated combination of commercial banks and large trading corporations. Initially it included commercial banks not connected with production financing. At most their ties with production amounted to purchasing, with the help of state officials, suitable enterprises at give-away prices to maximize their own profits or for further re-sale, mainly to foreign investors. In economics this is called the comprador function. The dominant role in this faction, however, was played by the ‘authorized banks’, 10 or 12 commercial banks chosen by the government to transfer budget allocations to state enterprises, organizations and so on, which enriched themselves mainly by using that money—for instance, foreign currency receipts of Rosvooruzheniye⁵ and enterprises of the defence industry that export their own products—illegally to make a profit for themselves. A decisive role was played by the special connections those banks had with senior government officials. The base of this faction consisted of many medium-sized and small commercial banks engaged exclusively in financial speculation (‘making money out of the air’). In 1995 there were 2025 banks in Russia, but by 1997 numbers had been reduced to 1697 by bankruptcies and the retraction of Central Bank licences from more than 300 banks.⁶

This faction of bureaucratic capital is more oriented to cooperation with the West than the other two. It is second in wealth and influence to the raw materials faction. These two ruled Russia for six years and provided financial support to President Yeltsin in the 1996 elections. Yeltsin acted de facto as an exponent of their interests, granting them multiple advantages and privileges through his decrees and orders.

The core of the industrial faction was the defence industries, including their civilian production, which had suffered the greatest damage in the course of the reforms. Between 1990 and 1996, overall production of the defence industry was reduced by 53 per cent.⁷ This does not mean that the director corps was starving. The scale of capital accumulation was smaller here than with the other two factions, but the process was intensive, primarily as a result of the

⁴ E.g., Lukoil and Gazprom are active in Azerbaijan, Iran, Iraq, Turkmenistan and even Africa. Narzikulov, R., ‘Zimnyaya gazovaya politika’ [Winter gas politics], *Nezavisimaya Gazeta*, 17 Feb. 1998; Alison, S., ‘Russian energy sector dismayed by strikes on Iraq’, Reuters (Moscow), 17 Dec. 1998; Ivanov, A., ‘Gazprom i Lukoil dopyli do Afriki’ [Gazprom and Lukoil swim as far as Africa], *Finansovye Izvestiya*, 1 Dec. 1998; and *OGJ Newsletter*, 28 Dec. 1998.

⁵ The state company for imports and exports of armaments and military technology, established in Nov. 1993 to coordinate arms export activity by absorbing most of the associations and enterprises that had the right to export arms. See also section IV of this chapter.

⁶ Sarkisyants, A., ‘Sliyaniya i bankrotstva bankov: mirovoy opyt’ [Bank mergers and bankruptcies: world experience], *Mirovaya Ekonomika i Mezhdunarodnye Otnosheniya (MEiMO)*, no. 10 (1998), p. 31.

⁷ *Nezavisimaya Gazeta*, 5 Feb. 1996; and Ivanter, A., Kirichenko, N. and Beletskiy, Yu., ‘Schastye v dolg ne voronesh’ [You can’t borrow happiness], *Expert*, no. 1–2 (Jan. 1999), p. 11.

notorious ‘voucher privatization’, which enabled the directors of the industry to concentrate the shares of their enterprises in their own hands.⁸ Enriching themselves by ‘eating through’ fixed and current capital, they used state resources initially for their own profit and resorted to other machinations. Their prosperity contrasted seriously with the hardships of workers in manufacturing industry who had not been paid for many months. However, this faction also has separate branches and enterprises which managed to find their own niche on the world market and thus are in a better position.

It would be wrong to say that the industrial faction was not represented at all in the government and in circles close to the president. After the appointment of Oleg Soskovets in 1993 as deputy prime minister responsible for industrial policy, the defence industry, conversion, engineering, transport and metallurgy, an industrial lobby began to form and for the time being received the support of the man closest to Yeltsin—the head of the presidential security guard, Major-General Alexander Korzhakov. An intense struggle began, in the course of which the Soskovets–Korzhakov group tried to expand its influence to the areas of banking and oil, although with no visible success. The Communist Party also took upon itself the role of representative of the industrial faction’s interests in the State Duma (the lower house of the Russian Parliament), but the Duma is hardly the body where real power is concentrated.

There were three stages in the emergence of bureaucratic capitalism: between 1992 and June 1996; from June 1996 to March 1997; and from March 1997 to March 1998.

In the first stage the raw materials and financial–trading factions dominated. They were united by the threat of opposition and by the fear that if a strong and patriotic personality came to power it might deprive them of their autonomy and impose on them a mechanism for the redistribution of their profits and incomes in the interests of the national economy. At the same time the contradictions between them were sometimes sharp and fundamental: for example, in 1993–94 they were engrossed in a stubborn struggle over the restructuring of the oil industry. Representatives of the industries engaged in raw materials production, headed by Chernomyrdin and Shafrannik, stood for the creation of a small number of vertically integrated companies, able to compete on world markets. The State Committee for the Management of State Property (Goskomimushchestvo) and the State Committee on Anti-Monopoly Policy, controlled by the Gaidar–Anatoly Chubais group, advocated a subdivision of the industry into a multitude of smaller enterprises, supposedly to stimulate competition.

A tendency for the financial–trading faction to be squeezed out of leading positions in the government increased. The elections to the Duma at the end of 1993 clearly demonstrated the narrowness of the social base of the radical democrats and liberals, heralding the end of the short era of ‘liberal romanticism’. In early 1994 Gaidar and many of his ministers lost their posts in the

⁸ A detailed description of this process is given in Blasi, J. R., Kroumova, M. and Kruse, D., *Kremlin Capitalism: Privatizing the Russian Economy* (Cornell University Press: Ithaca, N.Y. and London, 1997).

government and in February 1995 on the Security Council as well. Chubais remained as the only representative of the financial–trading faction in the executive. This may have been because of the president’s tactics of checks and balances, but Chernomyrdin also needed a representative of the young reformers in the government in order to deter the onslaught of the industrial lobby and to maintain a reforming image for the West. In January 1996, however, Chubais was also removed from the government.

The oil and gas bloc sometimes acted not only autonomously but also contrary to the line of the Foreign Ministry, for instance, over the issue of the status of the Caspian Sea. In an attempt to block the creation of international consortia for the development of the oil deposits on the Caspian Sea shelf by Azerbaijan, Kazakhstan and other republics, the Russian Foreign Ministry came out with its own approach to the issue. However, the pragmatic Russian oil lobby (Lukoil, supported by Chernomyrdin and Shafrannik) correctly believed that it was better to have a share in the consortia to be created than to engage for years to come in long altercations between the foreign ministries of the republics involved, allowing the initiative to pass to the transnational corporations.

The turn to the CIS was also profitable for a considerable part of the industrial faction, as the breaking of many industrial links of the former integrated Soviet economic complex had been almost the main reason for a sharp decline of industrial production both in Russia and in many of the CIS republics.

The activity of the oil and gas and industrial complexes became apparent beyond the borders of the CIS, including in Middle Eastern countries (Iran and Iraq) towards which the USA was pursuing a policy of isolation. Here also it contrasted during the first half of the 1990s with the general line of the Foreign Ministry.⁹ Their autonomy was, however, only relative because it was far from completely detached from the state in the financial and legal senses. To a great extent it depended on the benevolence of officials, primarily Chernomyrdin himself, and on various benefits and privileges (customs, taxation and so on).

After changes among the top Foreign Ministry officials in 1995, the first steps were taken to overcome the fragmentation and general unconcentrated nature of Russian foreign policy. Since then it has concentrated increasingly on defending the national interests of Russia. There was a slow turn in Russia’s policy on Asia—an intensification of the Russian presence in the Middle East, the establishment of a strategic partnership with China in April 1996, the first steps towards a normalization of relations with Japan and the first serious efforts to create the preconditions for integration with individual CIS states.

The second stage of the struggle between the factions of bureaucratic capital and related political groups began between the first and the second stages of the presidential elections in June–July 1996. A serious, basic regrouping of the opposing forces took place. Yeltsin reintroduced Chubais into his administration and ousted the Soskovets–Korzhakov–Barsukov group from the presiden-

⁹ Razuvayev, V., ‘Malenkaya neftyanaya vojna’ [A small oil war], *Segodnya*, 8 Sep. 1995; and Trofimov, V., ‘Chem pakhnut kaspiyskii neftedollary’ [What Caspian petrodollars smell of], *Nezavisimaya Gazeta*, 10 Jan. 1996.

tial Olympus and the government. Seizing the opportunity, Chernomyrdin in his turn replaced active opponents from the industrial faction, headed by Soskovets, with more friendly and loyal ministers. This was accompanied by action to 'punish' those commercial banks that had supported the Communist Party or General Alexander Lebed in the election campaign or were too closely connected with Soskovets. The licence of Tveruniversalbank was revoked, while Unikombank, Inkombank and Kredobank faced difficulties. It is believed that Kredobank had something to do with pumping money into Chechnya under the 'flag' of the Committee for the Economic Reconstruction of Chechnya, headed by Soskovets.¹⁰ However, Uneximbank, one of the largest banks that had been closely cooperating with Soskovets, suffered no damage. Chubais had always favoured this bank, repeatedly standing out, for instance, against the revision of the results of mortgage auctions where Uneximbank won. Chubais allied himself with the bank's president, Vladimir Potanin, and managed to achieve the appointment of Potanin to the post of deputy prime minister in August 1996.

