Conceptualizing FDI in the Russian Regions: Primore, Khabarovsk, and Sakhalin

by

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ABSTRACT

Since the Soviet Union collapsed in 1991, Russia has attracted a minuscule proportion of global FDI—only 1 percent of inflows to developing countries. Worse, most of Russia's FDI is "market-seeking"—geared to the domestic market—rather than the more productive export-oriented variety which dominates global FDI flows. Well over half of Russia's FDI goes to Moscow and St. Petersburg, a disparity which aggravates the developmental dislocation between the national center and the rest of the vast country.

In this dissertation, I examine variation in regional-level FDI policies—a key factor in attracting FDI to the regions. The empirical work focuses on FDI in the export-oriented industries of three regions in the Russian Far East—Primorski k krai, Khabarovskii krai, and Sakhalin oblast—all of which have been the object of intense interest from foreign investors. The three developed widely variegated FDI policies: During the 1990s, Primorski k krai grew increasingly hostile to foreign investors, Khabarovsk largely ignored foreign investment, while Sakhalin, actively sought out foreign investment. The dissertation finds that policy variation is a product of gubernatorial power. It shows that regional governors wielded decisive power in policy areas which directly affected FDI inflows—foreign acquisition of stock in privatizing Russian enterprises, joint-ventures, the development of legislation governing foreign investment into new "greenfield" ventures. Examining a wide range of explanations for regional policy variation, the dissertation finds that objectivist theories can not adequately explain variation in the governors' FDI policies. Focusing on the role of ideas, the dissertation develops an ideational model of causation which argues that the disparate ways in which the governors defined the post-Soviet crisis, explained its origin, and understood the concepts of a new era—democracy, reform, "Subject of the Federation," and patriotism—determined which FDI policies they considered legitimate. Ultimately, the policies of those governors who effectively "sold" their ideas in the locality—by cultivating support among regional elites and embedding their ideas into regional institutions—endured.

Thesis Supervisor: Richard Samuels
Title: Ford International Professor of Political Science
To my mother
Acknowledgments

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I was also fortunate to have the support of innumerable Russian citizens in the Far East and in Moscow who generously gave their time to discuss the project with me, provided me with invaluable documentation, and assisted me in setting up critical interviews. This project could not have been completed without them.

A great number of my friends and colleagues took the time to listen to my arguments, read and comment on my chapters, and provide moral support. Teresa Lynch in particular helped me with her insights into the literature, her thoughtful and detailed comments on the chapter drafts, and her constant encouragement. Stephen Herschler's unflagging support, generous sharing of material, and thoughtful commentary were absolutely critical to this dissertation. Karla Smith, Regina Smyth, Yoshiko Herrera, and Nigel Gould-Davies, all read portions of the dissertation and helped me think through the argument. My gratitude also goes to David Mendeloff, Jonathan Nagler, Kathy Gilman, Keith Darden, Lynnlie Browning-Darden, Eric Thun, Steve Clinkenbeard, Yitzhak Brudny, and Ashutosh Varshney, who generously supported and encouraged me through various stages of the dissertation.

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The Russian Far East: Administrative Regions
Part I: Introduction
Chapter 1

Russia, FDI, and Regional-Level Policy:
the significance of the dependent variable

When the Soviet Union collapsed, hopes both at home and abroad ran high that the new Russian Federation would join the global community of capitalist economies. With a highly educated work force, a large potential market, and rich natural resources, Russia's participation in economic globalization seemed a matter of course. In the decade following Soviet collapse, however, the Russian Federation failed to attract the kind of foreign investment that has brought new prosperity to many transitional and developing economies. Instead, levels of foreign direct investment to Russia remained stunningly low. The provinces, in particular, have fared poorly. This dissertation examines the evolution of regional-level FDI policy in an attempt to explain why FDI inflows to Russian regions have not risen despite over a decade of reform. It focuses on three regional case-studies in the Russian Far East: Primorskiy krai, Khabarovskii krai, and Sakhalin oblast. In examining these case-studies, the dissertation uncovers broad variation in FDI policy outcomes across the three regions. The primary task of this dissertation is to explain that variation.

No comprehensive study of FDI in Russia exists. For this reason, Chapter 1 offers an overview of the state of FDI in Russia, providing details of investment levels, regional disparities, and the FDI policy framework. Chapter 2 examines a range of materialist and ideational explanations for variation in regional FDI policy outcomes. The dissertation argues that ideational factors best explain policy outcomes, and chapter 2 presents a framework for understanding the causal linkages between ideas and policy outcomes.
Chapters 3, 4, and 5 address the regional case-studies. Chapter 6 provides a comparative analysis of the cases and offers conclusions about Russia's FDI policy and the role of ideational factors.

FDI and the Russian Federation

Russia is cash-poor. By most accounts, over 70 percent of enterprise transactions are conducted in kind.¹ Capital investment in the economy has fallen precipitously—by 1997 to a mere 17 percent of 1990 levels.² Estimates of Russia's capital investment needs vary, but all are beyond the capacity of Russia's capital markets and banks to provide. A 1996 study at the Institute for Advanced Studies in Vienna estimated Russia's capital needs at $100 billion a year.³ A more conservative estimate by the World Bank calculated Russian needs at $50 billion to maintain and develop the oil industry, $50 to $60 billion to restore and modernize manufacturing, and between $25 and $30 billion to convert defense enterprises.⁴ At Cambridge Energy Research Associates, director Thane Gustafson estimates that the Russian oil business needs to increase capital spending to $10-12 billion a year, from a current level of $2-3 billion.⁵ Even as the need for cash grows, Russian capital is fleeing the country. A common capital flight estimate for the

² Clifford G. Gaddy and Barry W. Ickes, "Russia's Virtual Economy," p. 54.
decade of the 1990s is $150 billion.⁶ A slightly higher estimate by the OECD puts it at $11 to $20 billion annually between 1995 and 2000.⁷ Many estimates are even higher. A report from the European Bank for Reconstruction and Development (EBRD) estimated capital flight in 1996 alone at $29 billion.⁸ A study at the Russian Ministry of Finance in the third quarter of 1999 found capital flight to total $2.9 billion a month.⁹ Meanwhile, the Russian budget is highly dependent on volatile factors beyond the country's control, especially world oil prices. A large portion of Russia's foreign cash reserves comes from exports of oil and natural gas so that a drop in world prices would severely compromise Russia's financial account. Together oil and gas account for approximately 40 percent of Russia's exports and contribute 13 percent of GDP. But in the post-Soviet era, oil production has plummeted—down by 23 percent between 1992 and 1998.¹⁰ Russian capital markets have not and can not generate the kind of investment the country needs, and the need is great. To meet that need, Russia will need to attract foreign investment.

But Russia's track record in FDI has been poor. Since 1991, the Russian Federation has attracted approximately one percent of the total annual FDI flows to developing and transitional countries.¹¹ By 1999, Russia's estimated FDI stock stood at a

---

¹¹ Approximately two-thirds of FDI flows to the developed countries, and one-third to developing and transition countries.
mere $17 billion;\textsuperscript{12} in that same year, global FDI flows exceeded $1 trillion.\textsuperscript{13} In comparison to other transitional economies, Russia has come up short. Russia's cumulative FDI for 1992-1999 represents only $96 per capita, substantially less than Poland at $511, Estonia at $863, the Czech Republic at $1493, and Hungary at $1581.\textsuperscript{14} FDI flows to Russia peaked at around $5 billion in 1997, far below those of the world's most successful developing economy, China, which attracted nearly $45 billion that same year (and that does not include over $11 billion to Hong Kong).\textsuperscript{15} Russia, it seems, is losing the FDI game. (Table 1)

\begin{table}
\centering
\caption{Russia's FDI Inflows in Comparative Perspective}
\begin{tabular}{|l|rrrrrrrrr|}
\hline
                     & 91 & 92 & 93 & 94 & 95 & 96 & 97 & 98 & 99 & 00 & 01 \\
\hline
USA bS\$            & 22.8 & 19.2 & 50.7 & 45.1 & 58.8 & 84.5 & 103.4 & 174.4 & 283.4 & 301 & 124.4 \\
France bS\$         & 15.2 & 17.9 & 16.4 & 15.6 & 23.7 & 22 & 23.2 & 31 & 47.1 & 43 & 52.6 \\
Spain bS\$          & 12.5 & 13.3 & 9.7 & 8.9 & 6.2 & 6.6 & 7.7 & 11.8 & 15.8 & 37.5 & 21.8 \\
China bS\$          & 4.4 & 11.2 & 27.5 & 33.8 & 35.9 & 40 & 44.2 & 43.8 & 40.3 & 40.8 & 46.9 \\
India mS\$          & 75 & 252 & 532 & 974 & 2151 & 2525 & 3619 & 2633 & 2168 & 2319 & 3403 \\
Kazakhstan mS\$     & 100 & 1271 & 660 & 984 & 1674 & 2107 & 1233 & 1468 & 1278 & 2760 & \\
Czech Republic mS\$ & 523 & 1003 & 654 & 869 & 2562 & 1428 & 1300 & 3718 & 6324 & 4986 & 4916 \\
Hungary mS\$        & 1459 & 1471 & 2339 & 1146 & 4453 & 2275 & 2173 & 2036 & 1944 & 1643 & 2414 \\
Poland mS\$         & 359 & 678 & 1715 & 1875 & 3659 & 4498 & 4908 & 6365 & 7270 & 9342 & 8830 \\
Russian Federation mS\$ & 700 & 1211 & 690 & 2066 & 2579 & 4865 & 2761 & 3309 & 2714 & 2540 & \\
\hline
\end{tabular}
\textit{Source}: Compiled from UNCTAD on-line statistical database @ http://www.unctad.org
\end{table}

More alarmingly, what little FDI Russia has attracted is not "efficiency-seeking"—that is, geared towards exports or integrated into trans-national production.

\textsuperscript{12} The Goskomstat figure for Russia's FDI stock in 1999 is $15.4 billion. Goskomstat methodology does not record many investment activities of smaller enterprises. The $17 billion figure is the OECD's estimation, including smaller amounts of investment.

\textsuperscript{13} OECD, 2001.


\textsuperscript{15} Figures from the United National Conference on Trade and Development (UNCTAD), http://www.unctad.org
networks. Instead, FDI in Russia functions according to an "old paradigm," meaning that it seeks access to inputs for production and sells on the domestic market. Market-seeking "old paradigm" investment confers limited benefits on recipient countries because, rather than producing at world-standards, it produces lower-quality goods for domestic consumption or simply extracts raw materials. According to 1999 estimates from the United Nations Conference on Trade and Development (UNCTAD), less than 16 percent of Russia's FDI inflows are efficiency-seeking, although figures for the status of foreign affiliates in Russia's exports are less generous (Table 2). Indeed, a sectoral breakdown shows that Russian FDI inflows have overwhelmingly focused on providing goods and services for the domestic market: In the 1990s, the sectors which received the most FDI were the food industry, telecommunications, and retail trade. Where Russia's FDI has focused on exports, it has dealt almost exclusively in extraction—not processing—of raw natural resources for export, especially oil, but even investment in Russian oil stagnated and fell over the course of the 1990s, as foreign companies grew weary waiting for supporting legislation. (Between 1994 and 1995 alone, FDI in Russian oil and gas halved, dropping from $522 million to $260 million.)

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16 The 1999 World Investment Report, the United Nations Conference on Trade and Development reported that less than 16 percent of FDI in Russia is "efficiency-seeking." Also see UNCTAD 2002, Bergsman, Broadman, and Drebentsov (World Bank) 2000, and Lankes and Stern (EBRD) 1997.

17 According to World Bank studies, the "old paradigm" of FDI dominated investment activities since the 1950s, but has given way to the new efficiency-seeking paradigm with the upsurge in global investment and trading activity in the newest wave of globalization. See World Investment Report 1999, UNCTAD, and Joel Bergsman, Harry G. Broadman, and Vladimir Drebentsov, Improving Russia's Policy on Foreign Direct Investment, World Bank Working Paper no. 2329, May 2000.

18 World Investment Report: Foreign Direct Investment and the Challenge of Development UNCTAD, 1999, p. 70. The 16 percent figure appears very generous. See Table 2.


20 Production-sharing legislation passed at the end of 1995, but implementation of production-
Table 2
Share of Foreign Affiliates in the Exports of Select Developing and Transitional Economies

<table>
<thead>
<tr>
<th>Economy</th>
<th>Year</th>
<th>Share</th>
</tr>
</thead>
<tbody>
<tr>
<td>China</td>
<td>1991*</td>
<td>17</td>
</tr>
<tr>
<td></td>
<td>2001*</td>
<td>50</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>1993**</td>
<td>15</td>
</tr>
<tr>
<td></td>
<td>1998**</td>
<td>47</td>
</tr>
<tr>
<td>Hungary</td>
<td>1995</td>
<td>58</td>
</tr>
<tr>
<td></td>
<td>1999</td>
<td>80</td>
</tr>
<tr>
<td>Poland</td>
<td>1998</td>
<td>48</td>
</tr>
<tr>
<td></td>
<td>2000</td>
<td>56</td>
</tr>
<tr>
<td>Russian Federation</td>
<td>1992***</td>
<td>3.5</td>
</tr>
<tr>
<td></td>
<td>1997***</td>
<td>7.3</td>
</tr>
</tbody>
</table>

Sources: UNCTAD World Investment Report 2002
*Data from China's Ministry of Foreign Trade and Economic Cooperation
**Data for manufacturing industries only.
***Author's calculations from Goskomstat data.

In the globalizing economies of the 1990s, FDI is increasingly of the "new paradigm" variety—intimately linked to the trading activities of trans-national corporations (TNCs). According to UNCTAD estimates, some two-thirds of world trade is conducted by TNCs invested in domestic economies: One third consists of intra-firm trade and the other third is TNC exports to non-affiliates. As one World Bank report notes: "Firms trade to invest and invest to trade." Because new paradigm FDI integrates national economies into competitive production networks focused on regional or global markets, it confers greater benefits on host economies. These far exceed the impact of sharing agreements required passage of other legislation, some of which has yet to pass. As a result, FDI into Russian oil stagnated. Between 1996 and 2000, the number of petroleum-oriented joint-ventures in Russia remained stable at about 70. See Dean E. Gaddy, "Yukos Priobskoye project litmus test for foreign investment in Russian E&P," *Oil and Gas Journal*, March 6, 2000, pp. 25-31.

21 Goskomstat.


23 Business executive at a year 2000 meeting of the OECD Trade Committee, cited in Bergsman,
actual capital flows, and include greater levels of technology transfer, the introduction of new methods of business organization, a powerful influence in building new financial and regulatory institutions, and a greater "demonstration effect" for domestic producers through introduction of world standards in marketing, production and services.\textsuperscript{24}

The "old paradigm" style of Russia's FDI inflows has contributed to a severe regional imbalance: Because Russian inflows seek out domestic markets, they have overwhelmingly concentrated on areas of the country which offer the best potential markets—Moscow and St. Petersburg. In post-Soviet Russia, production in the provinces to service the Moscow market is severely limited by escalating transportation costs as well as formal and informal barriers to "trading" across provincial borders.\textsuperscript{25} FDI geared to the domestic market is therefore heavily concentrated in areas in or immediately adjacent to the metropolitan centers of Moscow and St. Petersburg. As a result, between 1995 and 2000, out of a total of 89 Subjects of the Federation, four—Moscow city, Moscow oblast, St. Petersburg, and Leningrad oblast—together accounted for some 60 percent of Russian FDI inflows. The city of Moscow alone accounted for over 42 percent of cumulative FDI, and at the end of 2000, per capita cumulative FDI in Moscow exceeded $900, more than six times the national average. Among the 85 regions outside the "big four" listed above, twelve regions accounted for nearly 30 percent of 1995-2000 cumulative FDI (Table 3 and Map 1). This leaves a meager 10 percent shared among the remaining 73 Federation Subjects.


\textsuperscript{25} Common barriers to inter-provincial trade include sale bans on goods and services from one region to another and price-fixing. See OECD, 2001, p. 112.
### Table 3

**Top Twelve Regions by Cumulative FDI 1995-2000 (Outside the "big four") in thousands of US$**

<table>
<thead>
<tr>
<th></th>
<th>FDI 95</th>
<th>FDI 96</th>
<th>FDI 97</th>
<th>FDI 98</th>
<th>FDI 99</th>
<th>FDI 00</th>
<th>FDI 95-00</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Krasnodar</td>
<td>18,146</td>
<td>22,566</td>
<td>15,032</td>
<td>158,082</td>
<td>495,651</td>
<td>958,892</td>
<td>1,663,269</td>
<td>7.29</td>
</tr>
<tr>
<td>2 Sakhalin</td>
<td>49,619</td>
<td>49,900</td>
<td>49,046</td>
<td>131,925</td>
<td>1,023,884</td>
<td>246,131</td>
<td>1,542,005</td>
<td>7.03</td>
</tr>
<tr>
<td>3 Novosibirsk</td>
<td>10,201</td>
<td>20,791</td>
<td>50,713</td>
<td>159,130</td>
<td>130,978</td>
<td>151,782</td>
<td>523,595</td>
<td>2.39</td>
</tr>
<tr>
<td>4 Tyuman</td>
<td>32,613</td>
<td>30,423</td>
<td>65,369</td>
<td>90,685</td>
<td>107,299</td>
<td>147,996</td>
<td>474,385</td>
<td>2.16</td>
</tr>
<tr>
<td>5 Samara</td>
<td>44,745</td>
<td>29,594</td>
<td>68,210</td>
<td>185,857</td>
<td>76,322</td>
<td>59,630</td>
<td>464,358</td>
<td>2.12</td>
</tr>
<tr>
<td>6 Sverdlovsk</td>
<td>801</td>
<td>12,639</td>
<td>68,438</td>
<td>118,904</td>
<td>79,191</td>
<td>73,550</td>
<td>353,523</td>
<td>1.61</td>
</tr>
<tr>
<td>7 Volgograd</td>
<td>17,765</td>
<td>21,796</td>
<td>30,864</td>
<td>76,028</td>
<td>53,061</td>
<td>76,943</td>
<td>276,457</td>
<td>1.26</td>
</tr>
<tr>
<td>8 Primorsk</td>
<td>23,172</td>
<td>65,460</td>
<td>60,924</td>
<td>46,084</td>
<td>19,867</td>
<td>30,488</td>
<td>245,995</td>
<td>1.12</td>
</tr>
<tr>
<td>9 Kaluga</td>
<td>880</td>
<td>1027</td>
<td>674</td>
<td>65,181</td>
<td>92,102</td>
<td>74,241</td>
<td>234,105</td>
<td>1.07</td>
</tr>
<tr>
<td>10 Chelyabinsk</td>
<td>24,355</td>
<td>8,445</td>
<td>26,684</td>
<td>51,315</td>
<td>90,572</td>
<td>27,069</td>
<td>228,440</td>
<td>1.04</td>
</tr>
<tr>
<td>11 Khabarovsk</td>
<td>33,254</td>
<td>77,851</td>
<td>11,606</td>
<td>14,819</td>
<td>27,374</td>
<td>18,006</td>
<td>180,270</td>
<td>0.82</td>
</tr>
<tr>
<td>12 Nizhgorod</td>
<td>10,421</td>
<td>101,238</td>
<td>20,814</td>
<td>3,958</td>
<td>13,801</td>
<td>27,513</td>
<td>177,745</td>
<td>0.81</td>
</tr>
<tr>
<td>MOSCOW</td>
<td>1,024,172</td>
<td>1,031,888</td>
<td>4,117,916</td>
<td>803,255</td>
<td>787,590</td>
<td>1,422,807</td>
<td>9,237,629</td>
<td>42.14</td>
</tr>
<tr>
<td>RUSSIA</td>
<td>2,045,677</td>
<td>2,467,113</td>
<td>3,557,734</td>
<td>3,360,768</td>
<td>4,259,710</td>
<td>4,429,319</td>
<td>21,920,321</td>
<td>100</td>
</tr>
</tbody>
</table>

*Source: Goskomstat*
Russia's failure to attract significant FDI inflows is therefore the product of two inter-locking forces. The first is Russia's failure to attract "efficient" FDI—foreign investment which focuses on export-oriented industries. The second is Russia's inability to attract significant FDI into the provinces. The lack of markets in the provinces leaves two primary motivations for regional FDI: the extraction of natural resources for export, or investment in export-oriented industries. Investment into the top twelve recipients listed above is primarily of one or the other variety, and provinces short on natural resources need to attract the efficient variety. The data presented in table 3 suggests that in the 1990s, at least 12 provinces attracted respectable levels of FDI, and six of the twelve produce neither oil nor gas—factors which tend to attract "old paradigm" extractive FDI. As noted above, efficiency-seeking FDI to Russia has been extremely

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26 Krasnodar, Sakhalin, Novosibirsk, Tyumen, Samara, and Volgograd produce oil. Svetdlovsk, Primorsk, Kaluga, Chelyabinsk, Khabarovsk, and Nizhgorod are not oil producers.
limited. In order to explain why Russia has performed so poorly in FDI inflows therefore, we need to understand why most Russian provinces have failed to attract significant levels of export-oriented FDI. For this reason, the empirical analysis in this dissertation focuses on foreign investment in regional export-oriented industry.

The regional FDI imbalance brought about by "old paradigm" investment in Russia has consequences beyond the immediate economic repercussions. Russian and Western analysts have argued that the asymmetric distribution of investment activity contributes to the pattern of uneven economic development in Russia and to a widening income gap between Russia's rich regions and the rest of the country.27 In the West, some scholars have pointed out that asymmetries in foreign trade and investment among Russia's provinces threaten to exacerbate inter-regional political tensions and may pose challenges for Russia's federal structure.28 The issue of FDI distribution, therefore, is as much a political one, as it is economic.