Confrontations within the government structures between the two effectively ruling factions of Russian bureaucratic capital continued with variable success until the spring of 1997, when they resulted in another major reshuffle of government structures. However, one other important change in the structure of bureaucratic capitalism had begun, and was to develop later—the gradual fading away of the clear borders between the factions and the first signs of a restructuring of bureaucratic capital on a clan-group basis.

This was connected with two new elements. The first was the transition to a new phase of the division of state property—the putting up of the most valuable pieces of property for auction and tender, as a result of which the diversification of the large commercial banks' investment activity deepened. Some banks found interests in oil and other raw materials. Raw materials companies, in their turn, became owners or co-owners of certain industrial enterprises and commercial banks. Second, there appeared signs of a coalescence between financial and industrial capital in the shape of the establishment of financial-industrial groups. That process was to some extent initiated from above, that is, financial-industrial groups were created by the decision of the government, but they also developed spontaneously. Initially the commercial banks either bought enterprises that were already profitable (in order to maximize their own profits) or bought with the intention of reselling more profitably later. In any case they did not buy enterprises in order to invest in them seriously and expand production. This was a manifestation of the initial, rapacious stage of the primitive accumulation of capital, the separation of property from its traditional owner. The productive or creative function was still missing. Truly modern, vertically integrated corporations essentially appeared only in the oil and gas sector.

The beginning of the third stage was marked by a major victory of the 'financiers'—to be more exact, the group headed by Chubais. Chubais returned to the

¹⁰ See, e.g., Galperin, L., 'Balans posle bitvy' [Balance after the battle], *Moskovskiy Komsomolets*, 14 Aug. 1996.

government as First Deputy Prime Minister and Minister of Finance. Boris Nemtsov, the liberal Governor of Nizhniy Novgorod Region, joined the government as the other First Deputy Prime Minister and Minister of Fuel and Energy. It was now possible to speak of a strong 'anti-raw materials' team of young reformers. Branch ministries were abolished, as were the positions of members of the industrial faction in the government. Chubais put Alfred Kokh at the head of the State Committee on the Management of State Property in order to gain control over further privatizations. Yevgeny Yassin, the Minister of the Economy, was replaced by his tougher deputy Yakov Urinson, one of whose main goals was the restructuring of the defence industry.

The new group of reformers set out under the banner of the fight with the natural monopolies. To suggest the size of the task they took upon themselves, it can be noted that these monopolies provide up to 70 per cent of Russia's budget revenues.¹¹ The task was ostensibly defined even more widely—to tackle '*nomenklatura* capitalism'. Chubais stated that he wanted to break the union of privatized bureaucracy and bureaucratized capital.¹² Events were to show that he was the last person who could set himself such a task. He himself was one of those he intended to fight. In reality the idea was merely to ensure the victory of one faction over the other. Gazprom, of which Chernomyrdin had been chairman, was one of the first natural monopolies tackled by the reformers.

The odds in favour of the young reformers seemed so great that many newspapers began to write about one-party government and the forthcoming fall of Chernomyrdin.¹³ The outcome was much more complicated. The reformers' bold but poorly considered actions encouraged a broad front to form against them, uniting a wide variety of forces from the raw materials producers and industrial factions to the power ministries. Chubais, moreover, probably relying on his powerful position in the government and on the goodwill of Yeltsin, almost stopped performing the function of a political representative. Before and immediately after the presidential election he publicly assured all those who had contributed to Yeltsin's victory that they would be appropriately rewarded; later he concentrated his efforts on close cooperation with one—Uneximbank and its International Financial Corporation (IFC)—and thus turned all other parties, including former allies, against himself. As a result the struggle then continued along new lines.

Major financiers (Boris Berezovsky, associated with a variety of businesses, including Logovaz and Aeroflot, and a television channel; Vladimir Gusinsky, owner of Mostbank and a great media empire; and others) virtually declared war on Chubais, using all the media resources they controlled. As a result of the 'book scandal', Chubais' position was seriously undermined and he lost many

¹¹ Interfax-AiF, 14–20 Apr. 1997.

¹² Kolesnikov, A., 'Yakov Urinson—razrushitel nomenklaturnogo kapitalizma' [Yakov Urinson: destroyer of *nomenklatura* capitalism], *Segodnya*, 8 Apr. 1997.

¹³ See, e.g., Koshkareva, T. and Narzikulov, R., 'Molodye reformatory gotovyat Nemtsova na zamenu Yeltsinu' [Young reformers are preparing Nemtsov to replace Yeltsin], *Nezavisimaya Gazeta*, 8 Apr. 1997; and Latynina, Y., 'Chubais izgnal is Minfina trgovtsev' [Chubais banishes traders from the Ministry of Finance], *Izvestiya*, 22 Apr. 1997.

of his associates in key executive posts. The anti-Chubais coalition was later actively and effectively, but without fuss, supported by the Prime Minister himself. In late December 1997 and early 1998 he carried out another government reshuffle. Chubais and Nemtsov remained first deputy prime ministers but without their ‘armies’, that is, without their key ministries. Chubais lost control over the media and the State Committee on the Management of State Property. Chernomyrdin had been given control over the defence industry and Rosvoro-zheniye in July 1997 (see section IV below). The position of Chubais’ group was thus seriously weakened and Chubais found himself once again in the situation he had been in in 1994–95, when he was a symbol of democratic reforms, but this time with a seriously tarnished reputation.¹⁴

IV. The armed forces and the defence industry as factors in Russia’s foreign policy

The demolition of the Soviet system of decision making also allowed the Russian armed forces and defence industry a degree of independence. General liberalization and commercialization did not leave the military sphere unaffected, but promoted unprecedented corruption and thus the formation of a military faction of bureaucratic capital. The ‘honeymoon’ of the democrats and liberals with the West had its negative side in the Russian Government’s complete disregard for issues of military reform, reorganization and defence industry conversion. There was of course no lack of appropriate slogans and projects: only practical results were lacking. Besides, the new leadership of the armed forces found itself involved in the all-pervasive business of self-enrichment.

The armed forces

One of the hotbeds of corruption and embezzlement of state property was the Western Group of the armed forces. The Russian and foreign press revealed scandalous abuse connected with illegal sale of cigarettes, liquor and so on, the sale of military property, technology and even some types of weapons, and illegal use of transport by top military for their personal possessions. For six years in succession in Russia information emerged about abuse by the senior military of the free labour force represented by their soldiers for the construction of luxury villas and about budget money allotted for the maintenance of armed forces personnel being diverted for personal use. A considerable source of enrichment for the military bureaucracy was the division of military property, equipment and weaponry between the CIS member states consequent on the break-up of the USSR. This was accompanied by illegal transfers of large

¹⁴ ‘Politicheskkiye kollizii v Rossi v dekabre–yanvare’ [Political collisions in Russia in December–January], *Nezavisimaya Gazeta–Scenarii*, no. 2 (11 Feb. 1998), pp. 9–10.

quantities of weapons and ammunition.¹⁵ The situation was especially piquant when military deliveries were made to both sides involved in regional or local conflicts.¹⁶

Independent action by the armed forces within the CIS framework was favoured by the fact that the Gaidar Government, and especially the Foreign Ministry, not only lacked a considered strategy in that area but consciously ignored it. Thus, the initiative, almost by natural process, passed to the armed forces and real problems between Russia and other CIS members and conflict situations inside those states served as kind of springboard for the armed forces.

The armed forces during the first half of the 1990s were able to be a relatively independent actor in foreign policy. There were weighty reasons to justify this—concern for the security of Russia's new borders, Russia's need for a regional security system, and the preservation of old and acquisition of new military bases, tracking stations and so on. In the CIS area, furthermore, many new foreign policy problems had important military implications. The only problem was that the solution of those problems had to be found within the framework and on the basis of state foreign policy, and not by the generals on their own.

Finally, there was another source of mass enrichment—the trade in arms and ammunition on the territory of Russia itself. In recent years this trade has become so extensive that it has produced the strange (at first sight) phenomenon of repeated major explosions in military stores, intended to prevent the detection of theft. That there have been no human casualties in these explosions demonstrates unambiguously that they were planned. In the Far East Military District they had become almost an annual tradition and in February 1998 there were explosions in military stores in the region of Volgograd and in the suburbs of Saratov.¹⁷ An enormous 'contribution' was made by the protracted fighting in Chechnya after 1994. Unlike the Russian troops in Chechnya, local fighters never experienced any lack of modern Russian-made small or anti-tank arms.

There is a saying that 'fish starts rotting from the head'. This was never more true than it is of the role of former Defence Minister Pavel Grachev. Grachev displayed a strong inclination for commercial diversions. As early as February 1992, when he was chairman of the State Committee on Defence and First Deputy Commander-in-Chief of the CIS Armed Forces, he joined a group of generals, founders of a limited-liability company called *Aviakoninfo*, set up to sell construction materials, buy timber, run cafés and restaurants, and so on. The business was not a success because of interference 'from the top'. Soon

¹⁵ See, e.g., Anthony, I., 'Illicit arms transfers', ed. I. Anthony, SIPRI, *Russia and the Arms Trade* (Oxford University Press: Oxford, 1998), pp. 217–32. According to one (unnamed) senior officer from the Office of the Chief Military Prosecutor, the value of the illicit arms trade is comparable to the legal income of Rosvooruzheniye. *Profil*, no. 42 (16 Nov. 1998), p. 31.

¹⁶ Russia still recognizes the old government of Afghanistan. Nevertheless, it helped Ukraine to produce over 100 T-80 tanks which were delivered via Pakistan to the Taleban. Ivanov, N., "'Uspekhi" konversii' [The 'successes' of conversion], *Nezavisimaya Gazeta*, 8 Sep. 1998.

¹⁷ Shafurkin, A. and Serenko, A., 'Novye vzryvy na armeyskikh skladakh' [New explosions at army depots], *Nezavisimaya Gazeta*, 24 Feb. 1998.

enough, however, Grachev became Defence Minister, and in October 1992 he created a state company, Voyentekh, for the sale of vast surpluses of arms, military technology and army property.¹⁸ From 1993 'as an exception' Grachev allowed the air force to accept transport of commercial cargoes. Military transport aviation used to make several hundred such commercial flights a year. An approximate idea of the scale of that business can be given by the fact that for only three flights to Viet Nam in 1997 the air force earned a net profit of about \$300 000.¹⁹ Stories also circulated about malpractice in the navy in the process of writing off ships, the use of nuclear submarines and other matters.

The arms trade and military–technical cooperation

Perhaps the main part in the genesis of military bureaucratic capital was played by the official trade in arms and military technology within the framework programmes of military–technical cooperation with foreign countries.

In 1992, 12 special exporters were pursuing activities in that sphere. They worked very ineffectively, often breaking laws and regulations. Sometimes as many as 30 mediators circled around one serious contract. Then it was decided to reorganize the whole system of military–technical cooperation.²⁰ In November 1993 Rosvooruzheniye was created. Of the special exporters only MAPO (the Moscow Aircraft Production Organization) remained intact. At first Deputy Prime Minister Viktor Shumeiko tried to control Rosvooruzheniye and his nominee, Lieutenant-General Viktor Samoylov, was made Director-General. The initiative was joined by Soskovets, head of the Interdepartmental Coordinating Council for Military–Technical Policy (Koordinatsionny mezhvedomstvenny sovet po voyenno-tekhnicheskogo politike). However, the whole military–technical cooperation programme was subordinated directly to the president in 1994 and Korzhakov placed his people in key posts. Boris Kuzyk was appointed special assistant to the president on military–technical cooperation while General Alexander Kotelkin became Director-General of Rosvooruzheniye in October 1994.

The stormy history of the expansion of Russian arms sales, mainly on Asian markets, and the equally controversial enrichment of the actors in the business now began. Rosvooruzheniye practically monopolized the arms trade (up to 90 per cent)²¹ and when Grachev, who dreamed of bringing it once more under his own control, tried to intercept a contract with Malaysia for the sale of 18 MiG-29s in July 1997 Korzhakov immediately initiated a complex inspection of

¹⁸ *Profil*, no. 1 (12 Jan. 1998), p. 12.

¹⁹ *Kommersant–Vlast*, no. 2 (27 Jan. 1998), p. 25.

²⁰ On the organization of military–technical cooperation, see Anthony (note 15), chapters 5, 6 and 7; and 'The management of arms transfers', in A. A. Sergounin and S. V. Subbotin, *Russian Arms Transfers to East Asia in the 1990s*, SIPRI Research Report no. 15 (Oxford University Press: Oxford, 1999), pp. 44–69.

²¹ According to Kotelkin himself, the value of sales by Rosvooruzheniye increased from \$1.7 billion in 1994 to \$2.8 billion in 1995 (out of general sales by the defence industry as a whole of \$3.05 billion), and up to \$3.4 billion (of \$3.5 billion) in 1996. Interview with Kotelkin, *Vek*, no. 27 (July 1997).

Voyentekh which exposed its participation in shady deals and brought it to the verge of collapse. Grachev was 'excommunicated' from the arms business.²² From October 1995 Kotelkin virtually monopolized all cargo deliveries within the military–technical cooperation framework, having created a company, Cargotrans, on the basis of the transport department of Rosvooruzheniye.²³

The leaders of Rosvooruzheniye often gave themselves the credit for the survival of the defence industry. In March 1997, for instance, they announced that in 1996 Rosvooruzheniye's investment in the defence industry amounted to more than \$600 million.²⁴ Kotelkin interpreted the real contribution by Rosvooruzheniye to the defence industry rather differently: \$250 million in investment plus attraction of \$500 million in bank credits under the company's guarantees. A complex inspection of Rosvooruzheniye by the Attorney-General, Yury Skuratov, begun in the summer of 1996, revealed the scale of abuses by the company's leadership—enormous expenditure on the company itself against a background of debts to the defence industry totalling \$200 million, concealment of profits, illegal foreign currency deals and so on.²⁵

According to specialist observers, Rosvooruzheniye was by no means working as a charity in favour of the defence industry; rather it turned the latter into a source of enrichment. Valentin Trofimov, for instance, believes that its leadership chose to pay high rates of interest (20–25 per cent) to foreign agents' firms and 10 per cent more to a monopolistic transport company (in fact, to itself), and take between 7 and 10 per cent for 'services'. All this was a heavy burden for producers. Nevertheless, the narrow circle of lucky ones in the defence industry dared not grumble, as even the small sums they received from this trade were almost the only real money they could use to keep production and research and development (R&D) going. However, today the defence industry is dependent on external orders for 80 per cent of orders, instead of 20 per cent, as it was under the Soviet Union.²⁶

Following the removal of Korzhakov in the summer of 1996 a struggle started for his 'legacy'. In August 1997 the State Committee on Military–Technical Policy (Gosudarstvenny komitet po voyenno-tekhnicheskoy politike, GKVTTP), which had served as a connecting link between the President and Rosvooruzheniye, was abolished and control over exports of arms and military technology handed over to the Ministry of Foreign Economic Relations.²⁷ The government even tried to establish direct control over Rosvooruzheniye, but at the time this proved impossible owing to the interference of General Lebed, head of

²² *Profil*, no. 1 (12 Jan. 1998), p. 12.

²³ *Profil*, no. 3 (26 Jan. 1998), p. 62.

²⁴ *Delovye Lyudi*, no. 75 (Mar. 1997), p. 127.

²⁵ *Profil*, no. 3 (26 Jan. 1998), pp. 59–60. The head of the Omsk local office of Rosvooruzheniye states that out of \$230 million invested in production in 1996 and \$190 million in credits (not \$500 million) the Siberian military–industrial complex never received a single dollar. Interview with Vladimir Sosnin, *Moskovskiy Novosti*, 7–11 Sep. 1997.

²⁶ Gabovich, M., 'Sekretnaya trgovlya' [Secret trade], *Moskovskiy Novosti*, 31 Aug.–7 Sep. 1997; and Interview with Valentin Trofimov, *Moskovskiy Novosti*, 2–9 Oct. 1997, p. 12.

²⁷ Sergounin and Subbotin (note 20), pp. 57–60.

the Security Council.²⁸ An attempt to abolish the monopoly of Rosvooruzheniye in 1996, when several other enterprises and organizations were allowed to act as special exporters, had failed. Lacking experience, connections, know-how and information on the state of foreign markets, those enterprises were helpless and had once again to turn to Rosvooruzheniye.²⁹

The defence industry

Rosvooruzheniye was able to feed on the defence industry only thanks to the grievous state the industry had been in for six years. A sharp reduction in military expenditure—by 70 per cent over the two years 1991–92³⁰—along with the government's neglect of the problems the defence industry was facing produced serious crisis. In the early 1990s the magic word 'conversion' was on everyone's lips. Scholars and statesmen vied with each other to explain to the public how enterprises would be able to preserve their high-technology potential and their production thanks to conversion, but they failed to understand the real problems and difficulties connected with conversion. With very rare exceptions all the hopes and projects for conversion turned out to be myths. Production at converted enterprises proved to be two or three times more labour-intensive than that of civilian enterprises and their products five or six times more expensive. By the beginning of 1996 two-thirds of such enterprises were unprofitable.³¹

The government more or less kept aloof from active assistance to conversion, as financing from the federal budget illustrates.³²

As a result, after two or three years of unsuccessful efforts, the majority of enterprises stepped on to the road to deconversion. Naturally, this could not possibly succeed as the part of production that went to meet the state defence order was under-financed. The cumulative debt on the state defence order in 1992 totalled 7 billion roubles; in 1993, 920 billion roubles; in 1994, 4.2 trillion roubles; in 1995, 7.7 trillion roubles; and in 1997, 19.9 trillion roubles.³³

There was a peculiar division of labour: the president signed appropriate decrees and projects pertinent to the defence industry, while the government did not execute them and did not apportion money. This is not surprising. The government was dominated by representatives of the raw materials producers and of the fuel and energy complex, and the relationship between the latter and the defence industry after the break-up of the Soviet Union had changed in principle. Formerly the defence industry had been at the top of the pyramid and the fuel and energy complex was its foundation, feeding the defence industry with

²⁸ *Profil*, no. 38 (19 Oct. 1998), p. 31.