Since his election in 2000, Russian President Vladimir Putin has pledged to improve Russia's investment climate and has explicitly tied the attraction of foreign capital to the regulation and regularization of center-periphery relations. Only when Russia presents a "unified market" in which property rights are equally respected across regions, Putin has argued, can substantive FDI flows become a reality.29 To that end, his program for strategic development of Russia for the period 2000-2010 places particular

emphasis on streamlining federal and regional legislation in the interests of creating a favorable climate for foreign investment across the expanse of the Russian Federation.\textsuperscript{30} If Russia is to succeed in its endeavor to increase FDI levels, therefore, understanding the determinants of inflows to the regions is an increasingly important question, both for the stability of the Federation and for its overall economic well-being.

**The Dependent Variable: Regional-level Policy**

A growing literature on FDI flows and globalization points to the importance of policy factors over "natural" assets in determining inflows, and this analysis extends to the Russian regions: In discussing the forces driving inflows in Russia and the Commonwealth of Independent States (CIS) John Dunning points to "the active role of government in promoting a market-facilitating environment" as a key ingredient for success in attracting FDI.\textsuperscript{31} Similarly, in his study of transition economies, Klaus Meyer argued that "the policy environment has been a major, if not the main, determinant of the volume of incoming foreign direct investment."\textsuperscript{32} Outside Russia and the CIS, evidence is mounting that the provincial-level policy environment plays a key role in directing FDI flows to specific regions. Studies of the international activities of American states, French départements, and German lander, have shown that regional governments exert a powerful influence over capital flows into the locality. Such studies have argued that the increase in volume and complexity of capital flows during the 1980s and 1990s required an

\textsuperscript{30} OECD, 2001.


attention to locational detail which central governments are ill-equipped to provide, a
dynamic which elevated local decision-makers to the level of international players.\textsuperscript{33}
Outside Europe and North America, studies of provincial politics in China similarly point
to the critical role of regional leaders in directing FDI inflows.\textsuperscript{34}

In Russia, studies of FDI inflows to date indicate that the creation of a "business-
friendly" environment in the locality is key to attracting regional FDI. While there can be
no doubt that the presence of attractive "factors" such as oil for instance, provide a
tempting target for foreign investors, evidence from the foreign business community,
reputable studies of FDI flows to Russia, and the regional FDI data itself, suggest that
attractive factors alone cannot account for the current distribution of FDI among Russian
regions. While the importance of regional-level policies in creating a "user-friendly"
environment is widely recognized, no work to date has yet attempted to explain why
some localities are more adept in this endeavor than others. Thus, while identified as key
to determining inflows, regional-level policies remain one of the least understood
determinants of FDI.

\textsuperscript{33} See, for example, Francisco Aldecoa and Michael Keating eds., \textit{Paradiplomacy in Action: The
Duchacek, \textit{The Territorial Dimension of Politics: Within, Among and Across Nations}, Boulder:
Sovereignties and International Relations: Trans-Sovereign Contacts of Subnational
Governments}, New York: Greenwood Press, 1988; Andrew Fenton Cooper, "Subnational activity
and foreign economic policy-making in Canada and the United States: perspectives on
Role of State and Local Governments in U.S. Foreign Affairs}, New York: Council on Foreign
Relations Press, 1998; Hans J. Michelmann and Panayotis Soldatos, eds., \textit{Federalism and
\textsuperscript{34} See for example, David S.G. Goodman and Gerald Segal, \textit{China Deconstructs: Politics, trade
Perhaps the most universal claim about FDI to Russian regions holds that oil-rich provinces are the biggest FDI beneficiaries. Recent studies, however, disconfirm this argument. In 2001, World Bank economists Harry Broadman and Francesca Recanatini conducted a study of regional FDI in Russia. Using all available data from Russia's regions (approximately 70 observations), they conducted a series of econometric tests but found no correlation between oil production and FDI. 35 This point is readily discernible from the regional data: While it is certainly true that some of the top regional FDI performers are oil-rich provinces, the data on regional FDI distribution indicates that oil-wealth alone is no guarantee of FDI (Table 4). Although some oil-producing provinces, such as Tyumen, have consistently attracted large shares of Russia's FDI, other big producers, such as Bashkortostan, have attracted very little. Still others, notably Komi, Arkhangelsk, Tartarstan and Krasnoyarsk attracted sizable investments in the early part of the 1990s, but then lost their investments as the decade progressed. Arkhangelsk for example ranked first among Russia's regions for FDI in 1994, thanks to oil investment, but when oil projects foundered, Arkhangelsk fell to 39th place. 36 Yet other regions, such as Krasnodar and Sakhalin received little FDI in the early years but substantially increased inflows near the end of the decade. The relationship between oil-wealth and FDI is manifestly not straightforward, and the findings from the World Bank study show that success in attracting FDI—even among oil-producing regions—is tied to regional-level policy. Other analysts concur: In examining Sakhalin's success in attracting FDI, for example, Oil and Gas Journal analysts argue that "the key to a successful joint-venture or

35 Broadman and Recanatini.
36 See Financial News no. 1 (130), January 12, 1995 for Arkhangelsk rating in 1994. On the failure of oil ventures in Arkhangelsk see Russia economy: Which regions are winning FDI?
production-sharing agreement [lies with] committed and progressive-thinking regional leaders.\(^{37}\) (For a more in-depth discussion of oil-wealth and FDI see the Sakhalin chapter).

**Table 4: Oil-Producing Regions and FDI**

<table>
<thead>
<tr>
<th>Federation Subject</th>
<th>Oil &amp; Gas Concentrate prod. thous. tons for 1995</th>
<th>FDI 91-96 percentage of Russian total(^*)</th>
<th>FDI 91-96 rank among Federation Subjects</th>
<th>FDI 95-00 percentage of Russian total</th>
<th>FDI 95-00 rank among Federation Subjects</th>
</tr>
</thead>
<tbody>
<tr>
<td>Komi Republic</td>
<td>6876</td>
<td>2.19</td>
<td>8</td>
<td>0.55</td>
<td>21</td>
</tr>
<tr>
<td>Arkhangelsk oblast</td>
<td>2661</td>
<td>7.84</td>
<td>2</td>
<td>0.16</td>
<td>39</td>
</tr>
<tr>
<td>Kaliningrad oblast</td>
<td>769</td>
<td>0.51</td>
<td>32</td>
<td>0.3</td>
<td>30</td>
</tr>
<tr>
<td>Kalmyk Republic</td>
<td>403</td>
<td>0.02</td>
<td>66</td>
<td>0.01</td>
<td>71</td>
</tr>
<tr>
<td>Tartarstan</td>
<td>25692</td>
<td>2.41</td>
<td>7</td>
<td>0.76</td>
<td>19</td>
</tr>
<tr>
<td>Astrakhan oblast</td>
<td>1439</td>
<td>0.03</td>
<td>57</td>
<td>0.09</td>
<td>46</td>
</tr>
<tr>
<td>Volgograd oblast</td>
<td>2605</td>
<td>0.53</td>
<td>30</td>
<td>1.26</td>
<td>11</td>
</tr>
<tr>
<td>Penzen oblast</td>
<td>14</td>
<td>0.02</td>
<td>68</td>
<td>0.03</td>
<td>63</td>
</tr>
<tr>
<td>Samara oblast</td>
<td>9096</td>
<td>1.36</td>
<td>16</td>
<td>2.12</td>
<td>9</td>
</tr>
<tr>
<td>Saratov oblast</td>
<td>1193</td>
<td>0.42</td>
<td>34</td>
<td>0.28</td>
<td>32</td>
</tr>
<tr>
<td>Ulyanovsk oblast</td>
<td>175</td>
<td>0.03</td>
<td>64</td>
<td>0.01</td>
<td>67</td>
</tr>
<tr>
<td>Adygeya Republic</td>
<td>11</td>
<td>0</td>
<td>74</td>
<td>0.01</td>
<td>68</td>
</tr>
<tr>
<td>Dagestan</td>
<td>323</td>
<td>0</td>
<td>73</td>
<td>0.04</td>
<td>59</td>
</tr>
<tr>
<td>Ingushetia</td>
<td>110</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Chechnya</td>
<td>629</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Krasnodar krai</td>
<td>1559</td>
<td>1.12</td>
<td>20</td>
<td>7.59</td>
<td>3</td>
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<tr>
<td>Stavropol krai</td>
<td>744</td>
<td>0.53</td>
<td>31</td>
<td>0.64</td>
<td>24</td>
</tr>
<tr>
<td>Bashkortostan</td>
<td>15654</td>
<td>0.13</td>
<td>49</td>
<td>0.17</td>
<td>37</td>
</tr>
<tr>
<td>Udumurtia</td>
<td>8415</td>
<td>0.16</td>
<td>45</td>
<td>0.08</td>
<td>47</td>
</tr>
<tr>
<td>Orenburg oblast</td>
<td>8687</td>
<td>0.03</td>
<td>58</td>
<td>0.62</td>
<td>20</td>
</tr>
<tr>
<td>Perm oblast</td>
<td>9398</td>
<td>0.72</td>
<td>26</td>
<td>0.55</td>
<td>23</td>
</tr>
<tr>
<td>Novosibirsk oblast</td>
<td>25</td>
<td>1.12</td>
<td>21</td>
<td>2.39</td>
<td>7</td>
</tr>
<tr>
<td>Tomsk oblast</td>
<td>6741</td>
<td>1.15</td>
<td>13</td>
<td>0.1</td>
<td>43</td>
</tr>
<tr>
<td>Tyumen oblast</td>
<td>201592</td>
<td>3.52</td>
<td>6</td>
<td>2.16</td>
<td>8</td>
</tr>
<tr>
<td>Krasnoyar krai</td>
<td>108</td>
<td>4.84</td>
<td>4</td>
<td>0.29</td>
<td>31</td>
</tr>
<tr>
<td>Sakha Republic</td>
<td>185</td>
<td>0.31</td>
<td>38</td>
<td>0.11</td>
<td>42</td>
</tr>
<tr>
<td>Sakhalin oblast</td>
<td>1723</td>
<td>1.28</td>
<td>17</td>
<td>7.02</td>
<td>4</td>
</tr>
</tbody>
</table>

Source: Goskomstat

\(^*\)Cumulative FDI 91-96 data is from Rossijskie Regiony posle Vyborov-96. Goskomstat did not produce regional FDI data prior to 1995. Goskomstat data and the data from Vyborov-96 are not comparable. Each data set has been used here simply to produce a regional ranking.

\(^{37}\) Dean E. Gaddy, "Sakhalin ll Success Attests to Local Leaders' Commitment," *Oil and Gas Journal*, March 6, 2000, p. 30.
Evidence for the critical influence of oblast policy on FDI inflows also comes from studies conducted in Russia, including that by the reputable business publication *Expert*, and another from the Russian Bank Imperial conducted by a group which helped draft Russia's Foreign Investment Law. Similarly, a study of foreign investment in Russia published by the OECD in 2001 points to the critical role of regional policy in determining inflows to the provinces. In addition, the World Bank's large-n study of FDI in the Russian regions discussed above found that regional "policy framework factors" played a key role in determining FDI inflows, and indeed, that local policy framework was the only variable which consistently exerted an influence over FDI inflows throughout the 1990s (especially after 1998). Taken together, these studies provide convincing evidence for the key role of regional-level policy in determining FDI inflows.

In its 2001 study of investment in the Russian Federation, the OECD noted significant variation in regional commitment to attracting foreign investment and argued that a strong commitment on the part of regional officials accounted for an increase in FDI flows to the regions:

While natural resources have attracted many foreign investors to some regions, those with an overall positive approach to business development are increasingly having a degree of success despite structural and other disadvantages...On the other hand, investors encounter an inhospitable environment for their business activities in other regions despite their excellent location for foreign and domestic markets.38

Similarly, the Bank Imperial study conducted in 1995 argued that:

Inflows of FDI to different regions are preconditioned by both objective factors...and, in large part, by the policy of local governments and business circles in respect to foreign investors. Sometimes, such policy is

beneficial... Sometimes the regional governments and business community tend to protect domestic enterprises.  

Most recently, the 2001-2002 annual survey of investment in Russian regions conducted by *Expert* found that evaluations of regional investment risk were predominantly predicated on regional government policy; their results, *Expert* concluded, "confirm the high level of influence which the activities of regional powers exert over investment climate."  

A number of other studies have also noted the importance of regional government in attracting, or conversely stemming, inflows of FDI. An analysis by the Economist Intelligence Unit for example, attributed increasing FDI in Novgorod oblast to an "investor-friendly administration." Another study noted that a number of regions have been particularly active in "wooing foreign investors," and listed Moscow, Novgorod, Samara, Tatarstan, and Sakha as high performers. Other studies have noted a lack of zeal among regional administration which adversely affects investment inflows; one study describes "a mayor of a town which is host to a large consumer sector investment [who] said that they don't need to go out and solicit FDI, that...they can sit and wait for investors to come to them." Similarly, the Bank Imperial study cited above noted that regional antipathy for FDI "manifests itself...in the sluggishness and passivity in respect  

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39 Study from Bank Imperial, 1995, conducted by Alexander Astapovich (IMEMO), Mark Boguslavsky (Institute of State and Law RAN), Andrei Konoplyanik (IMEMO), and Yevgenya Yakovleva (IMEMO), p. 34.  
40 *Expert* findings reported @ http://www.expert.ru/expert/ratings/regions/reg2002  
41 *Russian economy: Which regions are winning FDI?* EIU, September 8, 2000.  
43 Richard Stern, p. 22.
to attracting foreign investment." Other studies note the adverse impact of regional policies including "an inefficient regional administration which is inflexible in accommodating foreign investors." 

The most convincing evidence for the influence of regional policy on FDI inflows comes from the study conducted by World Bank economists Harry Broadman and Francesca Recanatini. Broadman and Recanatini constructed a measure for regional policy framework using a multi-dimensional rating for regional business environment developed by Russian business periodical, *Ekspert*. Since 1995, *Ekspert* has assigned an ordinal ranking to Russian regions related to regional potential and risk for investors. Combining this ranking with actual levels of domestic private investment, Broadman and Recanatini developed an interactive variable designed to capture both perceived and actual outcomes of regional business policy environment. The study used this measure, together with a separate measure for actual domestic private investment level (what Broadman and Recanatini call a "complementary effect" whereby foreign investment is likely to follow domestic). Broadman and Recanatini used these measures of regional policy framework in developing a model to explain cumulative regional FDI inflows for 1995-1999. Their study considered four broad factors likely to influence FDI flows: economic conditions, physical infrastructure, regional policy framework, and institutional development. Using econometric tests, Broadman and Recanatini found that variables related to market size (gross regional product or GRP), infrastructure development (length of paved road normalized by size of region), and regional policy framework

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44 Bank Imperial, p. 34.
46 Broadman and Recanatini.
factors, explained most (R-square 0.8) of the variation across Russia's regions for the period 1995-99. However, Broadman and Recanatini also found that their model lost much of its explanatory power when the cities of Moscow and St. Petersburg—the two largest markets in Russia—were removed from the sample (R square fell to 0.325). Given that the bulk to FDI to Russia is market-seeking, and therefore focused on Moscow and St. Petersburg, their finding suggests that market considerations do not drive FDI inflows outside Russia's two major cities.

In addition, as indicated above, Broadman and Recanatini found that when they applied their analysis to annual FDI inflows, their model did not retain its robustness. For 1998, the coefficient for GRP became insignificant, as did that for infrastructure development. For 1999, market and infrastructure variables both displayed the incorrect sign. Broadman and Recanatini found that the only variables to consistently retain significant explanatory power across all years were those which measured regional policy framework. The change which Broadman and Recanatini find beginning in 1998 lends further credence to the argument that regional policy factors play a key role in determining FDI inflows. After the default and devaluation in the summer of 1998, foreign capital fled Russia, and the bulk of that flight consisted of market-seeking investment leaving Moscow. Following the crash, foreign investment fled the financial sector—where Moscow dominates: In 1997, nearly 60 percent of foreign investment in Russia went to finance and finance-related sectors; by 1999, that figure fell to 20 percent.\(^47\) Broadman and Recanatini's finding that regional policy factors have the most critical influence on FDI in 1998 and 1999, therefore, provides a clear indication that

\(^{47}\) OECD, 2001.
outside Moscow, it is policy, rather than markets and infrastructure, that drives FDI inflows.

In sum, Broadman and Recanatini's findings suggest that, in the provinces, both new and old paradigm FDI inflows are closely related to regional policy framework. Broadman and Recanatini's finding that regional FDI does not correlate with natural resource (oil-production) potential, in conjunction with their finding that the regional policy framework exerts an enduring influence over regional FDI inflows, suggests that even in the case of "old paradigm" extractive FDI, regional policies play a decisive role. In addition, their finding about the durability of regional policy factors suggests that any "new paradigm" investment in export-oriented industries is highly contingent on the regional policy framework.

It seems reasonable to conclude therefore, that developing an investor-friendly environment in the provinces is a significant consideration in attracting foreign investment to Russia. Broadman and Recanatini's study, along with the other studies and data presented here, highlight the importance of regional-level policy for FDI inflows but also raise questions about how and why policy framework factors influence FDI. This dissertation explores the ways in which local policy factors influence FDI inflows to the Russian regions and also investigates the determinants of regional policy: If foreign investors are drawn to regions with user-friendly policies, it asks, why do some provinces develop an investor-friendly policy environment, while others do not? Understanding when and why provinces develop a "user-friendly" policy towards foreign investors is an important step towards understanding FDI distribution and also contributes to our understanding of the dynamics of center-periphery relations within Russia's evolving
federal structure. Chapter 2 explores a range of possible explanations for variation in regional FDI policy outcomes.

**Russian Policies Related to FDI: Laws, Privatization, Political Decentralization**

**The Legal Framework of FDI**

A comprehensive review of Russian legislation pertaining to foreign investment over the course of the 1990s would comprise multiple volumes, and is beyond the scope of this dissertation. Foreign investment is affected by a wide range of policy areas and regulations. These include registration requirements, taxation, customs duties, restrictions on imports and exports, foreign exchange controls, banking regulations, and Russian accounting practices (which do not conform to international standards). In general, Russian legislation on foreign investment is largely declarative in nature—long on principles, short on specifics. In practice, frequent incompatibilities among normative acts, rapid changes and reversals in legislation, and a devolution of implementation to the provinces, have left the fate of foreign investment projects largely in the hands of local authorities. The result has been what President Putin has termed, the "lack of a unified legal and economic space in Russia."

Direct foreign investment into the Russian economy became possible with reform of the Soviet trade system in 1987, when the Soviet Union first permitted the establishment of joint-ventures. In September 1991, a Foreign Investment Law was enacted which allowed the creation of wholly foreign-owned subsidiaries. The Law was amended in 1993, 1995, and 1997, and eventually replaced by a new Law on Foreign

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Investment in 1999. In 1992, the State Privatization Program went into effect, and direct foreign purchase of shares in Russian enterprises became possible. There are thus three main vehicles for foreign investment in Russia: joint-ventures, wholly foreign-owned subsidiaries, and portfolio/direct investment. In addition, the passage of production-sharing (PSA) legislation in 1995 facilitated foreign investments in mining, oil, and gas, although implementation of PSA agreements has been hampered by inadequate supporting legislation and limits on the percentage of Russian resources that can be developed under PSA arrangements. Only three PSA projects actually began operation in Russia by the turn of the century.

Russian legislation seeks to create the appropriate conditions for investment, but consciously eschews specific strategies for attracting foreign investment. Thus one of the primary stated goals of Russia's foreign investment legislation is to ensure that foreigners secure the same rights and privileges as Russian enterprises to conduct economic activities on the territory of the Russian Federation. The Foreign Investment Laws of 1991 and 1999, as well as the Russian Constitution guarantee equal treatment for foreign and national investors. These include compensation in case of nationalization by the State, guarantees against confiscation or requisition, and authorization for repatriation of profit. Foreign ownership of stock in Russian enterprises is not restricted by law, except in a few specified industries including military-related and dual technologies.

50 According to Goskomstat, FDI is defined as a 10 percent or less equity state. Less than that constitutes portfolio investment.
Because Russian legislation is geared towards creating a level playing field for foreign and Russian investors, the law does not make special provisions to attract foreign investment. This aspect of Russian FDI legislation stands in stark contrast to other developing and transitional economies, such as those in Eastern Europe and China, in which government developed explicit measures—tax breaks, relief from customs duties, duty-free imports for foreign ventures engaged in exports—specifically (and successfully) designed to attract foreign investment. In Russia, however, attempts to attract foreign investment through special regimes, such as the creation of "special economic zones" (SEZs), have largely met with government indifference or hostility. Although a number of oblasts attempted to set up SEZs in the 1990s, the Russian government did not enact the necessary supporting legislation.\textsuperscript{52} Without official sanction, most SEZs in Russia failed to materialize, and when then did take form, were largely ineffectual. In fact, official hostility to the notion of SEZs has been the norm. In 1995, Igor Noskov, the head of the Ministry of Finance's department for international tax and investment coordination, called SEZs "illegal violators of federal tax legislation."\textsuperscript{53} In some cases, the Russian government actually stepped in to close SEZs down. Kaliningrad, for example, set up a SEZ in 1995 authorized by special decree, but found those privileges rescinded within the year. In July 1997, Vice Premier Anatolii Chubais personally removed special privileges from an Ingush SEZ, concluding that "it is not

\textsuperscript{52} After prolonged debate, the State Duma passed a law on SEZs in April 1997, but President Yeltsin did not sign it.

permissible to grant certain subjects of the Russian Federation privileged regimes of economic activity."

In practice, legal inconsistencies, and frequent changes in legal provisions, have made foreign investment in Russian particularly challenging and have strengthened the hand of the locality in determining the investment climate. One area which has proven of particular concern to joint-ventures and wholly-owned foreign businesses has been the ability to control profits. Legislation in this area has been unstable, particularly as it pertains to business ventures engaged in export. In December 1991, for example, a Presidential decree obliged all exporters, including joint-ventures with over 30 percent foreign ownership, to sell 10 percent of export revenues to the State. In February 1992, however, the state bank exempted all enterprises with foreign ownership from that requirement; but in June 1992, a new presidential decree upped the requirements for 30 percent foreign-owned enterprises to require that 50 percent of export revenues be exchanged on the domestic market. After the crash of 1998, the Central Bank imposed a 75 percent repatriation rule on all export revenues, later dropping the requirement to 50 percent, still a substantial percentage. Fluctuations such as these, and variation in their application at the regional level, have proven potent barriers to export-oriented foreign investment activity in the provinces.

The instability of the legal framework leaves regional authorities free to interpret federal legislation in a variety of ways and also to develop local legislation in

55 Adjubei, p. 117.
contravention of central authority. Indeed, in a statement soon after his election to the Presidency, Vladimir Putin referred to some 6000 local laws that were found to contravene federal legislation.\textsuperscript{57} In many cases, this state of affairs has lead to a \textit{de-facto} more restrictive investment environment for foreign businesses than for domestic ones. The situation has been compounded by the devolution of policy implementation to the regional level. As concerns registration for foreign businesses, for example, authority for the registration of joint ventures has devolved to the regional level, so that, in addition to the regular 5 or 6 approvals required of foreign businesses at the Ministerial level, localities are free to impose as many or as few registration requirements as they please.\textsuperscript{58}

In some cases, regional authorities have taken it upon themselves to enact local policies geared to facilitating foreign investment. Novgorod oblast, for example, established its own land code which leases land to foreigners for a period of 49 years, and Saratov, Tartarstan, and Samara followed suit.\textsuperscript{59}

Formal legislative acts, however, are only one, and not the most potent, of regional levers over FDI. Regional leaders also wield a range of informal controls over the local economy and FDI. Foreign investors have complained in particular of a variety of administrative impediments and corrupt practices originating at the regional level. These include obstacles of a mundane or petty nature such as overly lengthy customs inspections, frequent inspections and arbitrary fines and fees, special and costly fees for vehicle registration, but also larger and potentially more debilitating measures such as

\textsuperscript{57} OECD, 2001, p. 108.
\textsuperscript{58} Bradshaw 1997, p. 77.
interference in debt collection, direct interference in business management, and breaches of contractual obligations.

Privatization and FDI

Purchase of shares in privatized Russian enterprises has been one avenue of foreign investment into the Russian economy. Privatization has been a significant factor in attracting FDI inflows in a number of transitional economies, and indeed, as the EBRD has noted, "few countries have been able to attract sizable FDI inflows without the cash privatization of large-scale enterprises."60 Thus, Russia's privatization policy has a direct bearing on FDI levels.

In 1992, Russia undertook a mass privatization project which used vouchers to redistribute state property to millions of Russian citizens. Vouchers were distributed among the population and could be used to purchase enterprise shares at voucher auctions. In preparation for privatization, enterprises underwent a process of "corporatization" whereby a value was assigned to their assets, they acquired stock, senior management, and a board of directors. In this way, they registered as joint-stock companies with shares owned by the government through the Russian Property Fund. Enterprises next selected a method of privatization, and some three-quarters of joint-stock companies chose "option 2" which allowed 51 percent of the stock to be sold to workers, and the remaining 49 percent to be sold at auction or held by the state. After employees bought their shares, the region ran a voucher auction at which the state sold off a portion of its remaining shares. In general, the state held back between 10 and 20 percent of its

60 EBRD Transition Report 2000, p. 84.
shares, known as a "golden share," which were sold for cash following the completion of voucher privatization.\textsuperscript{61} Because vouchers were tradable, company insiders often acquired extra vouchers and bought up large shares of their enterprises—generally 65 percent of privatized enterprises were held by insiders.\textsuperscript{62} "Insider privatization" meant that the majority of the shares went to employees and management, outside shareholders generally owned about 20 percent, and the state held a little more than one tenth.\textsuperscript{63} In the process, some 21 million Russians acquired stock in privatized companies and 44 million acquired stock indirectly through investment funds.\textsuperscript{64} By the time voucher privatization was completed in 1994, over 40 percent of 240,000 state-owned enterprises had been transferred into private hands,\textsuperscript{65} and by 1996, the number of state-owned enterprises was further reduced to about 91,000.\textsuperscript{66}

The privatization process itself was carried out through the regional branches of the State Property Committee (GKI) and the State Property Fund. In theory, the Property Committee was charged with formulating privatization policy and the Property Fund was responsible for organizing enterprise sales, but in practice each encroached on the other's territory and disputes were common at both regional and central levels.\textsuperscript{67}

\begin{itemize}
\item \textsuperscript{62} Joseph Blasi and Andrei Schleifer, "Corporate Governance in Russia: An Initial Look," in Roman Frydman, Cheryl W. Gray, and Andrzej Rapaczynski eds., \textit{Corporate Governance in Central Europe and Russia}, Budapest: Central European University Press, 1996.
\item \textsuperscript{63} Blasi et al., 1997, pp. 51-52.
\item \textsuperscript{64} Gustafson, 1999, p. 41.
\item \textsuperscript{65} According to Article 9 of the July 1991 Russian Law on Privatization, an enterprise in which the State holds less than a 25 percent share is considered to be private.
\item \textsuperscript{66} Figures from OECD 2001, p. 147, and Gustafson, 1999, p. 36.
\end{itemize}
government, the Property Committee was affiliated with the executive branch, and the
Property Fund with the legislature. Appointments to the Heads of both Committee and
Fund were locally determined, and in the case of the Regional Property Committees, the
law required that the Head be a Deputy Governor in the regional government. In effect,
regional government officials became stakeholders in local enterprises.\textsuperscript{68} Regional
officials exerted a great deal of control over the privatization process in the regions under
their jurisdiction. In many instances regional elites fought to maintain controlling shares
of privatizing enterprises in the locality, and hostility towards outside investors—both
domestic investors from outside the region and foreign investors—was endemic.\textsuperscript{69} In
some instances, regional politicians would trade back taxes for shares in local enterprises
either for the regional government itself or for favored regional interests.\textsuperscript{70} In sum,
regional leaders often allied themselves with privatizing local enterprises in an effort to
retain control over privatized assets in the locality and defend against outside investors.\textsuperscript{71}
Ineffective central supervision of privatization in the provinces, coupled with struggles
between the GKI and Property Fund at the federal level, led to substantial regional
variation in both depth and method of privatization.\textsuperscript{72}

Opportunities for foreign participation in Russian privatization were very limited
in the initial stages, although they improved following the completion of voucher

\textsuperscript{68} Gustafson, 1999, p. 39.
\textsuperscript{69} See Darrell Slider, "Regional Aspects of Privatization in Russia," in Peter J. Stavrakis, Joan
DeBardeleben, and Larry Black eds., Beyond the Monolith: The Emergence of Regionalism in
\textsuperscript{70} Gustafson 1999, p. 48.
\textsuperscript{71} See Raj M. Desai and Izhak Goldberg, The Vicious Circles of Control: Regional Governments
and Insiders in Privatized Russian Enterprises, World Bank Working Paper #2287, February 1,
2000.
\textsuperscript{72} See Darrell Slider, "Privatization in Russia's Regions," Post-Soviet Affairs, Vol. 10, no. 4,
privatization. In principle, Russian privatization legislation provides free access and national treatment for foreign investors wishing to acquire company shares, with the exception of areas involving national security such as defense enterprises. In practice, foreign investors have encountered a number of administrative barriers, often emanating from the regional level. Foreigners were permitted to participate in the voucher stage of privatization, but foreign access was technically limited by the requirement that foreigners use Russian intermediaries to participate in voucher auctions. In addition, a lack of accurate information about Russian enterprises made it difficult for investors to ascertain the value of privatizing assets; this affected both domestic and foreign investors, but foreigners lacked access to informal channels of information which domestic investors were able to cultivate through connections to the enterprises themselves or else to the regional GKIs and Property Funds. After voucher privatization was concluded, the state began to sell off its remaining shares for cash, and enterprise stock also became available for cash sales. Foreigner investors could more easily purchase company shares on Russian secondary markets, and as the decade of the 1990s progressed, shares in some Russian companies also became available on equity markets overseas; equity issues generally took the form of ADRs or GDRs, but there were also direct listings on stock exchanges from London to New York. In 1996, Russian international equity issues

74 American and Global Depository Receipts are trading securities which are issued by banks to shield foreign investors from settlement and custody problems associated with weakly institutionalized domestic capital markets.
toted $800 million, and by the spring of 1997, 15 Russian corporate structures had set up ADR programs.\textsuperscript{75}

Despite these changes, with the exception of a few large investments in telecoms and oil sectors, foreign investment through privatization in Russia has been extremely limited (Table 5). Compared to privatization programs in Eastern European countries, Russia's privatization rendered enterprises both less attractive and less accessible to foreign investors. One issue was the sequence of reform: Unlike Russia which led off reform with privatization, both Poland and the Czech Republic began with macroeconomic stabilization measures\textsuperscript{76} which created an environment more hospitable to foreign investment. Also, because the Russian program favored immediate mass privatization over enterprise restructuring, Russian enterprises emerged from privatization with effectively unchanged Soviet-era structures. This rendered them unattractive to foreign investment. Another problem was Russia's insider privatization: Insider privatization meant that for the most part, Soviet era managers remained in control of privatized enterprises. In Poland and the Czech Republic, in contrast, state-owned enterprise (SOE) reforms prior to privatization allowed the Communist Parties to remove under-performing enterprise managers as late as 1989.\textsuperscript{77} Soviet era SOE reforms, however, granted enterprise directors the right to lease enterprise assets, and once privatization began, leaseholders were granted preferential access to purchase of company shares. In effect, this meant that transfer of property rights occurred \textit{de-facto}

\textsuperscript{75} Lankes and Stern, 1997.
\textsuperscript{76} Gustafson 1999, p. 36.
\textsuperscript{77} Desai and Goldberg 2000, p. 4.
prior to privatization, and that Soviet era managers had the inside track. This, together with insider privatization, made it extremely difficult for foreign investors to acquire a controlling share in enterprises, a situation which proved an effective deterrent to investors seeking to restructure privatized enterprises into effective corporations. Even when foreign investors did acquire a sizable block of enterprise shares, they found that stock purchase did not translate into a seat on the company board or even a say in enterprise affairs.

\begin{table}
\centering
\caption{Estimates of Ownership in Russian Enterprises 1994-1999 (percentage of share capital)}
\begin{tabular}{|l|c|c|c|c|c|}
\hline
\hline
Employees & 44-56 & 39-49 & 26-43 & 23-40 & 36 \\
Managers & 9-17 & 10-17 & 12-18 & 12-36 & 15 \\
Domestic legal entities & 7-11 & 20-23 & 23-25 & 22-24 & 23 \\
Domestic individuals & 3-6 & 9-11 & 8-12 & 11-13 & 16 \\
Foreign Owners & 1-2 & 1-2 & 1-2 & 4-5 & 8 \\
State Agencies & 12-20 & 11-13 & 9-11 & 7-14 & 3 \\
\hline
\end{tabular}
\end{table}

\textit{Source:} Data compiled by Raj M. Desai and Itzhak Goldberg, World Bank Working Paper #2287. No data available for 1998. Domestic legal entities include investment funds, all other firms (including holding companies and financial-industrial groups), and banks.

Different methods of privatization in Eastern Europe also brought in foreign investment. Hungary, for example, decided to forego voucher privatization and instead adopted a program designed to encourage cash infusions and foreign participation. Hungary was the first country to received significant FDI mostly under the privatization


program. By 1995, foreign capital had been invested in 17 percent of Hungarian enterprises, while in Russia, only 0.2 percent of enterprises had attracted foreign capital. The Czech Republic adopted a mass privatization program using vouchers, but did not grant the privileged share access to employees that gave rise to insider privatization in Russia. In Poland, privatization proceeded in conjunction with some twenty mutual funds managed by foreign banks, a system which endowed privatizing firms with one major shareholder charged with facilitating restructuring and encouraging foreign investment. Russia, on the other hand, consciously eschewed foreign investment in favor of mass privatization. When privatization began, the Russian State Committee on Foreign Investment was disbanded, its head was relegated to an honorific position in Washington, and its foreign advisors, Goldman Sachs, left Russia.

Federalism, Decentralization, and Market Distortions

The power of regional leaders to directly influence FDI inflows by official and unofficial means and through the privatization process, as elaborated above, was greatly enhanced by the decentralization of political power associated with Russian federalism in the 1990s. The process kicked off in 1991 with Yeltsin's now famous exhortation to the provinces to "take as much autonomy as you can swallow." Several aspects of the evolving federal configuration had a direct impact on regional leaders' capacity to direct

82 Appel, p. 521.
83 Boycko, Schleifer, and Vishny, p. 82.
84 Ibid., p. 12.
FDI inflows: Decentralization changed the configuration of power at the regional level empowering regional executives; the lack of unifying federal institutions—such as strong political parties—further enhanced regional power centers; and a lack of clarity and rapid changes in center-periphery relations afforded regional leaders the opportunity to both influence central policy and circumvent it. The result has been the evolution of a "market-distorting federalism," which has played out in regional FDI policies.

Institutional changes at the regional level brought new powers to regional executives. In the Soviet era, boundaries between executive and legislative powers were indistinct: Regional executives, called ispolkom, were elected by the regional legislature, called the soviet. The new federal order clearly differentiated between legislative and executive powers. The formal division took place immediately following the failed August 1991 coup: Executives were separated from legislatures, and the chairman of the executive was appointed by the Russian President. The legislature was called the Soviet and later the Duma, the executive branch—the Administration, and the head of the executive branch—the Head of Administration, and later, simply the Governor. Over the course of the first post-Soviet decade, executive power in the provinces quickly eclipsed the powers of the legislature. In the fall of 1993, when Yeltsin faced down the federal legislature, regional legislatures across the Federation were closed down and their powers transferred to the executive. In most cases, regional executives operated without regional legislatures well into 1994. Throughout the 1990s, regional legislatures proved

87 The most comprehensive analysis of regional party and government organs in the Soviet era is Jerry F. Hough, *The Soviet Prefects: The Local Party Organs in Industrial Decision-making,*
chronically unable to stand up to the governors, in large part because a great many of their members were themselves mayors of smaller towns or districts—positions they held by appointment of the regional governor. Regional governors continued to hold their position by appointment of the Russian President, but by the middle of the decade, in response to vocal demands from the governors themselves, the provinces won the right to hold gubernatorial elections. Popular electoral mandate further enhanced regional executive power. This concentration of regional political power in the executive branch meant that regional governors had wide powers to formulate and implement policy in the locality, and these powers extended to policies on FDI.

In the 1990s, the governors' power gained further momentum from the ineffectiveness of federal institutions designed to channel or constrain regional executives. For most of the decade, regional governors held seats in the upper house of the Russian Parliament—the Federation Council: In 1993, many governors won elected seats on the Federation Council, and from 1995 to 1999, the head of regional executives and legislatures were automatically given seats. The Federation Council was originally thought to provide a way for Moscow to demobilize regional voice, but instead it became a tool for regional governors to limit federal incursions into regional politics.\textsuperscript{88} Other institutions, such as national political parties with strong roots in the localities, could provide a mechanism for both aggregation and integration of regional interests, but in Russia, parties have weak regional structures.\textsuperscript{89} Party penetration into localities has been

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\textsuperscript{89} On the importance of national parties for integrating federal polities see William Riker, \textit{Federalism: Origin, Operation, Significance}, Boston: Little, Brown, and Co., 1964; on the
weak in national elections, and also in regional executive and legislative elections. 90
Some studies of Russian parties have even argued that regional governors act as "party
substitutes," commanding the loyalties of their regions and undermining the development
of national party structures. 91 One institution specifically designed to reign in regional
governors—the office of the Presidential Representative established by Boris Yeltsin in
August of 1991—placed representatives in each region to act as "the emperor's eye in the
localities." 92 The precise duties of the Representative were unclear, but the office was
intended to strengthen central government oversight over political activity in the
provinces. In practice, however, the Presidential Representatives were largely ineffectual
and often subordinate to regional governors. 93 The weakness of unifying federal
institutions to Russia meant that regional governors had considerable latitude to effect
policies which directly influenced FDI inflows into the localities.

90 See Steven M. Fish, "The Advent of Multipartism in Russia, 1993-1995," Post-Soviet Affairs,
Vol. 11, no. 4, pp. 340-385, October-December 1995; Kathryn Stoner-Weiss, "The Russian
Central State in Crisis: Center and Periphery in the Post Soviet Era," in Zoltan Barany and Robert
Moser eds., Russian Politics: Challenges of Democratization, Cambridge University Press, 2001;
and Kathryn Stoner-Weiss, "Central Governing Incapacity and the Weakness of Political Parties:
Democratization in Russia," unpublished manuscript, September 2002; a similar argument for the
primacy of regional governors over parties was made in Katherine Burns, "Primor'e: Local
Politics and a Coalition for Reform," in Timothy J. Colton and Jerry F. Hough, eds., Growing
92 FBIS, August 12, 1991, p. 49.
93 Kathryn Stoner-Weiss reports that the Presidential representatives in the regions she studied
held limited powers. Kathryn Stoner-Weiss, Local Heroes: The Political Economy of Russian
Regional Governance, Princeton NJ: Princeton University Press, 1997, pp. 75-78. In the cases
examined in this dissertation, I also found that Presidential Representatives were largely
powerless to affect regional policy, and were generally selected de facto by the governors.
A final aspect of Russian federalism which generated power in the office of the regional executive was the opaque, fluid, and ad hoc nature of center-periphery relations in the 1990s. Center-periphery relations in the Russian Federation were first formally defined in March 1992, when President Yeltsin signed three separate treaties: with autonomous republics, with autonomous okrugs, and with the non-ethnic oblasts and krais including the "federal cities" of Moscow and St. Petersburg. The treaties recognized two classes of Federation Subjects: ethnic republics which received expanded rights and were recognized as "sovereign states," and non-republic territories, which received little more than their original status as Subjects of the Federation. The Russian Constitution, ratified in December 1993 by referendum, did away with the two-tier system and treated republics and regions as equals. Republics were not supportive of the Constitution and pursued negotiations with Moscow to secure special status. Thus ensued a rash of bilateral treaties, first between the republics and Moscow, and then beginning in 1996, between the regions and Moscow. By mid-1998, more than half of Russia's 89 Federation Subjects had signed bilateral treaties with Moscow.94 In the process, Russia's regional governors won new powers and also grew increasingly assertive vis-à-vis the center.

The special provisions provided to particular regions in bilateral treaties, along with the unequal treatment of regions and republics, generated an "asymmetric federalism" in which governors, rather than the central government, increasingly became the guardians of regional interests. In addition, the frequent changes in center-periphery relations, lack of clarity about jurisdiction even within the treaty documents, and points of contradiction between bilateral treaty agreements and the Constitution gave rise to a

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94 Steven Solnick, "Russia between States and Markets: Transnational and Subnational Pressures in the Transition," in Aseem Prakash and Jeffrey A. Hart eds., Responding to Globalization,
fluidity in center-periphery relations by which regional governors often wielded significantly more de facto autonomy than formal documents would suggest.\textsuperscript{95} De-facto regional power also arose from a lack of central funding for nationally mandated policies which forced governors to either improvise ways to fulfill central mandate or else ignore central directives altogether. In some areas, federal law was simply silent, again giving rise to regional improvisation.\textsuperscript{96} The rise of de facto power in the regions was also a facet of the weakness of central institutions charged with enforcing constitutional guarantees and formal agreements—such as the Constitutional Court and the legal system in general.\textsuperscript{97} Thus regions regularly took extra-legal unilateral action—including placing limits on regional exports, appropriation of central funding for regionally designated purposes, or establishing land leasing regulations in the absence of a federal land code.\textsuperscript{98}

Darrell Slider has argued the structure of Russian federalism has a "market-distorting" effect. He points out that while regional leaders have gained control over economic matters, the lack of a clear division of labor between the region and the center, the power of regional leaders to regulate domestic and international trade, weak central control over tax collection and regional spending, and weakly institutionalized federal

\textsuperscript{95} A number of studies of have noted the rise of de-facto authority over areas of political and economic life in Russia's regions. Stoner-Weiss' work in this area is notable. See also Gary N. Wilson, "Crude" Federalism: Oil Politics and the Evolution of Intergovernmental Relations in Post-Soviet Russia, Dissertation Manuscript, University of Toronto, 2000, pp. 2-3.

\textsuperscript{96} See Kathryn Stoner-Weiss, "The Russian Central State in Crisis."


\textsuperscript{98} In 1997 and 1998, Novgorod, Saratov, Tatarstan, and Samara all adopted a regional land code which leased land to foreigners for a period of 49 years. See Kathryn Stoner-Weiss, "The Russian Central State in Crisis," and RFE/RF, June 26, 1998.
relations, have given rise to a poorly integrated national market. Similarly, the discussion of FDI-related policies and decentralization presented here suggests that poorly formulated or incomplete FDI legislation, the power of regional executives to interfere in the privatization process, and weakly institutionalized center-periphery relations set the stage for significant regional variation in FDI-related policies. Most importantly, the structure of Russia's federal state and the processes of decentralization delivered expanded powers over FDI-related policies into the hands of regional governors. In the 1990s, the paths which Russia's regions took in their encounter with global capital were intimately tied to the proclivities of the governor. This dissertation seeks to elucidate the forces which drove regional governors in disparate directions.