²⁹ *Delovye Lyudi*, no. 75 (Mar. 1997), p. 124.

³⁰ Sköns, E. *et al.*, 'Military expenditure and arms production', *SIPRI Yearbook 1998: Armaments, Disarmament and International Security* (Oxford University Press: Oxford, 1998), p. 223.

³¹ *Delovye Lyudi*, no. 75 (Mar. 1997), p. 124.

³² Only a fraction of the amount budgeted for defence industry conversion was disbursed in 1993–94, and none in 1995–97. Titova, E., 'Byudzhetnye dolgi "oboronke" otlozheny na polgodia' [State budget debts to the defence industry postponed by half a year], *Finansovye Izvestiya*, 30 Dec. 1997, p. iii.

³³ *Moskovskiy Novosti*, 1–8 Feb. 1998, p. 17.

cheap energy and necessary foreign currency. Now under conditions of relative autonomy the fuel and energy complex began to retain more of its profits, paying tax only with obvious reluctance and under severe pressure.

As a result of the abolition of the Soviet centralized management mechanism the defence industry turned into a chaotic set of different branches, open-type and limited joint-stock companies, separate enterprises, construction bureaux and organizations. Soon an elite group of enterprises and construction bureaux that had managed to find a niche in the world market stood out. They fell into two sub-groups, one which consolidated its position through cooperation with Western companies (for example, certain enterprises and construction bureaux in the aerospace industry) and one which consolidated its position with the help of military–technical cooperation and in competition with Western companies. Both groups improved the situation in their business affairs because of the external factor. However, in the latter group especially favourable conditions were developing for the formation of bureaucratic capital.

Most non-elite enterprises were vegetating and living in poverty. However, some of them became the objects of the aspirations, with various motivations, of different bureaucratic capital factions and large Western corporations.³⁴

The year 1997 was also the breaking-point in the struggle of different factions of bureaucratic capital for possession of the fattest pieces of the defence industry. The financial–trading faction delivered a weakening blow when the Ministry of the Defence Industry was abolished in March. However, by the summer of that year the initiative gradually began to pass to representatives of the raw materials producers. At the end of July a presidential decree gave the prime minister control of Rosvooruzheniye.³⁵ In August it was followed by a series of decrees that completely changed the defence industry system.³⁶ Rosvooruzheniye became a state unitary enterprise and two new intermediary organizations appeared on the stage—Promexport, which had to sell surplus Defence Ministry armaments, and Rossiyskiye Tekhnologii to deal in the sphere of military technologies. ‘In a further effort to weaken the Company’s [Rosvooruzheniye’s] grip on the arms market . . . [a] Kremlin decree granted the right to export weapons to two other state companies and to certain manufacturers . . . allowing more of the revenues to go to the Ministry of Defence and to arms manufacturers’.³⁷

One more exceptionally important aspect should be mentioned. In allowing two more intermediary organizations to be set up, Chernomyrdin acted as defender both of the interests of the defence industry and of the Defence

³⁴ Fairly typical examples of such intense opposition (in the course of ‘repeated’ privatizations, through sale of state shares of enterprises already incorporated) are the cases of Permskiye Motory in 1992 and Rybinskiye Motory in 1994. Municipal and regional authorities, arbitration courts at all levels, the Supreme Court, the government and the president found themselves involved in the struggle.

³⁵ ‘On measures to improve the system of management of military–technical cooperation with foreign states’, Presidential decree no. 792, 28 July 1997, reproduced in *Rossiyskaya Gazeta*, 2 Aug. 1997, p. 6.

³⁶ Sergounin and Subbotin (note 20), pp. 57–60.

³⁷ Freeland, C., ‘Yeltsin reasserts Kremlin control over arms trade’, *Financial Times*, 22 Aug. 1997; and *Expert*, no. 3 (26 Jan. 1998), p. 6.

Ministry (having granted them 'a piece each', not forgetting himself). The former head of the bank connected with MiG-MAPO, Yevgeny Ananyev, was made Director-General of Rosvooruzheniye in August 1997. *Delovye Lyudi* believes that this appointment was made thanks to the close ties of Ananyev with people from the presidential staff. As a result the people Uneximbank had long been counting on, such as Kotelkin, found themselves moved away from the direct management of the arms trade.³⁸ This is another angle on the developing 'anti-financiers' alliance. The positions of the financial faction were also considerably weakened by a scandal concerning deliveries (to be more exact, under-deliveries) of a batch of aircraft to India.³⁹

The struggle around the creation of new corporations resumed with new strength at the end of 1997, revealing a range of old and new conflicts—between construction bureaux and producers; among producers for leadership of future business corporations; between enterprises and Moscow commercial banks; between the banks themselves (for instance, between Uneximbank and Inkombank); between the legislative and executive powers; and between the centre and the regions which were striving to get their share in future corporations. Since the end of 1997 even the Mayor of Moscow, Yury Luzhkov, has found himself involved in the struggle.⁴⁰

Arms transfers to Asia

The crisis in the defence industry and the armed forces, their need for restructuring and the aspirations of military bureaucratic capital—all these factors encouraged the expansion of the trade in arms and military technology, and their main market after the loss of Eastern Europe was in Asia. Asia's share in total world imports of major conventional weapons in 1997 amounted to 49 per cent, while that of the Middle East was approximately 20–25 per cent.⁴¹ Those markets were not completely new for Russia: they had been the main markets for weapons from the USSR.⁴² The difference was that the USSR, like the USA, was guided in the process of arms deliveries abroad first of all by military and geopolitical considerations. Commercial interests have now come to the fore, although geopolitical considerations should probably not be ignored.

³⁸ *Delovye Lyudi*, no. 84 (Dec. 1997), p. 25; and Ryazskiy, Yu., 'Proshchay oruzhiye' [Farewell to arms], *Moskovskiy Komsomolets*, 14 Jan. 1998.

³⁹ For the detailed story of this illegal operation, see Nikitinskiy, L., 'Samolety, obligatsii i korobka' [Aircraft, bonds and a small box], *Moskovskiy Novosti*, 20–27 Sep. 1998, p. 12.

⁴⁰ Zusmanov, V. and Mikhailov, G., 'Kto vyidet iz vody s "Sukhim"' [Who will come out of the water with Sukhoi?], *Profil*, no. 7 (28 Feb. 1998), pp. 28–29; Interview with Mikhail Simonov, *Novaya Gazeta*, 2–8 Feb. 1998, p. 7; Onufriyev, A., 'MiG mezhdru proshlym i budushchim' [MiG between past and future], *Expert*, no. 12 (30 Mar. 1998), pp. 30–31; Isayev, M., 'Krutoye pike VPK i MAPO' [A steep dive by the military-industrial complex and MAPO], *Nezavisimaya Gazeta*, 6 Feb. 1998; and Rato, E., 'Deputaty zadumalis o voyennoy aviatsii' [Deputies ponder military aviation], *Segodnya*, 25 Feb. 1998.

⁴¹ Wezeman, S. T. and Wezeman, P. D., 'Transfers of major conventional weapons', *SIPRI Yearbook 1998: Armaments, Disarmament and International Security* (Oxford University Press: Oxford, 1998), pp. 298–99.

⁴² In 1991, the Middle East and Near East accounted for 69% and Asia for 17% of the USSR's arms exports. Anthony, I., 'Economic dimensions of Soviet and Russian arms exports', ed. Anthony (note 15), p. 77.

Rosvooruzheniye cooperates with 51 countries, but the main importers of Russian arms, as in the past, are China and India, which currently receive up to 70 per cent of Russia's military exports.⁴³ The first large military contract with China was signed during Gorbachev's rule, in 1989. In 1990 an agreement on fighter aircraft and air defence systems was signed, and cooperation was institutionalized by the establishment of an intergovernmental commission in November 1992. In June 1993 China's State Council agreed to a request from the Central Military Commission to allocate \$2.3–\$2.6 million for the period up to 1995 for the purchase of foreign (mainly Russian) military equipment and technologies.⁴⁴ In July 1994 the State Council approved imports worth \$5 billion from Russia, including an unspecified number of Su-30 MK and Su-35 fighter aircraft.⁴⁵ In December 1995 a further agreement was reached for the transfer of more Su-27 aircraft and Russia granted China a 15-year licence to produce Su-27-SK fighters without export rights.⁴⁶ With this and final confirmation of its order for two Sovremenny Class destroyers in July 1997, China was established as a major Russian client.⁴⁷

The largest contract with India, estimated to be worth \$1.8 billion, was signed in 1996 for delivery of 40 Su-30 MKs (at a time when even the Russian armed forces did not have them) and (reportedly) transfer of the technologies for serial production of a new Su-27 version after the delivery. Modernization of 125 MiG-21s has been ordered.⁴⁸ In December 1997 the ninth submarine for India was commissioned. The three-year long negotiations on the sale of the aircraft-carrier *Admiral Gorshkov* to India are coming to an end.⁴⁹ As of the end of 1997 the total value of contracts concluded with India amounted to \$8–9 billion.⁵⁰

Viet Nam was also a traditional client. In October 1993 its Foreign Minister held negotiations in Moscow on Russia's lease of the naval base at Cam Ranh Bay after 2000 following the expiry of the agreement now in force. In 1995 Russia delivered to Viet Nam six Su-27-UT fighter aircraft and in mid-1997 Rosvooruzheniye helped negotiate a contract for the delivery of four Su-27-UTs to Viet Nam. (Two aircraft were delivered in early December 1997; the other two were destroyed when a military transport aircraft crashed in Irkutsk on 6 December 1997.)⁵¹

⁴³ *Delovye Lyudi*, no. 75 (Mar. 1997), pp. 127, 147.