Cases

Case-Study Methodology

While it seems clear that regional-level policies are key to determining FDI flows, it is exceedingly difficult to capture this variable in a satisfactory measure, and to use such a measure for the purposes of large-n studies. Available measures, such as the Ekspert rating discussed above, fail to fully capture the full dynamic of regional policy, and also have difficulty addressing the wide-spread application of informal policy mechanisms which operate at the regional level. This dissertation, therefore, uses in-depth case-studies to investigate the determinants of regional foreign economic policy. By looking at several cases in-depth, the dissertation avoids some of the measurement problems which afflict large-n studies. For example, Broadman and Recanatini's use of

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the *Ekspert* rating to measure regional policy framework rests on the assumption that regional policies which are attractive to domestic investors will also attract foreign investors. While this may often be the case, in important instances, the *Ekspert* rating diverges sharply from actual foreign investment outcomes. In its year 2000 assessment of regions, for example, *Ekspert* predictably rated Moscow first—maximum potential, minimum risk—but relegated Sakhalin, the nation's leader in FDI for 1999, to the low potential, high risk category. Indeed, the only provinces which ranked lower were the war-torn republics of Chechnya and Ingushetiya, and the far northern region of Chukotka. This discrepancy suggests that while the Russian ratings generally appear to be a good indicator of regional policy, they do not fully capture the salient dynamics of regional policy for foreign investment activity. In addition, case-study analysis can capture the important informal policy mechanisms which directly affect regional business environment—*de-facto* foreign economic policy, which is difficult to capture in indicators for large-n studies. Particularly in the transition period, when institutions and legislation are in constant flux, informal policy mechanisms at the local level play a critical role in determining foreign economic policy and investor relations. In sum, regional policy factors appear to be critical determinants of FDI inflows; large-n measurement difficulties and a preponderance of informal policy mechanisms make case-study analysis the most appropriate method for exploring the ways in which regional policy affects FDI and explaining variation in regional policy outcomes.
Case Selection

This dissertation compares regional FDI polices across three provinces: Primorskii krai, Khabarovskii krai, and Sakhalin oblast. Case selection is designed to hold a number of variables constant—geographic location, export-orientation, resource-based economic structure—and also for broad variation in regional policy outcomes. The three provinces fall within the top twelve regional destinations for FDI identified above in table 3. To investigate regional FDI policies it seemed reasonable to select cases which have had a significant level of interaction with foreign investors. Their geographic proximity both to one another and to East Asia was also an important consideration. It meant that all three had proximate access to East Asian markets and sources of capital. When the Soviet Union collapsed, Asian traders and investors—mainly from Japan, Korea, and China—made an immediate appearance in all three Russian provinces. The three therefore had similar opportunities to interact with foreign investors. Further, the three provinces’ distance from Moscow combined with proximity to Asia increased the likelihood that FDI in these regions would be export-oriented. The Russian Far Eastern market is not large—some 8 million inhabitants in the entire Far Eastern region—so that FDI is unlikely to be geared towards servicing the domestic market. Indeed, foreign investors who visited the Far East in the wake of Soviet collapse were primarily interested in developing export-oriented projects. The three cases selected for this dissertation thus offer an excellent opportunity to examine the dynamics of export-oriented FDI at the regional level. In each case, therefore, I examine FDI in the region’s most important sector—each of which was in fact geared towards export in the post-Soviet era. Chapter 3, on Primorskii krai, examines the shipping and fishing business.
Chapter 4 on Khabarovskii krai looks at the timber business. And chapter 5, on Sakhalin, focuses on oil development.

**Similar Provinces, Different Paths: An Introduction to the Empirical Puzzle**

When the Soviet Union collapsed, Russia's 89 provinces—the new Subjects of the Federation, lost their financial lifeline.100 Gone were the days of centralized planning, generous state subsidies, and lucrative state orders on which regional economies under the Soviet system depended. In the resource-rich Far East—a vast swath of land beyond Siberia and larger than the continent of Australia—financial deprivation was further compounded by geographic dislocation from the Russian heartland—some nine thousand kilometers and seven time zones from Moscow. As the reality of Soviet disintegration sunk in across the Far East, salaries went unpaid for months on end, electricity and heat were cut for long hours in the dead of winter, social and health services dwindled to a trickle, and the great factories of the Soviet era ground to a slow, but unrelenting halt.

Rudely ripped from the safety of Soviet paternalism, and facing impending economic disaster, regional government leaders in the Russian Far East considered an obvious, yet in Soviet terms, truly revolutionary solution: fostering economic relations with their immediate neighbors to the east and south—Japan, China, and Korea. Soviet collapse saw an influx of foreign business into the Russian Far East, particularly from the Northeast Asian countries. Japanese think-tanks developed strategies for a new "Northeast Asian Community" in which Japanese and Korean capital would combine with Chinese labor and Russian Far Eastern natural resources in a cooperative

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100 Under the Soviet system, and also in post-Soviet Russia, provinces were called either "krai" or, more commonly "oblast." The meanings are essentially indistinguishable and both mean
arrangement which would bring economic prosperity to the subregion. Chinese traders moved into the Russian Far East in force while central and local Chinese governments laid plans for extensive cooperative port developments across the border. Powerful Korean companies set up shop in Vladivostok and re-visited relations with the Korean diaspora in Russia's Far East. At the same time, the dismantling of centralized Soviet control over foreign economic relations afforded Far Eastern leaders new opportunities to directly engage foreign business in regional economies. In the Russian Far East, therefore, it seemed that Soviet demise spelled the dawning of a bright new era of economic prosperity predicated on interaction with foreign capital. With new powers to direct foreign economic activity, and obvious interest from the foreign business community, Far Eastern leaders had both the opportunity and the capability to engage the foreign economic arena.

Few chose to do so. Rather, as the 1990s progressed, foreign economic policies in the Russian Far Eastern provinces took surprisingly variegated paths. This dissertation traces the fortunes of three Far Eastern provinces over the course of the first post-Soviet decade: In Primorskii krai, widely considered both at home and abroad to be the best candidate in the Russian Far East for foreign investment and trade, local leadership turned hostile to the outside world and to Asia in particular, whipping up xenophobic fears of a new "yellow peril" and inciting conflict with its neighbors. In Khabarovsk, international cooperative efforts played second fiddle to local leaders' primary goal: building and sustaining close ties to Moscow, much as the province operated in Soviet times. On the island province of Sakhalin, conversely, local political leadership formulated new and ambitious development plans and actively courted foreign
investment so that, by the turn of the century, Sakhalin stood second only to Moscow as a destination for foreign investment. Why these three provinces—Primorye, Khabarovsk, and Sakhalin—reacted so differently to the challenges and opportunities of global capital in the first post-Soviet decade forms the crux of the empirical puzzle that drives this dissertation.

Why would one province eschew foreign investors, another ignore them, and a third embrace them? The disparate responses of these three Far Eastern provinces are puzzling in view of the important political and economic features which they shared: similar challenges and opportunities offered by a peripheral geographic location, economies predominately based on natural resource extraction, the same political institutions of the new Federation. Most obviously, the three provinces shared a common geographic space—separated by a continent from Moscow, and therefore similarly alienated from the Russian heartland. The economic fall-out of Soviet collapse hit all of Russia's provinces hard, but the three provinces' physical distance from Moscow presented special common challenges. Most debilitating was the difficulty of economic dealings with European Russia once the railways were privatized and transportation lost its government subsidies: When transportation costs skyrocketed, the Far Eastern provinces could no longer afford shipping costs to and from European Russia.\textsuperscript{101}

Transportation links were especially important to the Far Eastern provinces because the vertical economic structure which they inherited from the Soviet system meant that most

\textsuperscript{101} A 1994 article on Primorski krai which appeared in Rossiiskaya gazeta explained: "The increase in transportation and fuel costs have cut the krai off from the rest of Russia. A 40 ton freight car of paper from the European part of the country costs 42 million rubles in Vladivostok. Transportation costs raise the price of cheap Kansk-Achinsk coal 6 times, and force the krai to import fuel from China. It is cheaper to buy grain in Canada than in Altai. An airplane ticket to Moscow costs 450,000 rubles." Rossiiskaya gazeta, September 28, 1994, pp. 1, 7.
enterprises did not manufacture their own parts, but depended on factories west of the Urals for essential inputs. Under the new market system, they bore responsibility for purchasing inputs and paying for transportation, a cost they could ill afford. In addition, their great distance from European Russia cut Far Eastern enterprises off from their traditional domestic markets west of the Urals, so that even if they did manage to continue production, the added cost of transportation either precluded shipping west or rendered their products too expensive to compete in the Russian market.  

Their common geography also afforded the provinces a common economic opportunity: Perched on the edge of the Pacific Rim, each had proximate access to Asian markets as well as to Asian sources of investment. Asian traders and investors recognized the opportunity: The year immediately following Soviet collapse saw an influx of foreign businesses into the Russian Far East, hoping to open Far Eastern markets, purchase Far Eastern primary resources, and invest in Far Eastern enterprises. This meant that economic and political leaders in the Far Eastern provinces all had ample opportunity to "sell their wares" on the global stage. In short, each province had an opportunity to pursue fruitful economic interaction with the outside world.  

Besides sharing the costs and benefits of shared geographic location, the three Far Eastern provinces also suffered a common economic plight. In each province, Soviet collapse brought serious economic downturn and resultant social unrest. In the southern-most province of the Far East, Primorskii krai, fishing equipment critical to the region's key industry lay idle and aging, while the great ships of the once-proud Soviet Pacific Fleet rocked rusting at their moorings. To the north, in Khabarovskii krai, production in

102 Before the Soviet Union collapsed, the Far East sent 75 percent of its produce to European Russia. See Russian Regional Report, Vol. 6, no. 29, August 22, 2001.
the pivotal timber industry fell off dramatically, leaving unemployment and rising poverty in the wake of its implosion. Off the eastern coast of Russia, on the island of Sakhalin, on-shore oil reserves were drying up and the local oil industry lacked the technical expertise and financial capacity to explore potentially large off-shore oil and gas reserves. Dismay followed upon shock, and then anger, as the economic realities of the post-Soviet era took their toll, and soon strikes and demonstrations by disgruntled workers, teachers, and their families became a common feature of the Far Eastern political landscape.

Under the new institutional arrangements of the Federation, each province gained new powers of control over foreign economic relations, and here again the three Far Eastern provinces had the same experience with decentralization, and won the same new rights and privileges. In Soviet times, foreign economic affairs in the Far East were strictly controlled by the center: Foreign Trade Associations—the largest were Dalintorg in charge of coastal and border trade, and Eksportles in charge of timber exports—controlled all Far Eastern foreign trade activities. The Foreign Trade Associations reported directly to the Ministry of Foreign Economic relations in Moscow, where decisions about export volumes and prices were made. Only the Associations could conduct foreign trade, and enterprises received orders for the delivery of goods to the Association for export. Regional government exerted virtually no control over these activities. After Soviet collapse, the rights of individual enterprises and regional government to conduct foreign trade expanded dramatically and the percentage of trade conducted through the Foreign Trade Associations declined precipitously.\footnote{See Pavel A. Minakir and Gregory L. Freeze eds., \textit{The Russian Far East: An Economic Handbook}, Armonk & London: M. E. Sharpe, 1994, pp. 245-247.}
governments formed departments of foreign economic relations, issued licenses to enterprises to conduct foreign trade, participated in the allocation of export quotas to local enterprises, and formulated development programs designed to engage foreign investors. In Primore, Khabarovsk and Sakhalin, regional governments enjoyed these same powers over foreign economic relations in the locality.

In sum, in the aftermath of Soviet collapse, the three Far Eastern provinces shared the challenges and opportunities of a common geographic space, had similar economic structures and problems, shared a common institutional structure and enjoyed the same rights and privileges to engage in foreign economic activity. Yet, actual decisions about foreign economic relations could not have been more different. In Primore, governor Evgenii Nazdratenko led a virtual siege on foreign investors by actively fostering a hostile and even dangerous environment which severely curtailed the province's foreign economic activities. In Khabarovsk, governor Viktor Ishaev officially endorsed a new era of expanded foreign economic activity but in practice, subordinated that effort to building a close partnership with the Russian Federal Government in Moscow. On Sakhalin, three consecutive governors—Valentin Fedorov, Evgenii Krasnoyarov, and Igor Farkhutdinov—struck out independently of Moscow to consistently and successfully work with foreign investors in an effort to bring ambitious new projects to fruition. The purpose of this dissertation is to explain the variation in these policies.
Chapter 2

Explaining Regional Policy Variation: Theoretical Approaches

In Chapter 1, I argued that Russia's poor showing in FDI inflows is linked first, to a dearth of substantive FDI to the regions, and second, to Russia's failure to attract efficient export-oriented FDI. I argued that regional FDI inflows correlate to the development of an investor-friendly environment at the regional level and I defended my selection of regional FDI policy as the dissertation's dependent variable. Chapter 1 also provided an overview of the aspects Russia's policy framework most closely related to FDI, and argued that the instability and fluidity of the reform process delivered new powers to Russian governors which enabled them to mold investment environments in the regions. I presented three regional case-studies and showed that regional FDI policies varied across the three. This chapter presents a variety of possible explanations for regional policy variation drawn from studies of Russia's economic and political development in the post-Soviet period and from the wider political economy literature. In this chapter, I attempt to draw out potential explanations for FDI policy variations from a broad range of literatures, some of which produce potentially compelling arguments, and others which, while intuitively appealing, do not. The main focus of the chapter is the theoretical material, however, the chapter does also provide some empirical data which I use to determine whether or not the theoretical argument merits consideration in the context of Russia's regional policy outcomes. Thus, some theoretical bodies of literature produce viable hypotheses for testing in the empirical chapters, while others do not. Because some arguments which do not produce useful hypotheses are nonetheless
intuitively appealing—namely the argument about regional political climate (voting patterns) presented below—or else appear to have direct bearing on FDI policy outcomes—such as the argument on fiscal federalism and globalization presented below—I take the time to outline and address them in the context of the Russian Federation. The central argument of this dissertation is that the different ideational frameworks which informed regional governors account for variation in policy outcomes. This chapter therefore dedicates considerable space to outlining constructivist explanations for policy outcomes and presents an outline of the ideational model which I later elaborate in the empirical chapters and the conclusion.

**Institutional Arguments and Reform Policies**

One way to explain policy variation focuses an analytical lens on institutional configurations.¹ "New institutionalist" analyses, for example, argue that institutions provide incentives and impose constraints which affect the strategies that actors use to achieve their goals. Perhaps the most obvious feature of Russian institutions in the 1990s was their extreme fluidity and instability—and therefore their inability to deliver clear signals to political and economic actors. For this reason, a number of studies of Russian reform in the new institutionalist tradition have focused on institutional failure and the weak capacity of institutions to effect reform. Another institutionalist approach, "historical institutionalism," argues that institutions shape actors' goals—thereby arguing that goals are socially and politically constructed. Studies of Russian reform in this

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¹ Peter Hall provides a standard definition for institutions as "the formal rules, compliance procedures, and standard operating practices that structure the relationship between individuals in various units of the polity and economy." Such institutions need not be formal organizations. Peter Hall, *Governing the Economy: The Politics of State Intervention in Britain and France*,
tradition call attention to the enduring influence of Soviet-style "Leninist" institutions into the post-Soviet era, and argue that the residual effects of the Soviet institutional legacy have delayed, (or by some analyses facilitated), the progress of Russian reforms.

**Partial-Reform**

An important argument about the effects of institutional capacity on Russian reform holds that initial reforms in Russia created a set of powerful "winners" who harbored a vested interest in maintaining a "partial reform equilibrium," and therefore opposed the progress of reform past the equilibrium point. In this way, the structure of the reform process itself—by creating winners with vested interests in partial reform—inevitably impedes progress towards a full market economy. According to this argument, opposition to continued reform is a function of rent-seeking opportunities at the partial reform point generated by price differentials between more fully liberalized sectors of the economy and those still subject to nonmarket mechanisms; rent-seeking opportunities inevitably arise in the process of reform because different reforms have different time horizons. Most forcefully enunciated by Joel Hellman, the partial reform argument identifies a number of winners of partial reform: "State managers turned private owners, who were the big winners from privatization, have prevented the creation of effective corporate governance structures and thus have delayed much needed enterprise restructuring...New entrepreneurs-cum-mafiosi, who have gained tremendously from the liberalization of domestic and foreign trade, have undermined the formation of a viable legal system to support the market economy...Local officials...have prevented market

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entry into their regions to protect their share of monopoly rents."² The way to counter winner opposition to deepening market reform, Hellman argues, is more democracy—expanding political participation in order to rein in the winners, by "including the very groups that suffer from the transitional costs of reform."³

This analysis suggests a possible explanation for variation in regional policy outcomes. Hellman's partial reform argument identifies regional leaders as "winners" who oppose further reform efforts. Other winners which Hellman identifies include large state-owned enterprises that have been reluctant to cede shares and power to outside investors (including foreign investors), and export-oriented industries that have benefited from the liberalization of foreign trade (and do not wish to share their profits with foreign investors). It is possible that the distribution of winners may have a regional dimension. Thus, we might expect that regions with a higher concentration of winners from partial reform would be unreceptive to foreign investment and would therefore fail to develop investor-friendly policies; conversely, regions with a preponderance of losers from partial reform would formulate investor-friendly policies. In my cases, I indeed found that Primorskii krai—with a high concentration of large state-owned enterprises and export-oriented industries—developed policies hostile to foreign investment. However, I also found that neighboring Khabarovsk, with a similar set of winners from partial reform, developed comparatively benign policies towards foreign investment. Sakhalin, with few winners, did—as the partial reform argument would predict—develop investor-friendly policies, but the biggest opponent to those policies was the local oil company—which

³ Ibid., p. 234.
was not a winner of partial reform. It seems therefore, that while the argument that the winners of partial reform are intent on preserving the status quo—and therefore unreceptive to foreign investors—explains some regional policy outcomes, it cannot explain the variation in regional outcomes observed among the Far Eastern cases. In developing an explanation for regional policy variation, therefore, the dissertation will attempt to determine why winners in some regions virulently oppose FDI, while in other regions, winners have a comparatively benign response to foreign investors; it will also attempt to explain why in some provinces, it is the losers of partial reform who oppose FDI.

**Soviet Institutional Legacies**

Another approach which focuses on institutional configurations points to the enduring influence of Soviet institutional structures. One argument, put forward by Kathryn Stoner-Weiss, holds that the legacy of Soviet economic planning has had a beneficial effect on post-Soviet reforms. Focusing her analysis specifically on the regional level, Stoner-Weiss argued that the "concentration" of regional economies brought about by Soviet planning mechanisms facilitated "good governance" in the Russian regions. Reflecting on the influence of Soviet institutional holdovers, Stoner-Weiss argued that the "company towns" which were a significant feature of Soviet economic planning, "facilitated the organization and packaging of social demands and promoted collective action between organized economic interests and regional governments. The stability and consensus over political goals that resulted from the
company town effect resulted in higher regional government performance."⁴ According to this argument, residual institutional structures from the Soviet era actually facilitate reform.

Applied to regional FDI policy, Stoner-Weiss' argument suggests that regions with a preponderance of company towns are likely to have a stable policy framework conducive to FDI. The evidence from my case-studies, however, suggests that this is not the case. Primorskii krai, for example, has the highest number of Soviet-style company towns among the three cases, but politics in the krai has been marred by strife, and regional FDI policy is hostile to foreign investment. Sakhalin, conversely, has the lowest number of company towns, but enjoyed a comparatively calm political environment and developed the most investor-friendly policies among the three cases. In the cases which this dissertation examines therefore, a prevalence of Soviet-style company towns ensures neither a stable regional polity nor an investor-friendly environment.

Most analyses of Russian reform, argue that the Soviet institutional legacy has had a detrimental effect on post-Soviet reform. Stephen Hanson, for example, points to "the socioeconomic legacy of Leninism...which has been by far the most intractable institutional obstacle to liberal capitalism in the post-Leninist context."⁵ In a similar vein, Michael McFaul's analysis of Russian privatization argues that post-Soviet institutional weakness, has left a "maze of nonmarket institutions still in place from the Soviet era" which choke the progress of economic reform.⁶ McFaul argues that the weak post-Soviet

⁶ Michael McFaul, "State Power, Institutional Change, and the Politics of Privatization in
state in Russia has allowed institutional holdovers from the Soviet period to exert an unhealthy influence over Russia's economic reform efforts, thereby undermining the "long-term goal of creating and sustaining a capitalist market economy." McFaul points to an undisciplined Central Bank, underdeveloped court system, uncodified accounting practices, lack of laws on disclosure, lack of a social security system, and the absence of institutions governing dividend payments, as evidence for the under-institutionalization of the market economy in Russia—resulting in the persistent pernicious effect of Soviet institutional structures. According to these analyses, the best way to get Russian reform on track is to strengthen the post-Soviet state and direct the state to overcome the Soviet institutional legacy by taking a more proactive role in dismantling Soviet era institutions and developing market-oriented institutions.

Applied to regional FDI policy, this argument suggests that regions in which regional governments have actively sponsored the growth of market-oriented institutions are most likely to develop investor-friendly policies. The record among the three Far Eastern cases presents conflicting evidence on this point. Primorski krai—the region most hostile to foreign investment—also has the most developed market institutions—the first functioning stock exchange in the Far East, for example. Sakhalin—the most receptive to foreign investment, also has the lowest percentage of small private enterprises (23.2 percent)—an important component of market reform. Khabarovsk—passive and indifferent to foreign investors, has a percentage of small private enterprises above the national mean (Khabarovsk: 37.7 percent; Russian average: 33.8 percent).
suggesting a regional policy conducive to market reform. Thus, there appears to be no clear correlation between the development of market-oriented institutions and an investor-friendly policy in the three regions which this dissertation examines.

**Network Arguments**

Another set of arguments which could explain FDI policy variation across provinces focuses on "networks"—the relationships between public officials and private economic actors. Some studies of Russian provinces have argued that close relations between local political and economic leaders lead to beneficial policy outcomes. Most, however, argue that a collusive relationship between business and government undermines economic reform. Given the fact that the primary goal of Russia's reformers was to "depoliticize" the economy, it would seem reasonable that business-government relations which maintain the political nature of economic affairs represent a reform failure and therefore have a detrimental effect on the progress of reforms.⁹

**Networks facilitate FDI**

Kathryn Stoner-Weiss' study of regional governments in Nizhnii Novgorod, Tyumen, Yaroslavl, and Saratov, made the case for the beneficial effects of close business-government cooperation. Focusing her study on "good governance," Stoner-

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⁹ Depoliticizing economic activity in Russia was the goal of privatization. In their book on privatization, Boycko, Schleifer, and Vishny state: "The goal of privatization was to sever the links between enterprise managers and politicians, including both the Moscow industrial ministers and local officials, so as to force firms to cater to consumers and share-holders rather than politicians. There is no other way to achieve restructuring and efficient operation of firms." Maxim Boycko, Andrei Schleifer, and Robert Vishny, *Privatizing Russia*, Cambridge,
Weiss argued that: "Cooperation between economic and political actors fostered higher levels of institutional performance by enabling the state to employ the authority of key groups of economic actors in return for granting them systematic access to state resources." Stoner-Weiss foresaw relative stability for regions in which government and business cooperated, at least for the short term. In an article on FDI in Russian provinces, Stoner-Weiss applied her findings on business-government relations to the question of FDI, and argued that close cooperation between economic and political elites in the regions created a stable business environment which attracted FDI.

Applied to regional FDI policy, Stoner-Weiss' argument suggests that close cooperation between political and economic elites at the regional level promotes political stability and enhances institutional performance, conditions which lead to the development of investor-friendly policies. Evidence from the three Far Eastern cases, however, shows that close business-government relations do not correlate with either stability or a business friendly environment. Networks of business-government relations in Primorskii krai were the densest of the three provinces, yet Primor'e developed the least investor-friendly policies. Relations between business and government in Khabarovsk were also dense, yet Khabarovsk's FDI-related policies did not reach the level of hostility to foreign investment of those in Primor'e. On Sakhalin, relations between the regional government and business were less dense, yet Sakhalin developed the most investor-friendly policies. These findings suggest that the density of business-government relations has little bearing on regional policy outcomes.

10 Kathryn Stoner-Weiss, 1997, p. 11.
11 Kathryn Stoner-Weiss, "Foreign Direct Investment and Democratic Development in the
Networks as obstacles to FDI

Contrary to Stoner-Weiss' argument, most studies of Russian reform note the detrimental effects of collusive relations between business and government. Indeed, the continuing " politicization" of regional economies has often been cited as an obstacle to reform. Several studies have argued that cooperation between regional government officials and enterprises has facilitated the rise of non-payments and barter transaction in Russia, by condoning and supporting barter transactions between enterprises and electricity suppliers, or by allowing the collection of taxes in kind and forcing enterprises to maintain overblown employment levels. Collusion between enterprise directors and regional government officials has been noted as one of the primary reasons for the failure of many large enterprises to restructure themselves into efficient corporate entities, thereby undermining the viability of regional economies. Collusion between regional economic and political actors has also been identified as a way by which regional governments conserve monopoly rents, as in the partial reform argument elaborated above, or a way to protect local employment and extract social benefits from enterprises—such as securing social security benefits, welfare, or housing facilities which enterprises provided under the Soviet system. Activities such as these, it has been


argued, obstruct the development of stable property rights, efficient enterprises, and the market economy in general.

Arguments which point to the deleterious effect of collusion among political and economic elites on economic reform argue that the failure to depoliticize the Russian economy has resulted either in state capture, or in market-distorting government interference in the economy; neither scenario gives rise to an hospitable business environment. However, the evidence I uncover in my cases suggests that although collusion does adversely effect business environment in some cases, such as that of Primor discussed above, in others, government interference in the regional economy produces investor friendly polices: On Sakhalin, it was regional government intervention in the affairs of the local oil enterprise that allowed the development of investor-friendly policy. Thus, in Primor, business-government networks served to block foreign investment, while on Sakhalin, the government forced an alliance with regional business that helped to bring foreign investment into the oblast. This suggests that while networks may play some role in facilitating or alternatively blocking the formulation of investor-friendly policies, the presence of networks in and of itself is insufficient to explain policy outcomes.

**Economic Structure**

Another way to approach variations in regional FDI policy focuses on the structure of regional economies. The strength and structure of regional economies varies widely among Russia's oblasts and krais, so that a reasonable assumption would hold that regional FDI policies arise from underlying differences in regional economies.
Arguments about economic structure are particularly appealing in the Russian Far Eastern cases because post-Soviet development plans for the region—namely economic integration into a wider Northeast Asian subzone—were explicitly predicated on the structure of regional economies: According to development programs worked out in the Russian Far East as well as in the neighboring Northeast Asian countries, the Far Eastern oblasts and krais have a "comparative advantage" in raw natural resources, which, combined with capital from Japan and Korea, and labor from China, could usefully contribute to a prospectively prosperous Northeast Asian subregion. By this way of thinking, regional FDI policies in the Russian Far East should arise from the structure of regional economies—namely a wealth of natural resources—and be designed to attract FDI for the purposes of resource exploitation and development. A variety of arguments in the political-economy literature, including studies of the Russian Federation, similarly hold that policy outcomes arise from some aspect of economic structure.

**Competitive Factors and Policy Outcomes**

While not specifically focused on FDI policy, a number of studies of Russian regions have focused on economic wealth to explain variation in regional policy. Studies of secessionism or movements for greater autonomy among Russia's regions, for example, often argue that wealthier regions are likely to be more assertive vis-à-vis the center, than regions with lesser economic endowments. In his study of separatist activism among ethnic regions in Russia, for example, Daniel Treisman found that those regions with greater economic prospects—large populations, high industrial output, major raw material producers, or high industrial exports—were more separatist, whereas regions
that relied heavily on central subventions were more cautious. Similarly, Gerald Easter's study of the Movement for a Urals Republic in Sverdlovsk oblast argued that economic wealth was a "potential power resource" which provided both a stimulus for the regional movement and a reason for the movement's success. Easter argued that: "Regional actors generally are advantaged or constrained in their efforts to wrest concessions from the center by the availability of potential power resources." According to Easter's argument, the Sverdlovsk movement produced positive results—the oblast was the first in Russia to be permitted gubernatorial elections—because oblast leaders had access to particular power resources: high tax revenues due to Sverdlovsk's "highest donor status", and commodity exports in minerals, metals and precious stones. In recent years, however, two studies of regional policy outcomes in Russia have challenged the notion that objective material factors translate into policy directives: Jane Prokop's study of industrial policy in the regions found no correlation between economic factors and government interference in the economy, and Yoshiko Herrera's study of secessionist movements found a weak correlation between economic factors and secessionist sentiment.

Focusing explicitly on FDI, Kathryn Stoner-Weiss offers another perspective on the effect of regional economic structure on policy outcomes. Stoner-Weiss links "concentrated" regional economies to regional FDI inflows. In her study of regional governance, Stoner-Weiss drew explicit parallels between her own work and factor

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endowment arguments such as those of Ronald Rogowski and Jeffry Freiden. She argued that concentrated regional economies—ones in which labor, assets, and productive output were concentrated in one sector or among a few large enterprises—foster close cooperation between economic and political elites. This in turn makes for good governance. Explicitly linking this argument to regional FDI, Stoner-Weiss attributed an "investor-friendly" environment to the lack of conflict in well-governed regions—i.e. those with concentrated regional economies. Most studies of FDI inflows agree that foreign investors favor a stable political environment, as Stoner-Weiss argues; however, Stoner-Weiss' study is unique in linking regional stability—and therefore investor-friendly regional FDI policies—to a prevalence of concentrated "company town" holdovers from the Soviet era.

Focusing more directly on the international economic activities of Russian regions, a study conducted by Steven Solnick on transnational and subnational pressures in the Russian transition argued that regions with globally competitive factors favor liberal market-oriented policy regimes which attract foreign investment: "Regions that stand to gain the most from foreign trade and investment favor less federal intervention, and looser controls over subnational administrations. Regions that are left out of the globalization bonanza, on the other hand, are more supportive of an interventionist

redistributive federal government."22 Solnick's argument dovetails with findings from other transitional economies, in which "progress in the transition" correlates strongly with FDI levels: In their study of Eastern European and CIS economies, Hans Peter Lankes and Nicholas Stern argued that "progress in the transition is and will be a driving force in integrating these economies into the global markets."23

A monograph by Peter Kirkow set out to test the hypothesis that regions which stand to gain the most from globalization favor liberal regimes.24 Using two detailed case-studies in Primorskii and Altaiskii krais, Kirkow hypothesized that Primore's "gateway" location—proximate access to Asian capital and markets and the prominent place of export industries in the regional economy—would make for a regional policy regime conducive to market forces and open to foreign economic interaction. Conversely, Kirkow speculated, Altai's inland location and predominantly agricultural economy, would favor a conservative approach to market reform which would direct krai energies to winning central subsides. In the language of factor analysis and of Solnick's analysis described above, Kirkow hypothesized that wealthier regions with export-oriented factors and more to gain from globalization are likely to favor market reform and be more receptive to foreign investment, while poorer regions with weaker factors and less to gain from globalization are likely to favor a redistributive federal system and develop a regional policy less receptive to foreign investment.

In his study, however, Kirkow did not find evidence to support this hypothesis. Instead, Kirkow found that his "gateway" region, Primorskii krai, concentrated considerable effort on obtaining central subsidies and developed a regional policy regime characterized by criminal activities, patron-client relations, and autocratic leadership—in sum a business environment conducive to foreign investment. Altaiskii krai, conversely, moved forward quickly with market-oriented reforms such as privatization, and developed trading linkages with western Siberia and Central Asia; however, Altai also attempted to counter federal policy on the separation of executive and legislative powers in the regions by approving a statute stipulating that the governor be elected by the regional legislature, rather than through popular elections. Kirkow concluded that factor arguments and geographic location could not explain policy outcomes in his cases, and that his study demonstrated "the profound impact regional leaders have on provincial (and partly national) policy making...."25 Kirkow's findings dovetail with those of the World Bank study on Russian regions and FDI discussed in Chapter 1, which found that a variety of geographic variables, including climate, access to coastline, distance from Moscow, and major port facilities, had no statistically significant impact on FDI inflows to the regions.26 (The World Bank study also found that regional crime rates correlate positively, although not significantly, with FDI inflows). Kirkow's findings are also in line with Jane Prokop's study of regional levels of marketization which found no correlation between the structure of regional economies and economic policy outcomes.27

27 Prokop, p. 19
In sum, research on the relationship between economic factors and policy outcomes in the Russian regions has produced conflicting results: some studies—Solnick and Stoner-Weiss—see a close relationship between factor competiveness (regions that stand to gain from globalization or economic "concentration") and policy outcomes, while others—Kirkow, Prokop, and the World Bank—find none. This dissertation will weigh in on this debate. As indicated in Chapter 1, the case-studies in this dissertation focus on those regional industries which stand the most to gain from globalization: export-oriented and trade dependent. Variation in regional FDI policy should, by the logic of Solnick's argument, correlate to a regional concentration of these potential beneficiaries. In the empirical chapters, I examine this proposition carefully. Like Kirkow, however, I find that a concentration of factors which stand to benefit from FDI does not translate into an investor-friendly policy framework in the regions.

**Energy Resources and Policy Outcomes**

Another set of factor explanations which could usefully apply to regional FDI policies in my cases examines FDI policies in regions with rich energy resources. A recent study conducted by Gary Wilson, for example, examines the evolution of production-sharing legislation—designed to facilitate foreign investment in Russia's energy sector. Tracing the debates over production-sharing legislation (passed in 1995) in the State Duma and Federation Council, Wilson argued that Russian regions that produce oil and gas were particularly active in drafting the legislation and shepherding it through the national legislature.28 Focusing his study on the Republic of Tartarstan and Khanty-

28 Gary N. Wilson, "Crude" Federalism: Oil Politics and the Evolution of Intergovernmental Relations in Post-Soviet Russia, Dissertation Manuscript, University of Toronto, 2000, especially
Maniisk Autonomous okrug (in Tyumen oblast), Wilson argued that the presence of particular economic factors—energy resources—led regional governments to favor policies conducive to foreign investment. However, as noted in Chapter 1, the World Bank's large-n study of FDI in Russian regions found no correlation between FDI inflows and regional energy production. One way to explain the World Bank's findings in light of Wilson's argument might be that regions with attractive factors such as energy were interested in developing a pro-FDI business environment, but that not every energy-rich region successfully attracted foreign investment. In my empirical cases, I examine the impact of energy wealth on policy outcomes in the oblast of Sakhalin. I find that Sakhalin did develop a pro-FDI policy framework designed to attract investment into the energy sector; however, by tracing the evolution of that policy at the regional level, I find that a pro-FDI policy framework did not flow smoothly from the regional economic structure and was indeed far from inevitable. Comparing FDI policy on Sakhalin to that of other energy rich regions in Russia, I find that Sakhalin's proactive stance on FDI was in fact anomalous. I argue that other variables—notably the character of regional government—were responsible for policy outcomes on Sakhalin.

Pauline Jones Luong and Erika Weinthal use political cleavages to offer a nuanced approach to understanding the impact of energy wealth on policy outcomes. Comparing energy policies in Russia, Turkmenistan, Uzbekistan, Azerbaijan and Kazakhstan, Luong and Weinthal argued that "energy development strategies are a product of the interaction between the degree to which alternative sources of revenue are available and the level of contestation over the basis for distributing political and

Chapter 3.
economic resources." According to their argument, state leaders allow foreign investment in the energy sector when they lack access to alternative rents and face powerful political opponents; foreign investment in energy expands the rents available to state leaders enabling them to "reward their supporters and appease or defeat their opponents." Alternatively, states with low access to alternative rents and low levels of political contestation also allow foreign investment in energy in order to generate the rents necessary to maintain the status quo. Under both scenarios, political leaders court foreign investment in the energy sector in order to generate rents which serve to bolster their political position. Applying this logic to Sakhalin's push for investment in energy, we would expect regional leaders to have little access to alternative rents and use energy rents to either maintain the status quo or defeat powerful opponents. The evidence from my study of Sakhalin, however, indicates that regional leaders had sufficient rents to retain office in the absence of FDI in energy. Moreover, although Sakhalin's leaders did face powerful regional opponents (contestation for gubernatorial office), these opponents arose in response to the governors' FDI policies. Thus, on Sakhalin, a pro-FDI policy, rather than serving to quell political opposition, actually generated political cleavages. This suggests that using alternative rent sources and pre-existing political cleavages to explain the development of pro-FDI policies in the energy sector cannot explain Sakhalin's policy outcomes. Chapter 5 on Sakhalin will examine this argument in greater detail.

Political Preference Arguments

A plausible way to approach regional policy variation is to examine the political preferences of each province—namely, the degree to which the region voted for communist or national parties, and the level of support for reform parties. Russia's Communist Party (KPRF) embraces anti-Westernism, Russian patriotism, and a nostalgia for the Soviet Union.\textsuperscript{31} The Liberal Democratic Party (LDPR) espouses a virulently nationalist anti-reform platform. If party platform means anything, high levels of voter support for either of these parties in the regions should correlate to a relatively inhospitable environment for foreign investment. On the reform side, Yabloko has been the most visible party, joined in 1999 by the Union of Right forces (SPS). Regions in which these parties performed particularly well should also provide investor-friendly business environments.

While this argument is intuitively appealing, outside the urban centers of Moscow and St. Petersburg, there is little evidence for a correlation between voting preference and regional FDI. In their study for the World Bank, Broadman and Recanatini attempted to correlate regional FDI levels with a number of variables reflecting political preferences. They considered the percentage of votes cast for the Communist Party in the State Duma elections of 1993, 1995, and 1999, the percentage of votes cast for communist candidate Zyuganov in the 1996 Presidential election, and the percentage of votes cast for liberal candidate Yavlinsky in 1996. However, the World Bank study found that none of these variables had a significant impact on FDI inflows. In an effort to measure the "civic

\textsuperscript{30} Ibid.
fabric" of a region, the World Bank study also considered the effect of voter participation (in the 1996 Presidential election) on FDI: Their results indicated not only that voter participation had no significant impact on FDI, but that it exhibited the wrong sign: Voter participation correlated negatively with FDI inflows.32

No Federation-wide rating of regional FDI policy exists, but a brief example which uses land policy as a proxy for FDI policy suggests a disjuncture between regional FDI policy and voter preferences. In the late 1990s, four regions adopted a land code designed to attract foreign investment by leasing land to foreigners for periods up to 49 years: Novgorod, Saratov, Tartarstan, and Samara. The voting record for these regions in the 1999 Parliamentary elections, however, does not indicate an overall preference for reform parties or a distaste for communist and nationalist parties (Table 1). With the exception of Novgorod, these regions turned out a vote for Yabloko below the national average. Moreover, although Novgorod turned out a high Yabloko vote, its LDPR vote also exceeded the national average. In 1999, Samara turned out an SPS vote considerably above the national average, but also exceeded the national average in the Communist vote. While far from conclusive, these findings do suggest that regional FDI policy does not correlate to voting preferences.

Table 1
1999 Parliamentary Election Results for Investor-Friendly Regions
(percentage of the vote)

<table>
<thead>
<tr>
<th></th>
<th>KPRF</th>
<th>LDPR</th>
<th>Yabloko</th>
<th>SPS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Novgorod</td>
<td>19.4</td>
<td>7.1</td>
<td>7.3</td>
<td>7.1</td>
</tr>
<tr>
<td>Saratov</td>
<td>31</td>
<td>5.6</td>
<td>4.4</td>
<td>7.2</td>
</tr>
<tr>
<td>Tartarstan</td>
<td>18.6</td>
<td>3.2</td>
<td>3</td>
<td>5.3</td>
</tr>
<tr>
<td>Samara</td>
<td>26.7</td>
<td>5.5</td>
<td>3.7</td>
<td>22.6</td>
</tr>
<tr>
<td>Russia</td>
<td>24.8</td>
<td>6.1</td>
<td>6.05</td>
<td>8.68</td>
</tr>
</tbody>
</table>


In this dissertation, I find no correlation between regional FDI policy and political stance—expressed in terms of Party voting preferences—among the Far Eastern cases. Sakhalin, which alone among the cases proactively developed an investor-friendly policy, voted heavily nationalist in 1993, and heavily communist in 1995—the same years in which it was actively and successfully courting foreign investment. Meanwhile, in isolationist Primore, more voters supported the liberal Yabloko Party in 1995 than in either internationalist Sakhalin or nationalist Khabarovsk; that same year, Primore's nationalist vote was nearly double the national average, and a regionally-initiated xenophobic drive to evict Asian investors and traders from the region reached a high point (Table 2). In short, it is difficult to make sense of regional FDI policy by examining Party voting preferences.
Table 2
Voting Preferences in the Russian Far Eastern Cases
(percentage of the vote)

<table>
<thead>
<tr>
<th></th>
<th>Primor'e Isolationist</th>
<th>Khabarovsk Nationalist</th>
<th>Sakhalin Internationalist</th>
<th>Russian Federation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Confidence in Yeltsin April 1993</td>
<td>64.3</td>
<td>70.2</td>
<td>60.9</td>
<td>58.8</td>
</tr>
<tr>
<td>Constitution</td>
<td>71.5</td>
<td>70.5</td>
<td>64</td>
<td>58.4</td>
</tr>
<tr>
<td>KPRF 93</td>
<td>8.7</td>
<td>12.1</td>
<td>8.9</td>
<td>12.4</td>
</tr>
<tr>
<td>LDPR 93</td>
<td>23.3</td>
<td>19.9</td>
<td>36.9</td>
<td>22.9</td>
</tr>
<tr>
<td>Yabloko 93</td>
<td>8.6</td>
<td>7.3</td>
<td>7.6</td>
<td>7.9</td>
</tr>
<tr>
<td>KPRF 95</td>
<td>18.5</td>
<td>16.1</td>
<td>24.6</td>
<td>22.3</td>
</tr>
<tr>
<td>LDPR 95</td>
<td>20.1</td>
<td>12.3</td>
<td>15.3</td>
<td>11.2</td>
</tr>
<tr>
<td>Yabloko 95</td>
<td>9.6</td>
<td>7.5</td>
<td>6.8</td>
<td>6.9</td>
</tr>
<tr>
<td>Yeltsin 96</td>
<td>52.3</td>
<td>59</td>
<td>53.4</td>
<td>53.8</td>
</tr>
<tr>
<td>Zyuganov 96</td>
<td>39.4</td>
<td>34</td>
<td>38.8</td>
<td>40.3</td>
</tr>
<tr>
<td>KPRF 99</td>
<td>23</td>
<td>21.3</td>
<td>24.7</td>
<td>24.8</td>
</tr>
<tr>
<td>LDPR 99</td>
<td>10.3</td>
<td>9.4</td>
<td>10.8</td>
<td>6.1</td>
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<tr>
<td>Yabloko 99</td>
<td>6.9</td>
<td>9</td>
<td>8.3</td>
<td>6.05</td>
</tr>
<tr>
<td>SPS 99</td>
<td>6.4</td>
<td>9.2</td>
<td>9.2</td>
<td>8.68</td>
</tr>
</tbody>
</table>


Another possible explanation which draws attention to voting patterns concerns levels of political polarization. A study of economic performance in postcommunist countries, conducted by Timothy Frye, makes this argument. In his study, Frye argues that countries with divided polities—those characterized by struggle between "communist and ex-communist" forces—suffer lower levels of economic performance. Conversely, countries in which one camp or the other dominates, perform better. Frye argues that political polarization exerts a deleterious effect on growth because politicians have difficulty agreeing on economic policies and because polarization increases the chances of sharp policy changes which undermine investor confidence in the government's ability.
to secure property rights in the long run. By this argument, the substance of political programs is less important than the balance among competing programs.  