⁴⁴ Arnett, E., 'Beyond threat perception: assessing military capacity and reducing the risk of war in southern Asia', ed. E. Arnett, SIPRI, *Military Capacity and the Risk of War* (Oxford University Press: Oxford, 1997), p. 35.

⁴⁵ Sergounin, A. A. and Subbotin, S. V., 'Sino-Russian military-technical cooperation: a Russian view', ed. Anthony (note 15), p. 210.

⁴⁶ Sergounin and Subbotin (note 45), p. 213.

⁴⁷ Wezeman and Wezeman (note 41), pp. 295–96. For a comprehensive list of Russia's exports of major conventional arms to Asian countries, see appendix 3 in this volume.

⁴⁸ Anthony, I., 'International trends since the cold war', ed. Anthony (note 15), p. 33; and *Delovye Lyudi*, no. 75 (Mar. 1997), p. 131, and no. 84 (Dec. 1997), p. 113.

⁴⁹ Golotyuk, Yu., 'Rossiya prodayet Indii "Admirala Gorshkova"' [Russia is selling *Admiral Gorshkov* to India], *Russkiy Telegraf*, 24 July 1998.

⁵⁰ *Profil*, no. 7 (Feb. 1998), pp. 28–29; and *Segodnya*, 27 Nov. 1997.

⁵¹ Mazin, A., 'Chto mozhet predlozhit stranam Yugo-Vostochnoy Asii i Okeanii VPK Rossii' [What the Russian military-industrial complex can offer South-East Asia and Oceania], *MEiMO*, no. 6 (1997),

In the summer of 1994 Rosvooruzheniye achieved a sensational breakthrough to the countries of South-East Asia, hitherto mainly a market for Western arms manufacturers, when it concluded a contract with Malaysia for 18 MiG-29 aircraft for \$550 million.⁵² Since then military–technical cooperation with Malaysia has taken the form of a joint venture, the Airspace Technology System Corporation, which in October 1997 signed an agreement with MiG, MAPO and Rosvooruzheniye for \$34.44 million for the modernization of the fighters already delivered.⁵³ Following Malaysia's example, Indonesia, Myanmar, the Philippines, Singapore and Thailand started negotiations with Russia for the purchase of various types of weaponry, military technology and military–technical cooperation. Several agreements were concluded⁵⁴ but some have been delayed or cancelled because of the Asian financial crisis of 1997–98.

Russia is also opening up the second most important Asian market, the Middle East. The main customers for Russian weapons there are now Kuwait and the United Arab Emirates (UAE). In the 1970s and 1980s, Syria was one of the largest importers of weapons from the USSR, but because of its accumulated debts (between \$7.5 billion and \$11 billion according to different assessments⁵⁵) the cooperation came to an end. In January 1998 a government delegation was sent to Syria to renew military–technical cooperation and to form a permanent committee on cooperation. This is evidence of the geopolitical aspects of arms sales. Russia, moreover, wants to keep Tartus, the only remaining naval base available to it on the Mediterranean Sea. (Syria, incidentally, asks no payment from Russia for the use of this base.)⁵⁶

Russia continues its military–technical cooperation with Iran under an agreement signed by Gorbachev in 1989 believed to run for 10 years and to involve the transfer of T-72 tanks and SA-5 surface-to-air missile (SAM) complexes.⁵⁷ In 1992 Russia and Iran made a further agreement for the transfer of T-72 and T-80 tanks. By an oral agreement with US President Bill Clinton of September 1994, Russia promised not to renew arms deliveries to Iran after the existing agreement expires.⁵⁸ However, the international situation might change: the USA itself has already started 'ping-pong' diplomacy with Iran.

Another breakthrough is of indisputable interest—with Turkey, one of the links in the NATO system. Russia has started to participate actively in arms

pp. 79–80; 'Kurs na Asiyu' [The course to Asia], *Expert*, no. 40 (26 Oct. 1998), p. 4; and Dybskiy, K., 'Sibirskaya tragediya' [Siberian tragedy], *Segodnya*, 9 Dec. 1997.

⁵² Anthony (note 42), pp. 90–91.

⁵³ Manvelov, N., 'Skromnoye oboyanie "Rosvooruzheniya"' [Rosvooruzheniye's discreet charm], *Več*, 4–10 Apr. 1997; and *Delovye Lyudi*, no. 84 (Dec. 1997), p. 119.

⁵⁴ See, e.g., *MEiMO*, no. 6 (1997), pp. 80–81; Sautin, A., 'Rossiya podbirayet klyuch k filippinskomu rynku' [Russia is picking up the keys to the Philippine market], *Finansovye Izvestiya*, 16 Sep. 1997; *Segodnya*, 30 June 1997, 10 July 1997, and 2 and 15 Oct. 1997; *Nezavisimaya Gazeta*, 17, 23 and 24 Oct. 1997; and Earl, G., 'Indonesia picks Russian jets', *Financial Times*, 6 Aug. 1997.

⁵⁵ Golotyuk, Yu., 'Moskva vozobnovlyayet postavki oruzhiya na blizhniy vostok' [Moscow resumes weapon deliveries to the Middle East], *Russkiy Telegraf*, 14 Feb. 1998.

⁵⁶ Golotyuk (note 55).

⁵⁷ Anthony, I., 'Arms exports to southern Asia: policies of technology transfer and denial in the supplier countries', ed. Arnett (note 44), p. 296.

⁵⁸ Anthony (note 57), p. 297.

tenders there. This is not an easy process: there is resistance not only from the USA and other Western countries but also from forces inside Russia itself. The scandal surrounding the joint project to produce a battle helicopter in Turkey, at a cost estimated at \$3.5 billion, illustrates this. Russia offered the most profitable conditions for the production of a helicopter through a consortium with a Turkish company and the participation of an Israeli corporation. Ukraine is also interested in this project. However, as the helicopters are planned to be produced on the basis of the Black Shark (Ka-50) and Alligator (Ka-52), the Progress producing plant in Primorskiy Kray (Maritime Province) is against placing production in Turkey. A successful Russian tender for tanks also faced strong resistance from the West. Here Russia also proposed a version of joint production of tanks in Turkey based on the T-90-C. The total cost of the project is approximately \$4.5 billion. The tender attracted the attention of all the significant producers of this technology from the USA to China and Ukraine.⁵⁹

The arms trade has helped to untie some complicated knots in general economic cooperation with Asian and other countries, for example, in resolving the problem of debts. So, for instance, out of income of \$3.5 billion announced by Rosvooruzheniye for 1996, only \$2.1 billion were received in foreign currency. A further \$350 million were in non-convertible (clearing) currency and weapons worth \$800 million were delivered to pay off debts to other countries. Delivery of weapons against debt to a value of \$360 million was planned for 1997; by the end of the year weapons worth \$250 million had been delivered.⁶⁰ Similar 'weapons for debts' deals were already in place with South Korea, to which Russia has delivered tanks, ICM-3 (BMP-3) infantry fighting vehicles, SA-16 SAM complexes and more.⁶¹ In August 1997 the Russian–Chinese committee on military–technical cooperation also discussed the question of Russia paying off its debt with arms.⁶²

Delivery of weapons supports Russia's expansion onto the civilian markets of Asian countries. Many contracts are accompanied by the exchange of non-military products and technology. This is already the case in Russia's cooperation with Malaysia and some other countries.

Military–technical cooperation with Russia is welcomed in the overwhelming majority of Asian countries. This is clear not only with such traditional buyers of Russian weapons as China, India, Viet Nam or certain Arab states but also with countries which for decades have been clients of the West, especially of the USA. There are probably two main reasons for this. The first is the urge to diversify their sources of weapons in order to avoid one-sided dependence. The

⁵⁹ Golotyuk, Yu., 'VPK rasschityvayet na turetskiye zakazy' [Military–industrial complex counting on Turkish orders], *Russkiy Telegram*, 29 Jan. 1998; and Georgiev, V., "'Chernye akuli" v Turtsii' [Black Sharks in Turkey], *Nezavisimaya Gazeta*, 25 Feb. 1998.

⁶⁰ Felgengauer, P., 'Oruzheyny export ne tak dokhoden, kak ob etom govoryat' [Arms exports not as profitable as people say], *Segodnya*, 26 Dec. 1997.