The argument about political polarization readily lends itself to regions and FDI policy. Foreign investors prefer stable to unstable polities, (as Stoner-Weiss' argued), and it seems reasonable that regions with stable polities are more likely to develop the credible long-term policies which investors prefer. The Party voting record at the regional level, displayed in Table 2, suggests that all three regions had divided polities, yet very different policy outcomes; it seems therefore that polarization between communist and ex-communist forces, per Frye's analysis, cannot explain variation in policy outcomes in the Far Eastern regions. However, the dissertation will consider the polarization argument by looking at the level of contestation which the governors faced in each region. Evaluating the stability of gubernatorial office entails more than examining the voting record for governors in each province. This is because in post-Soviet Russia, governors' ability to consistently garner a high percentage of the vote does not necessarily reflect political stability in the region. Powerful governors can and do manipulate the vote to their advantage through fraudulent methods or by forcibly removing powerful opposition candidates before election day. For this reason, the case-study chapters will evaluate the level of political conflict in each region by examining the level of conflict between governors and other political actors—such as city mayors and regional legislatures.

Historicist Explanations and Path Dependency

Historicist and path dependency arguments provide another way to explain variations in regional policy outcomes. Arthur Stinchcombe defines historicist explanations as ones in which "an effect created by causes at some previous period becomes a cause of that same effect in succeeding periods."\(^{34}\) Historicist arguments are likely to be particularly powerful at moments of change or upheaval, Stinchcombe argues, because people have a reduced capacity to evaluate the outcome of their actions and are wary of the risks which new directions entail: "The poorer the capacity of people to predict the consequences of an innovation, the more likely they are to (rationally) prefer what they already have, whose consequences they can predict from their experience."\(^{35}\) Historicist explanations can operate by pointing to institutional continuities, as do the arguments for "Leninist" institutions discussed above; they often entail a focus on powerful elites who "by selection, socialization, controlling conditions of incumbency, and hero worship...tend to regenerate the same institutions."\(^{36}\) Arguments which point to the enduring power of the Soviet-era nomenklatura fall into this category. Alternatively, an historicist approach can be used to explain the selection of functional alternatives,\(^{37}\) particularly in the face of uncertainty and instability, as has been the case in post-Soviet Russia. In a similar vein, path dependency approaches focus

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\(^{35}\) Stinchcombe, p. 123.

\(^{36}\) Ibid., p. 111.

\(^{37}\) Ibid., p. 105.
on institutional and organizational constraints which "lock-in" particular power
configurations or modes of operating.\textsuperscript{38}

Aside from the institutionalist arguments discussed above, few studies of Russian
reform have investigated path dependency arguments. Steven Solnick's work on
federalism does note that Russian regions have wide disparities in resource endowments
and argues that because of this, state structure in Russia is highly path dependent.\textsuperscript{39}
Solnick does not, however, explore the policy implications of path dependency in
Russian regions. In other fields, some scholars have linked regional policies to path
dependency. In a study of regional policies in China's automotive sector, for example,
Eric Thun argues that disparate policy initiatives in Chinese provinces are path
dependent; Thun argues that regional policy choice is a product of a province's historical
relationship with the central government.\textsuperscript{40}

Given the findings in other countries, and the disparate historical experiences in
the cases which this dissertation examines, it seems reasonable to hypothesize that
distinctive regional historical experiences may shape the ways in which post-Soviet
regions formulated FDI policy. The three regions which this dissertation examines did
have distinctive historical experiences in both Soviet and pre-Revolutionary periods, and
formulated distinctly different foreign economic policies in the post-Soviet period. By
examining the ways in which historical experiences shaped post-Soviet institutions and

\textsuperscript{38} See Douglass C. North, \textit{Institutions, Institutional Change and Economic Performance},
Cambridge: Cambridge University Press, 1990; for a path dependent approach to postcommunist
development see David Stark, "Path Dependence and Privatization Strategies in East Central
dependent argument which focuses on regional variation see Eric Thun, \textit{Changing Lanes in
China: Industrial Development in a Transitional Economy}, Dissertation manuscript, Harvard
University, 1999.
\textsuperscript{39} Solnick 1996, p. 19.
elites in the regions, the dissertation evaluates the power of historicist explanations. As will become evident in the empirical chapters, the dissertation finds that an historicist approach cannot adequately explain policy choice in the post-Soviet regions; however, the dissertation does marshal evidence to show that the direction which regional policy took in the early years after Soviet collapse set the course of regional policy for the remainder of the decade. Thus, the dissertation argues, while the historical legacy of Soviet and pre-Revolutionary times cannot explain post-Soviet policy outcomes, the direction of powerful governors in the early years of the Federal era did have a path dependent effect on policy outcomes for the duration of the first post-Soviet decade.

**Federalism: the balance of power between center and regions**

Studies of federalism provide another way to explain regional policy outcomes. Studies of federalism in Russia generally agree that the central state is weak and that the regions are able in some measure to either dictate central policy or else simply ignore it. Russian federalism, it is therefore argued, has had a deleterious effect on the capacity of the federal government to formulate and implement policy. Studies of Russian federalism present two competing visions of the state—the strategic state and the weak state. These competing understandings of the federal state suggest different sources of regional policy variation.


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The Strategic State

By some accounts, Russia's federal government reacts to regional demands by attempting to "pay off" vocal and recalcitrant regions. These accounts see the state as comparatively strong, because it is at least able to bargain with regions in a strategic manner. Analyses in this vein often focus on the fiscal relations between central and regional governments. Alexei Lavrov, for example, found that Moscow responded to regional opposition to the Constitutional referendum of 1993 by increasing budgetary transfers to unsupportive regions. In a similar vein, Daniel Treisman's study of fiscal transfers found that regions that presented a credible threat to central power won more transfers from Moscow, in a political game by which Moscow successfully appeased recalcitrant regions. Using regression analysis, Treisman showed that: "Those regions that had demonstrated discontent with the central regime—by voting against Yeltsin or his pro-reform allies, declaring sovereignty, staging major strikes, or not supporting Yeltsin and his allies at moments of heightened political competition—did better in the fiscal transfers game than their more compliant counterparts." In a similar vein, Peter Kirkow has noted "the granting of preferential treatment for various provinces in exchange for commitments by regional leaderships to preserve the territorial integrity of the Russian Federation."

41 Lavrov found that 55 percent of regions that failed to support the Constitution in the December 1993 referendum received increased budgetary transfers, while 40 percent of regions that supported the Constitution saw an increase in budgetary transfers. Alexei Lavrov, "Rossiiskii byudzhetnyi federalizm: pervye shagi, pervye itogi," Segodnya, June 7, 1995, p. 5.
Other studies of Russian federalism which depict the central state engaged in a strategic bargaining game with the regions, focus on the system of bilateral treaties. Steven Solnick, for example, has argued that Moscow's signing of bilateral treaties with Russian regions constitutes a strategic effort to maintain central control by placating restive regions—what he calls "co-optation by treaty." Solnick argued that bilateral treaties have further strengthened central power because they undermine regional associations—the development of a coalition among regions which could pose a viable threat to central control or territorial integrity. Examining the demise of two well-known regional associations—the Siberian Agreement and the Urals Republic effort—Solnick argued that both fell victim to Moscow's bilateral manipulations. He concluded that, "the potential benefits of collective action were outweighed by the tangible selective benefits controlled by Moscow."\footnote{Steven L. Solnick, "The Political Economy of Russian Federalism: A Framework for Analysis," \textit{Problems of Post-Communism}, November-December 1996, pp. 13-25, cite on p. 23.}

Applied to regional FDI policies, this vision of the Russian state as a strategic manipulator of Russian provinces suggests that regional policies may be the outcome of bargains between Moscow and the regions. The empirical chapters will consider this possibility. However, the evidence which emerges from the Far Eastern provinces suggests that, in the area of FDI policy, Moscow was generally indifferent to regional initiative, and that where federal government input did play a role—it was the region, not the center, that initiated and spearheaded the bargaining game. It may well be that in the policy areas where the strategic state argument has focused—intergovernmental fiscal relations—the central state does act strategically, while in other policy areas its does not.\footnote{Ibid., p. 22.}
In Treisman's argument about strategic central use of fiscal relations, the federal government dispenses moneys in response to credible regional threats of secession or substantive regional power-grabs. It seems reasonable to conclude that the threat of regional secession would provoke central response and give rise to some form of strategic engagement in the face of threats to the territorial integrity of the Russian Federation. Indeed, if Russia has had one stable policy in the post-Soviet era, it is to maintain national integrity.

The Weak State

Another perspective on Russian federalism sees a central government so weakened that it is incapable of strategic bargaining of the kind identified by Treisman and Solnick. Kathryn Stoner-Weiss' work on regional autonomy typifies this line of argument. In the matter of bilateral treaties, for example, Stoner-Weiss argues that the manner in which they arose—at the behest of the regions rather than as a strategic ploy from the center—shows that the regions, not the center, are the ultimate arbiters of intergovernmental relations in Russia. More importantly, Stoner-Weiss points to a range of policy areas in which Russian regions have abrogated de facto jurisdiction, to bolster her argument for a federative structure in which the regions define the rules of the game. From the appropriation of central funding for regionally determined purposes, to regional legislation which consistently contradicts federal law, and the outright refusal of many regions to comply with central dictate, regions in Russia, Stoner-Weiss argues, are building a federative structure in which regional leaders exercise de facto control over a patchwork of disparate territories. The result has been the rise of "contractual" relations
between regions and the center, rather than the "national-constitutional" basis for federal relations envisioned by the men and women who wrote Russia's 1993 Constitution.  

The evidence presented in the empirical chapters of this dissertation supports Stoner-Weiss' view of federal relations in post-Soviet Russia. As noted above, it appears probable different policy foci account for the different views of the state put forward by Treisman and Stoner-Weiss. Stoner-Weiss' argument focuses on regional non-compliance and de facto policy at the regional level in areas such as social welfare, enterprise restructuring, and prices. In areas such as these, where there is no immediate threat to the Russian Federation and central policy is itself unstable (as was also the case with FDI policy), a lack of strategic response from the center and the growing autonomy of the regions seems a reasonable argument. In sum, it is possible that fiscal outcomes in Russia are the result of strategic bargains between Moscow and the regions, while regional policy outcomes outside fiscal relations may be the result of federal neglect. By exploring regional policy variation on FDI, this dissertation contributes to the debate on federal relations in Russia.

Federalism and Globalization

As noted in chapter 1, a growing literature outside the Russia field has focused on the increasing importance of subnational government involvement in international economic affairs, and most of this literature is empirically focused on federal polities. 

47 See in particular, Douglas M. Brown and Earl H. Fry eds., States and Provinces in the International Economy, Institute of Governmental Studies Press, University of California, Berkeley, Institute of Intergovernmental Relations, Queen's University, 1993; Brian Hocking ed.,
The literature hones in on two areas of study: One focuses on the efforts of domestic subnational governments to "go global," and the other documents the effect of globalization forces on subnational actors. These studies may provide some clues to explaining regional FDI policy variation.

One of the major tasks of the literature on federalism and globalization has been to document subnational efforts to engage foreign capital. Studies of subnational government activities show how newly empowered subnational actors use supranational institutions to bypass national power structures, ally themselves with other subnational regions within their own nation states to wield new powers in the realm of foreign policy formulation, and forge bilateral and multilateral allegiances with other regions across national boundaries.48 By chronicling the activities of subnational governments in the international arena, these studies make an important contribution to our understanding of the kinds of international activities in which subnational governments are engaged.

However, the literature does not explicitly theorize on why some subnational governments chose to globalize while others do not. In general, this literature is driven by the assumption that states and provinces seek to expand wealth and power by engaging in

global economic activities; for this reason it often focuses on subnational "success stories."

Studies in this vein which focus on Europe have speculated that a new "Europe of Regions" may be in the making. This work focuses on a variety of European subregions, including one which "stretches from southern England through northern France and the Benelux countries and down the Rhine Valley and into Switzerland [and another which] forms an arc from the Veneto in Italy, west through Lombardy and the Piedmont into the Rhone-Alpes, across France's Mediterranean coast and hinterland, and into Catalonia." The literature also documents a plethora of smaller subregions, often drawn together by historic, economic and cultural ties: "Baden-Wurttemberg, Alsace, and Basel are now one region for employment purposes.... Saxony, in eastern Germany, is slowly becoming the midpoint of a similar region reaching north toward Berlin, south into the Czech republic, and east to Poland. (sic) In France, some are concerned that a piece of the southwest will again become part of the Catalan sphere of influence....(sic)

The wealthy triangle formed by Lyon, Turin, and Geneva—known as the Alpine Diamond—has a synergy that few regions of the world can match." 

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51 Ibid., pp. 71-72.
In North America, prominent studies have investigated the interaction between American states in the Pacific Northwest and the western Canadian provinces, particularly between Oregon and British Columbia.\(^5^2\) Others have focused on the phenomenon in the east, particularly relations among New England, New York, and Quebec.\(^5^3\) Yet another group of studies examines interactions along the Mexican border, especially those across the California border where merging economies and a flood of migration is changing the social and economic face of the region.\(^5^4\) The majority of these studies focus on the relationship between subnational regionalism, national foreign policy formulation, and NAFTA, with particular emphasis on trade, migration, labor, and environmental issues.

A second major task of the literature on federalism and international relations has been to document the ways in which global economic forces impact subnational governments. The literature points to a range of forces driving a rise in subnational engagement with global capital in the 1990s. One force is that of capital mobility which has heightened awareness of subnational conditions: In the subnational areas where multinationals invest, policies as diverse as education, employment, taxation, and the


\(^{54}\) In recent years, this issue has received particular attention in the *Journal of Borderland Studies* published by the San Diego State University Press.
environment all play into the investment climate. Another force is what Brian Hocking refers to as the "expanding agenda of world politics," whereby a decline in military-security issues in the 1990s, gave rise to a foreign policy agenda more focused on issues which directly impact subnational governments—such as free trade, environmental issues, human and labor rights, and economic development. In addition, this literature points out that the scope of foreign policy issues has expanded widely in an era of increased information flows, technological innovation, and complex economic interaction; national governments are ill-equipped to handle the growing complexity of global economic interactions, and they therefore seek to delegate responsibility to the subnational level, or, where they do not, subnational actors may move in to pick up the slack in an unmanageable foreign policy milieu. Some studies have also argued that the rise in subnational involvement in the international arena is linked to a decline in confidence in central government management. Hocking concludes that: "An ever-growing range of local groups and governmental agencies perceive themselves to be affected by events outside their national settings, and have the motivation, resources and opportunities to respond by projecting their interests at both the national and international level." In sum, studies in this vein argue that globalization has a decentralizing effect on nation-states (and federations in particular), but they do not explore the differential effects of those forces across subnational governments. For this reason, these studies to not readily lend themselves to generating explanations for variation in regional policy.

56 Ibid., p. 13.
57 Ibid., p. 15.
58 Shuman, "Dateline Main Street," p. 170.
Most of the literature on federalism and globalization focuses on the proactive efforts of subnational governments to engage global capital flows. The literature argues that globalization has a decentralizing effect on nation-states, but because it focuses on subnational success stories, it does not theorize on the differential effects of globalization across subregions, nor does it examine cases in which subregions do not seek to engage globalization. For this reason it does not lend itself to an explanation for variation in regional-level policy.

**Fiscal Federalism and Globalization**

While most studies of federalism and international economic affairs emphasize the decentralizing effects of global capital on federal states, a recent study by Geoffrey Garrett and Jonathan Rodden makes the opposite argument: Garrett and Rodden argue that globalization leads to fiscal centralization in federal states. Using data from forty-two countries (but not the Russian Federation), they argue that demands for fiscal centralization come from the subnational governments themselves—from politically complacent regions (those in which there is no secessionist movement), and also from restive regions engaged in international economic activities. Garrett and Rodden cite Daniel Treisman's work on fiscal federalism in the Russian Federation to argue that, in the face of secessionist threats from some provinces (they note oil-rich Russian republics in particular), less restive regions may be willing to pour more money into federal coffers, leading to fiscal centralization: "To the extent that there are benefits to the rest of the country from keeping breakaway regions in the union, the rest of the country may be

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willing to send disproportionately large transfers to such regions to buy their cooperation. Knowing this, of course, such regions face incentives to amplify their threats. This is a familiar story in post-Soviet Russia. Garrett and Rodden argue that globalization exacerbates this situation (greater demands from poorer regions for centralization) because as wealthy regions globalize, they demand higher pay-offs for stalling secession:

"...trade integration increases centralization because it increases the price in terms of fiscal redistribution from other areas that localities demand not to secede." Garrett and Rodden argue that wealthy globalizing regions also demand fiscal centralization because engagement with the global economy is inherently risky. They point out that decentralized systems provide "less cushioning of adverse economic shocks through fiscal policy," and argue that: "Powerful regions know that it is centralized systems of taxing and spending, rather than decentralized ones, that are likely to deliver the most fiscal redistribution in favor of their citizens. Hence, globalization increases fiscal centralization." In sum, they argue, "the more globalization proceeds, the stronger will be the demands from "at risk" localities to centralize fiscal policy."

Garrett and Rodden's study suggests that provinces that are benefiting from global capital flows, and particularly oil-rich Russian provinces, are likely to demand fiscal centralization, and that provinces that do not benefit from globalization will also demand fiscal centralization. In this dissertation, I find no evidence of demands for fiscal centralization among the Russian Far Eastern provinces. In all cases, provinces were

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anxious to increase the amount of funding from Moscow, but all the provinces also
sought to decrease the flow of money out of the locality to the center. In other words, the
Russian provinces sought to retain tax revenues in the locality, at times refusing to send
tax payments to Moscow, and also demanded increased transfers from the center; this did
not, however, translate into demands for fiscal centralization. In general, Garrett and
Rodden's framework does not appear to apply to the case of the Russian Federation. As
noted above, Daniel Treisman's work on fiscal federalism in Russia depicts a strategic
central state engaged in paying off potentially secessionist regions, but makes no
argument about regional demands for fiscal centralization to stem secessionism.65 Also,
Treisman's work on secessionism in ethnic republics found no correlation between
regional oil wealth and secessionism or fiscal transfers.66

Finally, in the Russian case, the relationship between globalization and fiscal
relations is tenuous. Garrett and Rodden argue that fiscal relations are key to
understanding subnational government involvement in the global economy: "Central
governments might ostensibly decentralize "formal" authority by increasing the
constitutional responsibilities or freedoms of subnational governments, by setting up
regional parliaments, or by introducing elections for municipal officials. But if increased
taxing authority or intergovernmental transfers do not accompany these moves, they will
not change the "rules of the game" in any substantial way."67 In Russia, however,
regional governments control and benefit from global capital flows in a wide variety of
ways which are not reflected in regional budgets or in intergovernmental transfers. Even

64 Ibid, p. 8.
65 Treisman, 1999.
if fiscal relations in Russia did exert an influence on globalization, a focus on regional budgetary transfers does not reflect regional influence: Garrett and Rodden define decentralization as the subnational shares of total public sector revenues and expenditures; in Russia, this is extremely difficult to measure. Alexei Lavrov, a prominent Russian specialist on fiscal federalism, has noted that only some 15 percent of fiscal flows from Moscow to the regions go through the regional budget.68 Treisman's study takes two types of flows into account: budgetary transfers (which amounted to 3.4 percent of GDP in 1994), and "directed credits" from the Central Bank (which amounted to 5 percent of GDP in 1993). Other important types of transfers are, however, impossible to track. Treisman notes that "off-budget funds" amounted to 8 percent of GDP in 1994, but there is no data on the regional distribution of this funding. Similarly, he notes that there is no data for the regional distribution of "discretionary benefits" which amounted to 2.5 percent of GDP in 1992.69 In sum, the degree of de-facto fiscal decentralization or centralization in Russia cannot be ascertained by investigating data on public sector revenues and expenditures,70 and the multitude of informal interactions among regional governments, economic actors in the locality, and foreign capital provide a wide range of regional levers over globalization which are far more effective and powerful than regional government control over public sector moneys. For this reason, the empirical chapters do not focus on the impact of FDI on fiscal relations between the Russian regions and the center.

67 Garrett and Rodden, pp. 1-2.
68 Author's interview with Lavrov, Moscow, March 13, 1996.
69 Treisman 1999, pp. 53-54.
70 Solnick also argues that the data on fiscal transfers in Russia is so poor that it is impossible to assertion how centralized or decentralized the system truly is. Solnick, 1996, pp. 17-18.
Ideas

Ideational explanations which focus on the beliefs and perceptions of political and economic actors—generally referred to as the "constructivist" approach—provide another way to explain regional policy variation. According to ideational explanations, we can explain variation in policy outcomes by examining how actors think about the world around them. In short, different ideas lead to different outcomes. Constructivist analysis differs from materialist explanations which focus analytical attention on objective circumstance. As David Lake and Robert Powell explain, materialist or rational choice approaches focus on "analyzing the strategic setting in which individuals make choices, rather than how they process information..."71 Constructivist approaches, on the other hand, focus on individuals' subjective interpretation of reality. Materialist approaches generally assume actor self-interest and argue that because actors seek to "maximize utility," (commonly understood as the pursuit of wealth and power), we can best explain policy outcomes by examining factors such as institutional constraints, economic factor endowments, and information asymmetries. Constructivist approaches argue that because individual interpretations of objective circumstance differ, actors facing the same set of objective circumstances may generate very different responses.

Critical Junctures

Ideational explanations are particularly appealing in the context of Russia's transformation, precisely because Russia is in crisis: In the Russia field and beyond, ideational explanations are most potent at times of crisis when institutions are in flux. In

71 David A. Lake and Robert Powell, "International Relations: A Strategic-Choice Approach," in David A. Lake and Robert Powell eds., Strategic Choice and International Relations, Princeton
other words, ideas become particularly important when central signals are weak. Drawing on the broader literature on ideas, studies which proffer ideational explanations for outcomes in Russia emphasize the importance of an "enabling context," or "critical juncture." Jane Prokop's comparative study of industrial policy and marketization in the Russian regions, for example, calls attention to the fluidity of Russian politics and society to explain the prominence of ideas in explaining regional government decisions about the level of involvement in the economy. 72 Referring to "critical junctures," first elaborated by Lipset and Rokkan in 1967, 73 Prokop notes that at times of crisis, such as the dissolution of the Soviet Union and the dismantling of Soviet institutions, "we cannot point to a stable pattern of interests and incentives created by well-established institutions." 74 Similarly, in a study of secessionism in Russian regions, Yoshiko Herrera points to the importance of an "enabling context"—massive institutional breakdown, glastnost, and perestroika. 75 Outside the Russia field as well, scholars who point to the role of ideas emphasize ideational response to dramatic policy shocks, failures or crises in which past institutions are discredited and ideas form the bases of new solutions to unprecedented crises. 76 Mark Blyth's recent study of 20th century liberal institutions in the United States and Sweden, for example, emphasizes the importance of ideas under

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74 Prokop, p. 29.
conditions of economic crisis---what Blyth refers to as Knightian uncertainty, defined as "situations regarded by contemporary agents as unique events where the agents are unsure as to what their interests actually are, let alone how to realize them." Russia's economic and political crisis of the 1990s certainly qualifies.

**Ideas and Interests**

One of the primary tasks of the constructivist project has been to explore the interaction between ideas and objectively defined material interests. In this endeavor, constructivist approaches make two main arguments: According to one argument, ideas serve actors' interests by providing different ways to achieve assumed material goals. These analyses do not question the material nature of assumed goals---wealth and power as in the rational choice tradition---but they do argue that the ways in which actors chose to pursue these goals cannot be derived from objective circumstances such as economic structure or institutional configuration. Another constructivist argument holds that ideas and interests are analytically inseparable and cannot be considered as mutually exclusive categories. Analyses in this vein explore the ways in which ideas shape actors' interests.

Max Weber's classic formulation of the relationship between ideas and interests underlies the first constructivist approach. In Weber's analysis, "Not ideas, but material and ideal interests, directly govern men's conduct. Yet frequently the 'world images' that have been created by ideas have, like switchmen, determined the tracks along which.....

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action has been pushed by the dynamic of interest."\textsuperscript{78} A number of constructivist studies fall into this category of argument. Peter Hall's study of the spread of Keynesian ideas, for example, argued that ideas become powerful when they are streamlined with the structure of a nation's political discourse and serve to strengthen the political power of ruling parties.\textsuperscript{79} Similarly, G. John Ikenberry's study of the Anglo-American post-war settlement argued that ideas operate as switchmen and serve to facilitate cooperation amongst a group of actors whose interests are assumed.\textsuperscript{80} Among post-communist analyses, Keith Darden's study of post-Soviet states' response to regional institutions, similarly assumes that states are interested in maximizing economic returns, and argues that the paths states chose towards that end vary according to the ideational framework which informs government actors. In Darden's words, "...the intent of the study is to explain why different governments believed different economic institutions were necessary to obtain the same end goal of material welfare."\textsuperscript{81}

Approaches which differentiate ideas from interests have been criticized by a number of scholars who argue that ideas and interests should not be held analytically separate. Alexander Wendt, for example, has argued that interests need to be understood in terms of actors' beliefs about what is desirable, or simply put: "we want what we want


\textsuperscript{81} Keith Alexander Darden, \textit{The Origins of Economic Interests: Economic Ideas and the Formation of Regional Institutions among the Post-Soviet States}, Ph. D. Dissertation, University of California, Berkeley, 2000, p. 98.
because of how we think about it."82 Similarly, Mark Blyth has argued that "we require a...conceptual reformulation—that is, to break the long-standing tendency within political science to hold ideas and interests as mutually exclusive analytic categories."83 Blyth argued that "analysts should see interests as being necessarily ideationally bound...."84 Analyses such as those by Wendt and Blyth reflect changes in the field of economics where the assumption of rationality in economic decision-making has been challenged by studies drawing on the field of psychology. Such studies introduce evidence from the fields of cognitive psychology and behavioral economics to demonstrate the impact of emotions and other biases on decision-making. The most celebrated of these is a seminal paper written by Princeton psychology professor Daniel Kahneman who was awarded the Nobel Prize in Economics in 2002. Kahneman's award winning paper, which appeared in the economics journal *Econometrica* in 1979, examined decision-making under risk, and argued that individuals' perceptions of value, not objectively-defined value, drive economic decisions.85 Other important works in this genre argue that contextual variables including the point of initial reference, the manner in which preferences were elicited, the prominence of norms of fairness, and wording or framing, all lead to deviations from rational choice predictions.86

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84 Blyth, p. 34.
In line with the arguments put forward by Kahneman, Blyth, and Wendt, this dissertation recasts material interests in terms of ideas. By this argument, actors' pursuit of material wealth or power cannot be assumed; instead, a desire for wealth or power is the product of a particular idea, namely the notion that the accumulation of wealth and power constitutes a desirable goal in and of itself. In this way, the dissertation opens up the range of potential goals that actors pursue in the formulation of economic policy. I introduce this range in the section which summarizes my argument below.

**Ideas and Outcomes**

One of the most important and challenging tasks of the constructivist project is to demonstrate causality. Constructivist analyses to date have identified a number of ways in which ideas influence policy outcomes. Judith Goldstein and Robert Keohane distinguish among three categories of ideas which they argue exert a causal effect over outcomes: world views, principled beliefs, and causal beliefs. They define world views as the "universe of possibilities for action," principled beliefs, as normative distinctions between right and wrong, and causal beliefs as ideas about cause and effect.87 Ideas affect policy by providing "road maps" which help individuals to identify their preferences, by acting as "focal points" which facilitate coordinated decision-making, and in the long-term, by embedding themselves in institutions.

Most constructivist studies emphasize the causal power of ideas as they become embedded into institutions. In their study of policy responses to the Great Depression, for example, Theda Skocpol and Margaret Weir argued that the transformative power of

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87 Keohane and Goldstein, pp. 8-10.
ideas is predicated on the degree to which institutions are open or closed to new ideas.\textsuperscript{88} Similarly, in her study of developmentalist ideas in Brazil and Argentina, Kathryn Sikkink argued that successful implementation of a developmental economic model in Latin America depended on the degree to which developmentalist ideas became embedded in state institutions.\textsuperscript{89} In a parallel argument, Sheri Berman argued that ideas played a critical role in determining the course of interwar politics in Germany and Sweden, once they became embedded in Social Democratic Parties. Berman argued that "to be heard in a world where many views call out for attention, an idea must first be adopted by a person or group able to make others listen."\textsuperscript{90}

Mark Blyth's study of institutional change in the United States and Sweden offers a sequential causal argument which examines the impact of ideas beyond their power in the institutional context. Blyth's analysis proceeds in five steps: First, he argues, in periods of crisis, ideas provide a mechanism to interpret the crisis and thereby reduce uncertainty. Here Blyth's argument draws on the broader constructivist argument about the importance of critical junctures. Second, paralleling Goldstein and Keohane's argument about "focal points," Blyth argues that ideas facilitate collective action and the construction of coalitions. Third, Blyth argues that actors use ideas to delegitimate existing institutions—what Blyth calls institutional contestation. Fourth, in a prelude to embedding, ideas provide blueprints for the construction of new institutions. Fifth in line

\textsuperscript{88} Theda Skocpol and Margaret Weir, "State Structures and the Possibilities for Keynesian Responses to the Depression in Sweden, Britain and the United States," in Peter B. Evans, Dietrich Rueschemeyerm and Theda Skocpol eds., \textit{Bringing the State Back In}, Cambridge: Cambridge University Press, 1985, pp. 107-163.


with the constructivist literature on ideas and institutions, Blyth argues that ideas become embedded into institutions and thereby promote institutional stability by coordinating expectations.\(^{91}\)

**Ideas and Policy Outcomes in the Russian Regions**

A number of recent studies of post-Soviet transition have used ideational factors to explain a range of outcomes from secessionist movements in the provinces, to government intervention in the economy, to privatization strategies, and decisions about international economic relations. In addition, even in more materialist analyses of the transition—those which emphasize institutional configurations or intergovernmental relations, the literature on transitions has witnessed creeping references to beliefs, principles, and ideology.\(^{92}\) Two studies in particular have explored the ways in which ideas influence policy outcomes at the regional level: one by Jane Prokop and another by Yoshiko Herrera.

In a study of industrial policy in Sverdlovsk, Irkutsk, and Primore, Jane Prokop argued that the beliefs of individual policy-makers—most importantly regional governors—determined the level of regional government intervention in the economy. Drawing on the Judith Goldstein and Robert Keohane's concept of "causal beliefs,"\(^{93}\) Prokop found "systematic co-variation between the level of government intervention, and regional policymakers' belief about the causal mechanisms at work during the transition

\(^{91}\) Blyth, pp. 34-44.

\(^{92}\) Stoner-Weiss' analysis of bilateral treaties and "contractual federalism," for example, argues that conflicts between the regions and the center reflect "conflicting perspectives on the shape of the Russian state" (emphasis added).

\(^{93}\) Judith Goldstein and Robert O. Keohane, "Ideas and Foreign Policy: An Analytical
to the market." In particular, Prokop drew a distinction between regional governors who believed that transition to the market could be achieved through use of foreign capital and those who believed that foreign capital could not meet regional investment needs. Governors with prior Soviet-era exposure to the West (Sverdlovsk), Prokop argued, believed that market transition could be achieved with the use of foreign capital and therefore favored less government intervention in regional economies. Conversely, governors who had limited experience with the West (Irkutsk and Primore) lacked faith in the benefits of foreign capital and favored active government intervention in the economy.

Yoshiko Herrera's study of the secessionist movement in Sverdlovsk offers a different approach to the use of ideas as explanations for policy outcomes—one which focuses on popularly-held beliefs. Like Prokop, Herrera found that objective economic factors could not account for policy outcomes. Rather than focusing on the causal beliefs held by regional governors, however, Herrera argued that "imaginings" or "prototypes" of the regional economy—widely-held beliefs which Herrera culled from regional newspapers—accounted for policy outcomes. Comparing Sverdlovsk's secessionist movement with Samara, where no such movement arose, Herrera argued that "the difference between outcomes in Sverdlovsk and Samara regarding movements for greater sovereignty ultimately was that, in comparison to Sverdlovsk, in Samara there were less negative prototypes of the economy and therefore a less nurturing context for the

Framework," in Goldstein and Keohane eds., Ideas and Foreign Policy, 1993, pp. 3-30.
94 Prokop, p. 28.
elaboration and resonance of the idea of constitutional and economic inequality towards Samara in the Russian Federation. "95

Both of the regional studies elaborated here could provide the basis for an ideational explanation of regional FDI policies. However, in the cases examined in this dissertation, I found that neither approach adequately explained the variation in regional FDI policies which I observed. In my cases, I found that widely-held beliefs about the economy—particularly as reflected in regional newspapers—generally reflected the policies of the regional government. This was because the governors effectively owned or directly controlled the regional press. Thus the lines of causation I observed are the mirror opposite of those in Herrera's analysis: In Sverdlovsk and Samara, Herrera argued, popularly-held "imaginings" about the economy accounted for regional policy outcomes—the presence or absence of a secessionist movement. Conversely, in the Far Eastern cases, I found that popularly-held beliefs (as reflected in newspaper articles) were the result, not the cause, of particular policy directives taken by the regional governors.

My findings more closely approximate Prokop's argument that policy outcomes are a reflection of the ideas held by powerful regional policymakers. My findings, however, differ from Prokop's in several respects. First, where Prokop argued that regional governors with prior exposure to the West favored foreign investment into regional economies, I found that this was not the case in the regions which I studied. On Sakhalin, for example, a governor with limited exposure to the West developed pro-FDI policies; conversely, I found that in the case of Khabarovsk, a governor with comparatively greater exposure to the West displayed minimal interest in attracting

95 Herrera, p. 250.
foreign investment to the region. Second, where Prokop argued that regional governors who opposed FDI did so because they believed that foreign investment could not meet regional needs, I found that all the governors I interviewed were well aware of the potential benefits of foreign investment; governors who chose not to engage foreign investors, or who actively opposed foreign investment, were aware of the opportunities, but still chose not to take advantage of them. Finally, Prokop draws a causal link between openness to foreign investment and low levels of government interference in regional economies. As indicated in the discussion on networks above, in my cases I found that government interference in the economy did not preclude openness to FDI: Indeed, I found that in the case of Sakhalin, direct government interference in regional enterprises paved the way to a pro-FDI policy. Thus, while this dissertation builds on Prokop’s argument about the impact of regional governors’ ideas on policy outcomes, the I find that the ideational mechanisms which Prokop identifies in her study do not explain the outcomes I observed in my cases.

**Summary of the Argument**

This dissertation explains regional FDI policies in ideational terms. It argues that regional FDI policy variations can best be explained by examining the ideas of the powerful regional governors—ideas about the nature of the crisis facing post-Soviet Russia, the genesis of that crisis, and the meaning of key new concepts in the federal context. These ideas, I argue generated policy outcomes which then gradually became embedded in regional institutional structures. This section provides an overview of the argument. It proceeds from a "critical juncture" and lays out five ways in which ideas
drive policy outcomes. The argument builds on Mark Blyth's five-part presentation of ideational impact, but differs from Blyth's approach both in the causal mechanisms and in sequencing. While the order of presentation suggests sequential ideational impact, as Blyth argued, the dissertation also notes "feedback effects" among the different impacting mechanisms.

**Critical Junctures and Russia's Identity Crisis**

Like the ideational arguments discussed above, the argument of this dissertation proceeds from a particular "critical juncture." I have already elaborated the main institutional and legislative elements of that juncture in this chapter and in chapter 1, so I will simply review the critical elements here: They include the dissolution of the political and economic institutions of Soviet power, their replacement with the new institutions of the federal state, and the profound state of economic crisis in which the regions found themselves. From the point of view of the regions, the most important institutional changes were those which elevated regional governors to unprecedented positions of power: These included the relative power of regional executives over legislatures and the increased power and legitimacy which popular gubernatorial elections granted the governors. In addition, several important aspects of the reform process gave governors new formal and informal mechanisms of control over regional policy including policies which affected FDI inflows. First, the Russian Federation's legal framework in areas relating to FDI was largely declarative in nature and failed to draw clear distinctions between regional and central jurisdictions. Second, the legal framework fluctuated rapidly and often over the course of the 1990s giving rise to a fluidity which made it
difficult for regional leaders to keep up, and opened the door to diverse regional interpretations. Third, laws pertaining to FDI at both the national and regional levels were often mutually contradictory leading to considerable confusion and allowing the newly powerful governors to generate ad hoc de-jure and de-facto policies. Within this context, the dissertation argues, governors' ideas about the genesis of economic crisis and the appropriate measures to address it came to play a decisive role in regional FDI policy outcomes.

In addition to Russia's institutional and economic crisis, this dissertation draws attention to the profound identity crisis which underlies Russia's economic and political transformation following the collapse of Soviet power. Here the dissertation builds on other studies which note the importance of ideational and identity issues in the post-Soviet period. Steven Solnick's work in particular, notes the weakness of post-Soviet Russia's identity, pointing out that "Russian leaders and the Russian people have faced the challenge of reconceiving the Russian state as a post-Imperial power." So acute is the crisis of identity in Russia, Solnick writes, that "the new Russian national anthem still has no lyrics [and] Boris Yeltsin actually appointed a presidential commission of scholars in 1996 to devise a new 'Russian national idea.'"96 After a year during which the commission published a collection of articles entitled "Russia in Search of an Idea," the commission wrapped up its work inconclusively.97 Solnick's discussion of weak state identity in the aftermath of Soviet collapse points to the importance of ideas and identity

97 Nezavisimaya gazeta, August 9, 1997.
in the dual processes of state-building and globalization. This absence of a solid state identity, I argue, opened the door to alternative regional interpretations of economic and political reform, which provide the point of departure for a variety of regional policy outcomes.

The ideational vacuum emanating from Moscow after Soviet collapse was not the only source of Russia's identity crisis. Russia's reform programs, notably privatization, represented a fundamental ideological break with the communist past, but the reformers failed to make a strong popular case for the new economic order. Most academic analyses of post-Soviet Russia's economic transformation have skirted the issue of ideological change in favor of a focus on institutional change, but the architects of reform themselves were not shy about articulating the ideological foundations of the economic changes they sought to bring about. Indeed, the reformers were explicit about the ideological underpinnings of their undertaking, and used words like "ideas" and "beliefs" to describe the foundations of the economic reform process in Russia. They argued that privatization "drew its momentum from the power of...key economic ideas," spoke of "fundamental beliefs," the most important of which was a conviction that "the Russian people, like the rest of the people in the world, were 'economic men' who rationally responded to incentives." In short, economic reform in Russia was as much an ideational struggle as it was an institutional endeavor. It should not be surprising, therefore that much of the opposition to economic reform was ideationally inspired. The opponents of reform had different ideas about reform. They believed that an equitable redistribution of property to common Russian citizens, not the bottom line, should be the primary concern of the

privatization process. Leaders from Civic Union and the Russian Union of Industrialists and Entrepreneurs objected to mass privatization precisely because they believed that rather than redistributing property, the program would concentrate ownership in the hands of a privileged few.100 Disparate views on privatization were the primary point of contention in the September 1993 showdown between Yeltsin and the Russian Parliament which ended when Russian tanks fired into the Parliament building.

The ideational underpinnings of economic reform did more than excite opposition. The very nature of the belief system which underpinned economic reform—what Mike McFaul has called the "neoliberal philosophy" which placed its faith in the invisible hand of the market—actually contributed to the crisis. McFaul makes this argument most eloquently in his analysis of Russian privatization. He argues that the ideational foundations of market reform in Russia precluded the creation of viable institutions to support that reform: "Because of their militant belief in the power of the invisible hand, Gaidar's team did not envision a role for the state in creating market-supporting institutions. Rather, these institutions were to form spontaneously. In Russia, however, this ideological perspective proved to be fundamentally flawed....Russia needs a state policy that would create and nurture market-supporting institutions. The lack of attention to the role of the state in this process, coupled with the weakness of the state more generally, has resulted in a dearth of several key institutions critical for free enterprise."101 In sum, faith in "neoliberal philosophy," in McFaul's terms, or "economic man," in Schleifer's terms, translated into an inattention to economic institution-building.

99 Boycko, Schleifer, and Vishny, pp. 8-9.
The prolonged weakness of economic institutions throughout the 1990s contributed to a lack of direction and coherence in economic policy which opened up the space for a range of ideational interpretations of the reform process. Where institutions were wanting, therefore, elite ideas about economic reform exerted an unusually strong influence over institutional functioning and de-facto policy. At the regional level, ideas were instrumental in building institutions and determining how they actually functioned. This process was clearly in evidence in the realm of FDI policy, which, as indicated above, was plagued by institutional and policy weakness.

The faith of Russian reformers and the Russian government in neoliberal philosophy and the concomitant assumption that the Russian people were "economic men," gave rise to two interlinking tendencies which exacerbated the identity crisis. First, the reformers did little to promote popular support for market reform because they assumed that most Russians were economically motivated and that embracing institutions such as private property would be the natural course of events. Second, as a result of this assumption, they failed to provide a strong ideational context for reform which could generate popular support for the process. In this, Russia stands in striking contrast to other transitional economies where leaders consciously linked the reform process to motivating ideas such as those associated with nationalism. China's leaders, for instance, recast the debate over privatization in nationalist terms; as Mary Gallagher argues: "Privatization has become acceptable because it is justified in nationalistic terms—it will save Chinese industry from the threat of foreign competition." \(^{102}\) In Eastern Europe as

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well, privatization was accompanied by "ideological reinforcing mechanisms" which
couched economic reform in terms of a nationalist, anticommunist and pro-European
undertaking. As Hilary Appel argues: "In the Czech Republic the reformers strengthened
the case for privatization by portraying it as anticommunist (for example, with the
Property Restitution laws) and pro-European (with the institutionalization of a private
system of ownership)—and thus they argued, essentially Czech."\textsuperscript{103} Russian reformers,
conversely, consciously steered clear of "Russian cultural symbols or historic referents,"
in the process of implementing privatization, because "any campaign linking privatization
to specifically Russian cultural or historic symbols or any revision of the program to
make it appear particularly suited to the Russian context would imply that Russians do
not respond rationally to material incentives."\textsuperscript{104} In the Russian regions, this lack of
strong ideational underpinnings, I argue, created the conditions for variation in the
interpretation of reform, which resulted in divergent regional policy outcomes.

Part 1: Crisis? What Crisis? Ideas identify the salient crisis

In 1991, the Soviet Union underwent a change of momentous proportions which
affected the Russian regions in a range of critical areas. The crisis in the regions cannot
be reduced to one area: It was simultaneously economic, political, and institutional.
Institutionally, the relationship between the regions and the center underwent drastic
restructuring. Where under the Soviet system the regions were "prefects," as Jerry Hough
described them, and primary power resided in Moscow, in the new federal order, regions
became "Subjects of the Federation" with dramatically increased powers both vis-à-vis

\textsuperscript{103} Appel, p. 540.