⁶¹ Karnakov, Yu., 'Rossiyskikh raketnikov mogut pozvat v Seul' [Russian missile specialists may be called to Seoul], *Russkiy Telegram*, 20 Nov. 1997.

⁶² 'Rossiya i Kitay proveli peregovory o voyenno-tekhnicheskoy sotrudnichestve' [Russia and China held negotiations on military–technical cooperation], *Finansovye Izvestiya*, 28 Aug. 1997.

second is more complicated. While the bipolar confrontation of the two superpowers continued, the USA willingly delivered weapons to those countries frequently even gratis. Now, however, former 'allied' countries in Asia and other parts of the world have lost their military–geopolitical significance for the USA. Many of them, furthermore, are becoming its economic competitors. That is why the USA and some other countries suddenly recalled problems with democracy and human rights in those countries which formerly hardly troubled them. Russia, in its turn, prefers not to interfere in the domestic situation in developing countries (the more so as it has quite enough work to do in this sphere at home). That is why Russia is a more comfortable and more understandable partner for Asian states than Western countries.

Arms exports are not the only important factor here. A more strategic factor is the Russian defence industry's need for integration into international military–technical cooperation. Many experts in Russia believe that at the present stage the Western defence industries are not the main channel through which such integration can be accomplished.⁶³ The West is not enthusiastic in this respect. All in all, it does not wish to participate in the restructuring of the Russian defence industry—there are no major projects in this sphere—and it remains a jealous competitor of Russia. Integration processes will therefore move and in fact have already started to move in the Asian direction. Asia in its turn cannot always rely on the West in such military–technical cooperation as Russia is ready for today regarding high-technology joint production, exchange of technologies and so on. Some Asian 'tigers' have expressed interest in and readiness to invest in the newest Russian technologies.⁶⁴

V. The Russian regions as foreign policy actors

Since the collapse of the USSR a new autonomous component has begun to form in the Russian statehood—the regions.⁶⁵ The change was born of Yeltsin's struggle against Gorbachev, during one stage of which Yeltsin put before the regions the slogan: 'Take as much sovereignty as you can eat'. In the very first year of his presidency Yeltsin had to meet the bills. The autonomies began to demand more and more sovereignty and more and more privileges. Yeltsin failed to stop the 'parade of sovereignties' with the Federation Treaty of 31 March 1992.⁶⁶

When later on in his struggle with the Supreme Soviet, headed by its speaker, Ruslan Khasbulatov, Yeltsin decided to seek the support of the regions, some of

⁶³ See, e.g., *MEiMO*, no. 3 (1997), pp. 114–17; and Gabovich, M., 'Sekretnaya trgovlya' [Secret trade], *Moskovskie Novosti*, 31 Aug.–7 Sep. 1997.

⁶⁴ *Passport*, Mar./Apr. 1997, p. 79 (in Russian).

⁶⁵ There are 89 subjects of the Russian Federation—the parts of which it is composed. They include 32 ethno-national territories (21 republics, 1 autonomous region and 10 autonomous districts) and 57 administrative entities (49 regions or *oblasti*, 6 territories or *kraya* and 2 federal cities (Moscow and St Petersburg)).

⁶⁶ Simonia, N., 'The development of Russia's statehood', in *Building Nation, State and Regime: Some Post-Communist Examples* (Slavic Research Centre, Hokkaido University: Sapporo, 1997), pp. 1–30.

them started to demand the transformation of Russia from a constitutional federation into a contractual one. Yeltsin continued to lean on the regions, paying for their support with subventions and privileges in taxation, export quotas on raw materials developed on their territories, and so on. All these were registered officially by special, sometimes secret, decrees or through bilateral treaties between the Russian Federation and its regions. Appointed governors served as a considerable support for the presidential power. However, in 1995–96, under pressure from the regions, Yeltsin began allowing the election of governors, until by 1997 this had become universal practice. Aware of their new elective legitimacy, governors then became more independent, asserting themselves regarding the distribution of budget money, the shares of their regions in tax revenues and so on. As a result the Council of the Federation changed from being the mainly decorative upper chamber of the Federal Assembly into a quite independent centre of power and influence. Finally the country found itself in a rather strange form of federation, representing a mixture of elements of constitutional and contractual federalism.⁶⁷

The granting of privileges and benefits to one group of subjects of the federation, the ethnic republics, caused resentment in other regions, the *oblasti* (regions) and *kraya* (territories).⁶⁸ In response there began a ‘sovereignization’ movement, manifested in projects to create Siberian, Ural, Yenisey, Far Eastern and other republics. This could not be regarded as separatism; it was used mainly as a means to put pressure on the centre in order to extract additional benefits and concessions. After 1996 Yeltsin started to ‘equalize’ (although quite selectively) the subjects of the federation, concluding bilateral treaties.

Neither the regions’ demands for ‘equality’ nor the centre’s ‘equal’ attitude towards each and every one of them was entirely sincere. The development of the regions has always been uneven and today they are in genuinely unequal situations. Only 10 out of 89 subjects of the federation are net contributors to the federal budget; the rest are subsidized, that is, they depend on federal aid or redistribution of resources through the federal budget. Demands for equality come first of all from non-subsidized regions, which refuse to finance the development of other territories.⁶⁹ Starting from the genuine need to redistribute resources through the federal budget and bearing in mind the lack of any clear legislation on budget federalism, the government is acting quite in the Soviet manner: it demands that the regions transfer all their tax receipts to the centre, and then forces them to beg the federal ministries for transfers, resources for executing federal programmes on their territories and financial support from special funds.

⁶⁷ As the Chairman of the Council of the Federation, Yegor Stroyev, put it in an interview: ‘We are still unable to determine what exactly we are building—a federative state or a unitarian one’. *Kommersant-Vlast*, no. 7 (3 Mar. 1998), p. 23.

⁶⁸ *Passport* (note 64).

⁶⁹ In Nov. 1996 leaders of 10 ‘donor’ regions gathered in Nizhniy Novgorod to formulate recommendations on changes in economic policy. Soon after that Luzhkov organized a ‘round table’ in Moscow for leaders of the regional elite, who made a set of 20 demands aimed at preventing the country from falling into crisis. The government ignored these demands. *Ogonek*, no. 50 (Dec. 1996), p. 18.

Naturally, such a system is open to abuse. The actual volume of transfers between the different federal subjects in 1997 was between 30 and 90 per cent of what had been planned.⁷⁰ This whole system of redistribution is kept secret, even from appropriate committees of the Duma, and is frequently used to stimulate obedient and punish recalcitrant regions.

Here, and not in political separatism, lie the principal contradictions between the centre and the regions.

Now the question of the relationship between the federal centre and the regions in these processes arises. In today's Russia Moscow has three 'parts'. First, it is the centre of the federal administration, which is trying to get as much as possible from the regions and to give them as little as possible in return—the centre that in recent years almost left the regions to the mercy of fate. (As Yegor Stroyev, Chairman of the Council of the Federation, put it, 'this Moscow pot has long stopped cooking anything'.⁷¹) Second, Moscow is a federal city and subject of the federation but is using to the utmost its role as the capital in order to obtain benefits and privileges. In this role it is the object of envy and a model for imitation for other regions.⁷² However, there is a third Moscow—the economic centre of new Russian bureaucratic capitalism at the federal level. This is where the largest commercial banks, financial–industrial groups and scientific–technical and information centres are concentrated.

This third Moscow will have to be the main force for integration in Russia. Regardless of the subjective aspirations of different representatives of bureaucratic capital, the objective needs of bureaucratic state capitalism and especially of the financial–industrial groups are inciting them to involve the regions in the future all-Russian market. Initially, when the financial–trading faction tried a 'Bolshevik-type onslaught' to conquer the regions, the latter put up stubborn resistance.

Bureaucratic capital is forming rapidly at the regional level, has gained strength especially with the institution of elected regional governors, and is refusing to lose control over 'its own' natural resources and give everything to 'the federals'. Even so, recently a more flexible, compromise policy towards the regions has begun to break through. Oil corporations and large commercial banks began to race one another to conclude general agreements on cooperation with the regions, territories and republics. This has meant a clear tendency towards the amalgamation of bureaucratic capital at federal and regional levels for mutual benefit. At the same time, naturally, because they have the financial

⁷⁰ Pismennaya, E., 'Pravitelstvo pytayetsya sdelat prozrachnym raspredeleniye sredstv mezhdru regionami' [The government is trying to make the distribution of funds between regions transparent], *Finansovye Izvestiya*, 3 Mar. 1998.

⁷¹ *Kommersant-Vlast*, no. 7 (1997), p. 22.

⁷² In 1997 Moscow with its population of 8.6 million had 10.9% of Russia's gross domestic product (GDP), about 5% of its industrial production, and an average per capita income of \$6122 per year as compared with \$1797 in Russia as a whole. It had the highest investment rating and it swallows about two-thirds of all foreign investment. *The Economist*, 6 Sep. 1997, p. 38; and Interfax-AiF, 1–7 Dec. 1997, p. 12.

opportunities, know-how and so on, the federal corporations and commercial banks are destined to play the leading part in this union.

Bearing all these tendencies in mind, talk on the part of some Western scholars and specialists of democracy in the regions confronting the 'imperial aspirations of the Moscow elite' and advice to the US Administration, based on similar analysis, to support the Russian regions seem naive.⁷³ If these tendencies do prevail, and it seems that they really may, then the conclusion of *The Economist*, that 'Dissolution is unlikely, but less unlikely than coup d'état or civil war',⁷⁴ will also turn out to be incorrect. Regions involved in large 'federal business' will hardly think about separation or even isolation from the centre. A coup d'état is much more likely, especially if the central executive power fails to defend the interests of this emerging and strengthening 'union' of federal- and regional-level bourgeoisies efficiently and effectively.

Ideas and apprehensions regarding regional separatism, expressed both abroad and at home, may be seriously exaggerated, as they are mostly based on exterior manifestations of regional leaders' activity—sharp statements regarding the centre, inter-regional activities and so on—or on the course of events in Chechnya, which is not typical for Russia. Even *The Economist* points out that, in spite of the sovereignization of Tatarstan, the right which it won to conduct its own 'foreign economic policy' has still produced only a trade agreement with Iran and small investments from Malaysia.⁷⁵ The same can be said of Primorskiy Krai and its permanently rebellious Governor, Yevgeny Nazdratenko, even though, unlike Tatarstan, Primorskiy Krai has direct land and sea outlets to Asia–Pacific. The scale of its foreign economic cooperation leaves much to be desired and it shows no serious signs of separatism. Real integration of the Russian far east in Asia–Pacific, which is vitally important for the whole of Russia, will be possible only in close coordination with efforts by the federal centre.

The best proof of this is the breakthrough in cooperation between Russia and Asia–Pacific (China and Japan) achieved in the autumn of 1997 after two summit meetings. President Yeltsin visited China and Japanese Prime Minister Ryutaro Hashimoto visited Russia. Preliminary agreement was reached on a broad list of economic projects, especially important being several for the supply of Russian gas, oil and electricity from Siberia and the Russian far east to China, Japan and Korea. Taking into account the growth of demand for energy in Asia and the fact that North-East Asia is one of the world's oil and gas 'havens', there is a possibility that Russia in the 21st century will become almost the sole exporter of oil within the Asia–Pacific region.⁷⁶

⁷³ See, e.g., Hamilton, L., 'Pay attention to Russia's reforming regions', *International Herald Tribune*, 16 July 1997.

⁷⁴ 'A survey of Russia', *The Economist*, 12 July 1997 (supplement), p. 16.

⁷⁵ See note 74.

⁷⁶ Simonia, N., 'Russia and energy security in the Asia–Pacific region', Paper presented to the 8th International Conference on North-East Asia, Yanago, Japan, July 1998.

VI. 1998: crisis of the ultra-liberal model

In March 1998, when Chernomyrdin believed that he had concentrated almost all the levers of executive power in his hands and obviously anticipated becoming president in the near future, Yeltsin, displeased with Chernomyrdin's rapid rise and increasing independence, dismissed the entire government.

This marked the turning point in Russia's development. The structural crisis that had hitherto been semi-latent entered its open phase. In the following four or five months it became obvious that the model of development formed over the preceding six years was a blind alley. In the socio-political sphere the favourite method of the president, manoeuvring and playing colleagues off against one another, ceased to work. The illusory relative stability was broken even at the highest level of the executive power. There appeared signs of split and demoralization in the apparatus of the presidential administration and even in the narrow circle closest to Yeltsin. For instance, although Yumashev and Berezovsky had jointly initiated the removal of Chernomyrdin, they immediately split over the question of who was to become the next 'pocket' prime minister. Defying Berezovsky, Yumashev pressed for Sergey Kiriyenko.

Even more importantly, the spring and summer of 1998 revealed the complete exhaustion of the socio-economic model established as a result of the action of previous governments with the active cooperation of the IMF. A central element of that model was macroeconomic stabilization, interpreted as the fight against inflation at any cost. The result was a rather strange 'market economy' in which the greater part of industrial production appeared to be cut off from the system of monetary payment and moved into the shadow economy of barter, which even by the more modest estimates exceeded 50 per cent of the economy,⁷⁷ and the use of surrogate money. The credit system was isolated from the 'real', productive sectors of the economy and instead of performing its main function of serving those sectors it acted (together with the exchange markets) as a mechanism for pumping abroad a considerable part of the value added in production. This happened thanks to the ultra-liberal foreign currency market created with the assistance of Western experts. This situation meant that the state was unable to collect taxes, and as a consequence led to an increase of the budget deficit.

Meanwhile, as IMF instructions excluded the possibility of covering the budget deficit by printing money, starting from 1995 the government switched to financing the deficit exclusively by loan. A giant pyramid of treasury short-term bonds was built up, which very soon turned from being a means of patching holes in the budget to being a powerful means to take money, including that received from the international financial organizations, out of the budget. The growth of the pyramid was accelerated by the fact that in 1996–97 the Central Bank opened the treasury short-term bonds markets for foreign investors who had been previously acting through dummy Russian structures.

⁷⁷ Ivanter *et al.* (note 7); and *Expert*, no. 1–2 (18 Jan. 1999), p. 11 (in Russian).

Kiriyenko became Prime Minister at the very moment when net returns from selling treasury short-term bonds came down to zero, and since then the net capital outflow has never let up, increasing monthly by 5 billion roubles. On the eve of the collapse of 17 August 1998 the treasury was paying out \$1 billion per week on old bonds and had stopped the distribution of new bonds.⁷⁸ Oil prices remained depressed. The state found itself on the verge of bankruptcy.

Kiriyenko, calling his government a technocratic one, tried to be above the fight among the factions of bureaucratic capital, started to talk about industrial policy and began to create a ministry of industry and trade. However, the crisis had gone too far and the contradictions between the social and political forces in the country had been greatly aggravated. In this extreme situation another regrouping of forces took place. The representatives of big bureaucratic business separated into two camps, which had different views of the way out of the crisis.

One (relatively anti-Western) group consisted of those who were against the domineering role of the IMF and the Western transnational corporations in determining the tactics for Russia's way out of the crisis and the strategy for its future economic development. It was a large but ill-assorted group, including those 'oligarchs' who could not exist and flourish without the hot-house conditions created for them by previous governments and/or were reliant on corrupt ties with top officials, as well as those corporations (Lukoil and Gazprom) which had already obtained strong positions but which wanted to preserve them, including partnerships with foreign capital, and gain new privileges from the state.

Naturally, there could be no absolute cohesion within that group. For instance, the raw materials exporters were seriously interested in devaluation of the rouble as it could bring them considerable profit even while prices on the world market were low, but for the big financiers devaluation could be fatal as it would undermine their ability to settle credits received in the process of constructing the treasury short-term bonds pyramid, in which they had actively participated. Nevertheless, at that point in time they were united by the intention to prevent events developing according to the 'Western script'. Boris Berezovsky acted as their informal (and temporary) leader.

The second, more 'Western-oriented', group included those who believed it necessary to follow the recommendations of the IMF and were ready to play the role of junior partner of the Western transnational corporations. The undoubted leader of this group was and still is Anatoly Chubais.

Kiriyenko, although he had officially proclaimed a policy of neutrality, was in reality inclined to cooperate with the second group, which naturally caused great discontent among the first. Open riot seemed unavoidable. On 22 July 1998 the heads of six oil companies issued a sharp criticism of the conditions attached to the next IMF credit, calling the economic policy of the international financial organizations, which in particular involved an increase of fiscal pres-

⁷⁸ Ivanter *et al.* (note 7), p. 8.

sure on the industries of the 'real economy', 'unreasonable and irresponsible'. *Nezavisimaya Gazeta* (controlled by Berezovsky) did not hesitate to threaten to 'sweep away' the government of Kiriyenko.⁷⁹

As the culmination of the crisis approached, Kiriyenko openly took the 'Western-oriented' course and the final decision on crisis measures proclaimed on 17 August was made with the direct participation of Chubais, preceded by consultations with Yegor Gaidar, the international financier George Soros and the leaders of the relevant US government agencies.⁸⁰

On the face of it the decision on simultaneous default and devaluation had to satisfy both exporters and the commercial banks, which were forbidden to make payments on their foreign debts. In fact matters were more complicated and worse. First, the default was announced only for three months, which was too short a time for banks to solve the problem of their debt: by the end of the period the majority of them were expected to go bankrupt. Second and more importantly, Kiriyenko and Chubais prepared a 'Western version' of restructuring, putting the country's finances on a sound basis and allowing for bankruptcies. On the eve of the default Chubais openly called on foreign banks to participate in the restructuring of the Russian banking sector.⁸¹ Not long after that, Nemtsov stated that Kiriyenko intended to apply a package of tough and radical reforms which Western leaders insisted on and which included the bankruptcy of politically influential but economically weak commercial banks and oil companies. It was envisaged that stronger companies, including Western creditors, could take control over weaker firms.⁸²

The leaders of the opposite camp learned of those plans. With the help of the presidential administration Berezovsky made another 'upheaval' and secured the removal of Kiriyenko. Nevertheless, as in March 1998, the operation was only a partial success: the attempt to return Chernomyrdin to power was frustrated by the Duma.

The approval of Yevgeny Primakov as Prime Minister on 11 September brought immediate relative political stability. This was the first government to enjoy the support not only of the President and his administration but of the Duma and the Council of the Federation, as well as broad sympathy among the general public (as was more than once established by opinion polls). This may be connected with the fact that for the first time the executive power was led by a man who had no connections with any faction of bureaucratic capital and was a consistent statist.

The general features of the course taken by the Primakov Government were apparent—the gradual dismantling of the existing neo-colonial and neo-comprador model; the focusing of economic policy on solving the problems of

⁷⁹ 'Neft i politikantstvo' [Oil and intrigues], *Nezavisimaya Gazeta*, 23 July 1998.

⁸⁰ Interview given by Kiriyenko and abstracts from Soros, G., [The end of capitalism], published in *Expert*, no. 1–2 (18 Jan. 1998), pp. 8, 10 (in Russian).

⁸¹ Krutakov, L., 'Chubais khotel sdal banki inostrantsam' [Chubais wanted to give away the banks to foreigners], *Moskovskiy Komsomolets*, 26 Aug. 1998.

⁸² Abstracts from an interview by Boris Nemtsov and comments on it, *Russkiy Telegraf*, 27 Aug. 1998; and *Expert*, no. 32 (31 Aug. 1998), p. 11 (in Russian).

the real economy; the restructuring of the banking system and industry in the interests of general economic development instead of self-enrichment; and the continuation of socially oriented economic reforms.

In order to develop this strategy fully, Primakov's Government had to solve the most complicated problem of debt, both foreign and domestic. The great difficulty here lay in the fact that the government was forced to solve this problem at the same time as developing a new strategy. For that purpose a number of long-term measures were undertaken.

The Russian Federal Property Fund established an Agency for the Restructuring of Credit Organizations, the goal of which was the creation of a new banking system, a return to normal working for the 18 largest banks, large regional banks, and the bankruptcy of approximately 720 banks which were beyond saving.⁸³ A new Russian Development Bank (RDB) was formed with capital from the 1999 development budget and the possibility of international financial groups participating in the bank's capital was envisaged. The RDB was created to accumulate means from foreign and home sources to provide credit for the 'real sector' regardless of forms of property—the main criterion was efficiency—using the mechanism of distribution of state investments on a competitive basis and provision of state guarantees.⁸⁴ In the course of setting up these two institutions the government resorted to consultations with the International Bank for Reconstruction and Development (IBRD) and the European Bank for Reconstruction and Development (EBRD). In its turn the Central Bank started to construct a post-crisis model of the home currency market instead of the former ultra-liberal one, with exporters being obliged to sell to the Central Bank 75 per cent of their foreign exchange earnings and with more effective regulation of exchange-rate fluctuations.⁸⁵

In spite of another 'mutiny of the oil generals' in October 1998, the government increased its efforts to restructure this most important industry. The main directions of these efforts were: (a) a reduction of the number of companies through the merger of Rosneft, Slavneft, Onako (and then probably of Tyumenskaya), forming a large national oil company in which 75 per cent of shares would belong to the state; (b) the formation of a working group to control oil exports and related matters;⁸⁶ and (c) partial rationalization of those enterprises that were seized by the 'oligarchs' during the division of state property but which they failed to 'digest' and which had become a burden to them.

Foreign investment was another matter where Primakov did not support either of the opposing groups. Russia's interests and its national economy were his priority. He expressed a negative attitude to speculative portfolio investments and stood for promotion of direct private investments. Here a serious breakthrough has already been achieved: on 9 December 1998 the Duma passed

⁸³ For details, see *Kommersant-Vlast*, no. 46 (1 Dec. 1998), p. 28; and *Segodnya*, 18 Dec. 1998.

⁸⁴ For details, see *Segodnya*, 23 Dec. 1998; and *Nezavisimaya Gazeta*, 30 Dec. 1998.

⁸⁵ For a more substantial analysis of these measures, see Makovskaya, E., 'Valutu tolko po nuzhdey' [Foreign currency only if needed], *Expert*, no. 37 (5 Oct. 1998), p. 6.

⁸⁶ *Finansovye Izvestiya*, 22 Dec. 1998; and *Moskovskie Novosti*, 22–29 Nov. 1998.

legislation enabling production-sharing agreements (PSAs) and thereby promising to change the landscape of oil industry investment in Russia.⁸⁷ This added impetus to foreign investment in the already functioning Sakhalin-1 and Sakhalin-2 projects. Negotiations with Exxon on the Sakhalin-3 project became brisker. The Sakhalin-4 and Sakhalin-5 projects were next in turn. All this meant that the prospects for the development of the Russian far east and for energy cooperation with the Asia-Pacific countries could be regarded with more optimism. Immediately after the first breakthrough the government started preparing other important bills on foreign investments (for example, 'On concessions', 'On free economic zones' and 'On accounting') for introduction to the Duma.

The large part of industry that was excluded from the money circulation process was less affected by the recent financial shocks. Combined with a considerable weakening of the leading bureaucratic capital factions, this created favourable conditions for the government to concentrate on industrial expansion. Tight as the 1999 state budget was, the government put into the 'development' budget 21.6 billion roubles—five times more than in previous years.⁸⁸ However, it was not by any means planning to save industry in general. The approach was strictly selective. Only efficient industries were to be supported—those which were promising from the point of view of export and competitiveness on the home market or strategically important.

Naturally, the government proceeded from an understanding that foreign participation in this restructuring was necessary and was ready to allow foreign investors considerable financial privileges. Thus, while adopting at the end of January 1999 a plan of financial support for the Rosselmash joint-stock company (a monopoly in combine construction), it took into consideration the intention of the US company John Deere to participate in joint production, and was ready to give the plant a four-year debt postponement plus another four-year instalment on its main debt and a 10-year instalment on accumulated penalties.⁸⁹ In the defence industry the government started the process of centralization of production, coordination of research and creation of vertically integrated corporations. The creation of a large holding in Rossiyskiye Raketnye Dvigateli (Russian Rocket Engines), where it was decided to leave 51 per cent of shares to the state and grant 34 per cent to Russian and foreign investors, and the decision on the merger of the Sukhoi Construction Bureau with the MiG aviation complex⁹⁰ were examples.

In general the new government strategy was a resolute rejection of unbridled liberalization, but it was also almost as clear a rejection of a return to centralized administration.

⁸⁷ *OGJ Newsletter*, 4 Jan. 1999.

⁸⁸ *Nezavisimaya Gazeta*, 30 Dec. 1998; and *Segodnya*, 27 Jan. 1999.

⁸⁹ *Izvestiya*, 29 Jan. 1999.

⁹⁰ *Izvestiya*, 17 Dec. 1998; and *Nezavisimaya Gazeta*, 20 Jan. 1999.

The implications for Russian foreign policy

What were the foreign policy implications of Primakov's coming to power ?

First and foremost, the question facing Primakov was how better to balance foreign policy orientations within the framework of a multipolar world concept.

If a snapshot of the international situation could be superimposed on a map of the gross domestic product (GDP) of the larger countries, their military potential and so on, then the impression would be that a unipolar world is emerging. Nevertheless, if the international situation is examined objectively it becomes clear that there is long-term continuity in the tendency for the world to become multipolar. This tendency began with the collapse of colonialism and recovery from World War II. It was favoured by the emergence of the non-aligned movement, by increasing integration in Europe and by other processes that could not be confined in the framework of the cold war bipolar opposition. The break-up of the bipolar system gave it additional stimulus and widened the circle of countries participating in the process. Even former allies no longer needed to line up on one or other side of the barricades. However, the multipolar system is still far from taking final shape.

The goal of Primakov's foreign policy was in no way a reorientation from the West to the East but a better balance between the West and the East—a lifting of the level of relations with the East which was previously unreasonably low. Meanwhile the position of the West, and especially that of the USA, left much to be desired. Behind complacent assurances and good wishes, an urge to isolate Russia, including within the framework of the CIS, was easy to see, as well as a reluctance to intensify and expand cooperation in the sphere of high technology. (Such cooperation took place only in cases where the technological advantage was on Russia's side, and even then the USA presented it as a boon to Russia and when opportunity offered used it as a means of putting on political pressure.) Finally, the West's watchful attitude to and even disapproval of Primakov's very appointment as prime minister and a refusal or delay in giving his government even modest financial support, while all previous governments, in spite of rampant corruption and the squandering of credits, were quite regularly granted credits—all this and much more seemed as if deliberately intended to push Russia towards orientation to the East. It hardly corresponded to the interests of strengthening global and regional security.

Under Primakov's Government Russia attempted to halt the process of decline to the role of a second-rate regional power. Relying on a real tendency for a multipolar world to develop, and basing its policy in particular on cooperation with Asian and Asia-Pacific countries, Russia was led to turn back the negative tendencies of its socio-economic development and to occupy a worthy place in the future world order, not as another superpower but as one of the great equal powers of the future world.