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Moscow and within their own regional jurisdictions. Politically, where political life had been dominated by the Communist Party of the Soviet Union, regional and federal elections and a range of political parties operated in a new democratic system. Economically, decentralization and reform accompanied a severe crisis in which industrial production dropped precipitously, salaries went unpaid, and social security benefits withered away.

In discussing responses to economic reform, most analyses intuitively turn to responses to the economic crisis itself. In the regions, the economic crisis was certainly a matter of considerable concern. However, regional leaders differentiated among the different facets of change in Russia, and economic crisis did not always top the list of their priorities. For some, the primary crisis was the rearrangement of center-periphery relations under the federal system. For others, the political changes wrought by the collapse of the Soviet Union—namely the lack of "political unity" brought about by the democratic system—were of central concern. Some did focus on the economic crisis itself as the first order of business. In order to understand how regional elites formulated regional FDI policy, the first step therefore, is to understand how they defined the crisis at the outset. Particularly for those regions which did not set economic crisis as their first concern, the evolution of regional FDI policy needs to be understood within the context of regional priorities.

104 Appel, p. 538.
Part 2: *Kto vinovat?* Ideas explain the causes of economic crisis

In the 1990s, the Russian economy experienced a shock of momentous proportions—both because the economic system of the Soviet Union with its links to the Union Republics collapsed, and also due to the shock of the economic reform policies themselves. In the years following Soviet collapse, the leaders of the new Russian Federation sought to make sense of what had happened. For reformers, the explanation for the state of the Russian economy lay in the structure of the Soviet past. In their book on Russian privatization, Boycko, Schleifer, and Vishny point in particular to the problematic influence of politics over economics in the Soviet system, arguing that: "...political influence over economic life was the fundamental cause of economic inefficiency..."105 Others, however, argued that economic chaos in Russia was a direct result of Gorbachev's economic reforms and the resulting break-up of the Soviet Union. Still others blamed the reformers and the reform process itself which they believed was undermining the inherent strength of the Russian economy. In the absence of central consensus on the causes of the crisis, the powerful new governors developed their own explanations for the state of economic affairs.

Building on Goldstein and Koehane's concept of "causal beliefs" and Mark Blyth's argument about the importance of explanations for crisis, the dissertation argues that the way in which governors understood and explained the post-Soviet economic crisis in their regions was critical to the subsequent formulation of regional-level policies—including policies that affected FDI inflows. Mark Blyth has argued that the ways in which critical actors diagnose economic crisis determines the policies they

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105 Boycko, Schleifer, and Vishny, pp. 10-11.
develop to address it. Referring to the economic crisis of the 1930s for example, he explains: "...if one accepts a diagnosis of the economic slump as a result of insufficient purchasing power, then one's interest lies in voting for a reflationary social democratic party. If one accepts the diagnosis of the crisis as due to the machinations of "World Jewry," then regardless of factorial position, structural location, or asset specificity, one's interest lies in promoting genocide." 106 Governors in Russia developed a range of explanations for the crises they faced in their regions. When Moscow ceased to be forthcoming with subsidies, a number of regional leaders explained economic crisis as the result of Moscow's default on its responsibilities. Others blamed the defunct Soviet system itself, claiming that Soviet economic planners had undermined the viability of regional economies. Still others placed the burden of responsibility on the shoulders of mysterious foreign forces and their reformist allies in the Kremlin, all intent on destroying Russia's economy, (and possibly also responsible for the dissolution of the Soviet Union). Between 1991 and 1993, these various explanations were hotly debated in the regions, at times between governors and regional opponents, at others within the regional administration itself. The outcome of these debates—and the answer to the old Soviet question, "who is to blame" or "kto vinovat?"—was critically important in determining the future course of regional FDI policies. By the middle of 1993, regions settled on one explanation, and although debate on this question continued, the general contours of regional explanation for the crisis had taken shape. In some cases, resolution of the debate coincided with the removal of one governor and his replacement by another.

106 Blyth, p. 32, ft. 67.
In other cases, the regional administration simply resolved the question internally to its own satisfaction.

**Part 3: Westernizers and Slavophiles? Ideas (Re-)Define Key Concepts**

In the Soviet Union, people knew where the belonged. They knew that they were members in a Union of Socialist Republics, they knew that theirs was a communist country and that capitalism was anathema to socialism, they knew that defending communism was a glorious national endeavor and many had fought and died in several wars to defend the national honor and the glory of the socialist way. When the Soviet Union imploded, the legitimacy of these beliefs went with it. In their place came new concepts: democracy, reform, and "Subject" of the Federation. Few in Russia had a clear notion of what these concepts were intended to convey or how they related to their new nation. In the ideological vacuum and institutional morass of the 1990s, regional leaders developed their own ideas. For some, democracy was simply a new tool to consolidate power in their own hands, or conversely a ploy by economic tycoons to grab power from the people. To others, it was a step on the path to a modern Westernized civilization, away from the dark Slavophile past. Some equated economic reform with a premeditated effort to rob Russia of its wealth and status; for others it embodied liberation from the shackles of Soviet planners. The new status of the region too came under scrutiny. Some governors saw their role akin to that of faithful serf to distant patriarch; others saw themselves caste out of the national whole and the victim of central neglect; yet others saw the region as an integral member of a new federative community. In the context of these interpretive understandings of the changing ideational context, regional governors
struggled to define a new national interest. What did it mean to be a patriotic region in the new Russia? Some believed that patriotism meant building a strong regional economy; others argued that re-establishing close linkages to Moscow was the best way to serve the national interest; for yet others, the most patriotic act was to oppose foreign influence of any kind. With Moscow providing no clear leadership on what the national interest actual was, regional governors developed their own range of ideas.

Part 4: What is to be Done? Ideas Generate Legitimate Policy Alternatives

The ideological angst in which the new Federation was born was accompanied by a more specific concern about what exactly should be done to embark on a new, if murky, road. The institutional parameters and legislative acts governing economic reform and FDI in the new Russian Federation were unstable and amorphous, and to the regions, provided no clear signals on the direction that FDI policy should take. This situation presented regional leaders with a wide range of possible de-jure and de-facto policy alternatives. Under these circumstances, I argue, it was the ideas of the powerful regional governors—ideas about the nature of the crisis, its genesis, and what key concepts of the reform process really meant—that drove policy formulation. Here the dissertation builds on constructivist studies which argue that policy choice is predicated upon the belief systems of leadership. Jane Prokop's study discussed above, for example, explained levels of regional marketization in terms of the beliefs of regional governors. Another study, by Keith Darden, explained economic policy outcomes in the Soviet successor states in terms of distinct "ideational frameworks"—organicist, market-liberal, and

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mercantalist—which informed the thinking of state leaders. In a similar argument, Rawi Abdelal's study of economic policy-making in post-Soviet states explained policy variation in terms of leaders' interpretation of economic dependence on Russia.

In this dissertation, I distinguish three broad policy alternatives by which regional leaders addressed FDI: isolationist policies, which were geared to blocking FDI inflows into the region; nationalist policies, which focused on developing a federation-wide (as opposed to a region-specific) FDI policy; and internationalist policies, which worked specifically to draw FDI into the region. Policy selection, I argue, was predicated on a set of ideas. Isolationist policies were a product of a particular set of ideas embraced by those regional leaders who believed that the break-up of the Soviet Union and political reform were the primary crises facing the region, that responsibility for economic crisis lay with foreigners and their traitorous Russian allies, and that patriotism in the new Russia meant the eviction of alien forces from Russian territory. Nationalist policies, I argue, emerged when leaders believed that the primary crisis they faced was the disruption of center-periphery relations brought about by decentralization, that the cause of economic crisis was Moscow's abdication of its regional responsibilities, and that patriotism meant the re-establishment of a "national whole" through the strengthening of relations between the region and the center. Internationalist policies were the product of yet another belief set, one by which regional leaders believed that economic crisis was of paramount concern, that the cause of that crisis was the legacy of the Soviet system, and that patriotism meant the enrichment of regional economies.

Step 5: Forward to a bright future! Ideas become embedded in institutions

Given the relative youth of Russia's Federation, it is perhaps too soon to judge the durability of regional policy initiatives or the strength of the institutional arrangements which arose to support them. Nonetheless, the cases presented in this dissertation provide evidence of a surprising durability of regional FDI policy directives from 1993 on through the end of the decade. As noted above, much of the constructivist literature, as well as the literature on historical institutionalism, points to the important influence of institutionally embedded ideas over policy outcomes. Work by Skocpol and Weir, Sikkink, and Berman all discuss the role of ideas as they operate in the institutional context. Jane Prokop's ideational approach to regional economic policy outcomes also points to the role of institutionalization, and argues that "new political institutions tend to be more a result than a cause of policymaking."109 In the Russian Far Eastern regions, the institutional arrangements governing FDI and economic policy in general developed as a result of gubernatorial policy initiatives, and those initiatives, I argue, were ideationally inspired.

The empirical chapters lay out the ways in which governors insured policy continuity, both during their own tenure and across administrations, so that a path-dependent policy emerged following an initial period of debate between 1991 and 1993. The power of gubernatorial office meant that most of the key regional institutions were effectively beholden to the governor. Thus governors were able to control appointments to important offices such as the Regional Privatization Funds, the courts, and branch federal offices, as well as reaching into the regional legislature and local enterprises.

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109 Prokop, Abstract.
Either through direct power of appointment, or through informal mechanisms of control, governors ensured that those who shared their beliefs controlled key positions in the region. Measures such as these, I argue, ensured the durability of beliefs systems beyond the tenure of particular governors.

Methods and Research

Demonstrating ideational causality is challenging. In a constructivist analysis of the origins of the European Union, Craig Parsons highlights one of the primary methodological challenges for ideational arguments, which he calls the "Janus-faced" nature of ideas: "Sometimes actors' beliefs guide their actions; sometimes apparent beliefs only rationalize strategies chosen for other reasons."\(^{110}\) Parsons suggests two approaches to address this difficulty. The first, a widely used social science methodology, is "process tracing," whereby "the observer traces the objective pressures impinging on certain decisions and concludes that they did not fully determine a choice. Thus we need to interpret the beliefs that did."\(^{111}\) A second method is comparison across structurally similar cases with varying policy outcomes. In this dissertation, I use both methods. In the empirical chapters, I trace the development of FDI policies and examine their operation in the context of the region's key export industry. In each case, I consider the degree to which materialist explanations can explain policy outcomes, show where materialist arguments cannot explain outcomes, and introduce an ideational argument

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which I argue does explain those outcomes. In the conclusion, I tie my findings together and offer a comparison across cases which highlights the ideational variation across regions.

The evidence offered in this dissertation comes from a range of sources including personal interviews conducted by the author, internal regional government and enterprise documents, official publications, and regional and central newspaper articles. These materials were collected over the space of five years during five separate research trips to the Russian Far East. I collected the first materials during the month I spent in Primorskii krai conducting a study of the first national elections in December 1993. I returned to Primore in 1995, first for four months from April through July, then again for a month from late November through late December. I followed this up with a two week trip in September of 1997. My work in Primore took me beyond Vladivostok to Arsenev and Spassk in the northern reaches of the krai, to the ports of Nakhodka and Vostochny, to Ussuriisk, and also to the southern port of Zarubino. My research in Khabarovsk took place over the course of three trips—one for a week in August 1995, the second for a week at the end of December 1995, and the third for a week in October 1999. On Sakhalin I conducted my research over the course of two trips. The first, for three weeks in August 1995, took me to the regional capital of Yuzhno-Sakhalinsk, as well as to the southern port of Khomsk, and north overland to the oil town of Okha. The second, for two weeks in November 1995 focused primarily on the regional capital. In my work, I interviewed regional government officials, enterprises directors, and foreign business representatives in each location. I also had the opportunity to interview top regional officials and the governors in Japan—in October 1994 and January 1995.
Conclusion

This chapter has presented a range of possible explanations for regional FDI policy outcomes, drawn from the literature on post-Soviet transitions and also from a broader literature in the fields of political-economy and federalism. Some of these literatures yielded interesting explanations which will be considered in the empirical chapters. The partial-reform argument, which emphasizes the dampening effect of "winners" from partial reform on the further progress of reform efforts, will be considered as it appears to explain at least some of the outcomes in the Far Eastern cases. Other arguments about the impact of Soviet-style institutions and business-government networks will also be evaluated to determine the extent to which these variables affect policy outcomes. Arguments about economic factors will be given particular consideration, as at least some of the literature on regional policy outcomes has made a forceful case for the impact of economic structure. The empirical analysis will also consider levels of political polarization in the region—although not party voting patterns, as the data presented in this chapter found no correlation between party voting and regional FDI policy—and strategic interactions between central and regional government actors. Finally the empirical chapters will consider historicist explanations. Each empirical chapter will also elaborate on the ideational argument outlined in this chapter to argue that ideational factors best explain regional policy variation in matters pertaining to FDI.
Part II: Cases
Primorskii krai
Chapter 3

Isolationism: The Case of Primorski krai

I was in Vladivostok. I can only say one thing about the Primorski region: appalling poverty. Poverty, ignorance, and insignificance that could drive one to despair. —Anton Chekhov, 1890.

We would like it to be our window opened widely on the East. —Mikhail Gorbachev, 1986.

In 1991, Primorski krai was one of the most promising destinations for foreign investment in Russia. The krai’s geographic location, export-oriented industry and infrastructure, and human resources, lead foreign investors and domestic observers to believe that with the Cold War over, Primor’e would develop into a vibrant commercial center. Located in the southern reaches of the Far East, and with three major ports, Primor’e’s proximate access to Asian markets and sources of Asian capital raised hopes that the end of the Soviet Union spelled the birth of a new age of prosperity based on investments from Asia and beyond. Articles appeared in the foreign press proclaiming imminent economic transformation in Primor’e, and Japanese government officials pronounced Vladivostok and neighboring Nakhodka, budding "entrepots for exports to and from Asia."¹

In the early years of post-Soviet rule, foreign business flooded into the krai as an energetic young governor set out to woo foreign investors. The easing of travel restrictions along the krai’s long border with China gave rise to a burgeoning trade in consumer products and foodstuffs, Korean businesses set up electronics joint-ventures and shops, and Japanese companies moved in with representative offices and telecommunications know-how. Primor’e looked set to realize its dreams. But by the middle of 1993, all that began to change. A new governor introduced policies designed to

¹ Mark Clifford, "On the brink: Soviet Far East poised for big economic transformation," Far
limit contact with the outside world—tightening border controls, deporting foreign businessmen, and tying up shipments of foreign goods. In 1994, trade with neighboring China plummeted, and would-be foreign investors found their projects beset by a mass of locally generated restrictions. The process continued throughout the 1990s, as foreign investment—at first hesitantly, but then *en masse*—beat a fearful retreat from the krai.

Why did the policies of the regional administration towards foreign investment change so abruptly? Chapter 2 presented a number of possible explanations for policy outcomes, including ones based on economic factor considerations, institutions and policies, business-government networks, and center-periphery relations. This chapter will argue that none of these explanations is sufficient to explain policy outcomes in Primorskii krai. Rather, it will argue that the ideas which informed regional policy-makers—notably the governors—were responsible for Primor'e's policy towards foreign investment in the 1990s.

The chapter begins with an historical introduction to the krai which highlights the schizophrenic nature post-Soviet Primor'e's historical legacy. Next it introduces the policies of Primorskii krai's two post-Soviet governors—one who embraced an internationalist approach to foreign investment, and the other who advocated isolating the krai from foreign economic influence. Finally, it discusses the experiences of the krai's two most important export-dependent industries—shipping and fishing—as they encountered a post-Soviet world of unrestricted exports and FDI. At each stage, the chapter examines a variety of possible explanations for policy outcomes and argues that ideational explanations, rather than materialist ones, best explain those outcomes. A

concluding section draws the argument together and summarizes the ways in which the ideas of krai leaders drove policy outcomes.

**Historical Background**

Post-Soviet Primore, and its capital city Vladivostok—the name means Ruler of the East—inhired a schizophrenic historical legacy: flourishing international port under the Tsarist regime, and highly militarized closed port under the Soviets. Pre-Soviet Vladivostok was a veritable international entrepot, a flourishing commercial center, and home to foreign citizens from across the globe. When the Revolution came, the foreigners fled, taking their commerce and Vladivostok’s vibrant international culture with them. Instead, Vladivostok became first port of call for thousands of political exiles on their way to Stalinist labor camps in the frozen reaches of the Far East. It was this dual legacy—on the one hand international center, on the other militarized Soviet port—that informed leaders in the post-Soviet years.

Pre-Revolutionary Vladivostok was colorful and cosmopolitan. Founded in 1860, it was blessed with a natural deep harbor, the Golden Horn (*Zolotoi Rog*), and quickly grew into a vibrant trading port. In 1871, it also became Imperial Russia’s Far Eastern Navy port, lending the city instant prestige. By 1880, Vladivostok’s population grew to 13,000 people, and about 60 foreign ships a year sailed into its harbor. The city was internationally oriented and closely linked to Asia: Four of every five civilians was Korean or Chinese, and that proportion remained constant for the remainder of the century. In 1886, Tsar Alexander II authorized the construction of the trans-Siberian Railroad, linking Moscow to Vladivostok, a project which took 25 years and was
completed in 1911. Vladivostok prospered: Trading houses imported goods from the Middle East, Australia, Europe, and America and the city teemed with German shopkeepers, French hoteliers, and Swiss speculators; reflecting this diversity there were several Russian Orthodox churches, as well as a Catholic and a Lutheran Church, a Korean Buddhist temple, and a Japanese Shinto shrine.\(^2\) By the time the First World War broke out in 1914, Vladivostok was home to consulates from China, Japan, Great Britain, France, Greece, the Netherlands, Denmark, Norway, Italy, and the United States.\(^3\)

All that changed shortly after 1917. As the revolution took place in Moscow, Japanese, American, French, and British troops poured into Vladivostok in support of the Tsarist counterattack. Soviet power reached Vladivostok in October of 1922. Under Stalin, Vladivostok became a transit station for prisoners on their way to the Soviet gulag. In 1948, Stalin closed the American Consulate in Vladivostok, and in 1958 the entire city was closed to both foreigners and Russians, sealing off the home of the Soviet Union's formidable Pacific Fleet. For over thirty years, until its opening on January 1, 1992, Vladivostok labored beneath a veil of secrecy.

**Geography, Infrastructure and Economic Structure**

Post-Soviet Primor'e's geographic location, human resources, and infrastructural development were well-suited to foreign investment—particularly of the export-oriented variety. Of all the Far Eastern provinces, Primor'e enjoys the most proximate physical access to East Asia. The krai borders China to the south and west, the Korean Peninsula


to the south, and is a mere hour's flight west of Japan and north of Seoul. In addition, Primor'e southern location—Vladivostok lies at the same latitude as Milan—offers a climate markedly more hospitable than that of its frozen Far Eastern neighbors whose territories reach as far north as the arctic circle. Among the Far Eastern provinces, Primor'e also boasts unparalleled human resources. When the Soviet Union collapsed, the krai's population stood at 2.3 million or nearly one third the population of the entire Far Eastern region. With a relatively small territory—less than 3 percent of the Far East—Primor'e was also the most densely populated region with some 14 inhabitants per square kilometer. Moreover, that population was highly urbanized—and therefore accessible to foreign projects—concentrated in 11 urban centers, more cities than any other province in the Far East. Primorski krai also boasts the physical infrastructure necessary to take advantage of its proximity to Asian markets and capital. Three large ports (out of a total of four in the entire Far East) lie within the boundaries of its territory: Vladivostok itself, Nakhodka—home to the only functioning Special Economic Zone in the Far East, and Vostochnyi—the Far East's primary container port. In 1990, as the Soviet era drew to a close, these three ports handled some 34 million tons of cargo annually, mostly materials shipped from Siberia and other Far Eastern regions along the Trans-Siberian Railroad. Vladivostok is the terminus of the Trans-Siberian Railroad which provides a direct link to

Press, 1994, pp. 84-86.
European Russia via 9 thousand kilometers of track. Under the Soviets, Primor'e's
resources flowed primarily to Moscow and other parts of the Soviet Union. But in
January 1992, when Vladivostok at last opened to both Russian and foreign visitors, the
krai's access to Asia increased dramatically.

In many respects, Primorski krai's industrial structure in 1991 was well-suited to
export-oriented investment. Transportation—particularly sea transport services—was a
leading sector. Primor'e is home to Russia's largest shipping enterprise—the Far East
Shipping Company—and the krai provided 80 percent of all sea transportation services in
the Soviet Far East. A well developed fishing industry accounted for a third of the krai's
industrial production in the early 1990s and caught two-thirds of all fish in the Russian
Far East. Under the Soviet system, most of the catch went to European Russia, but with
the lifting of restrictions on foreign trade, Primor'e's fishing enterprises were free to trade
with their Asian neighbors. Both of these industries—transportation and fishing—are
intimately linked to export, and this was increasingly so when restrictions on foreign
trade were lifted soon after Soviet collapse.

Other aspects of Primor'e's economy appear less amenable to foreign investment,
noteably the krai's sizable defense industry. Defense enterprises in Russia were among the
last to privatize—many were forbidden to privatize at all—and highly dependent on state
orders. Defense enterprises in Soviet Russia were huge, insular, state-owned entities,
which in addition to employment, provided everything from health care to housing to
education facilities for their employees. Highly secretive and specialized, they had
virtually no exposure to the outside world. A high concentration of defense enterprises
could mitigate against the development of an hospitable FDI policy. In 1991, the defense
sector in Primorskii krai accounted for 13.6 percent of industrial production and 20 percent of employment.7 Primorskii krai’s defense sector specialized in shipbuilding and ship repair designed to service the Soviet Pacific Fleet, as well as military aviation—the krai produced the famous Black Shark helicopters. Nine defense enterprises in Vladivostok itself accounted for nearly 50 percent of the city’s total industrial production in the late Soviet period. The krai was also home to a number of mono-industrial towns—dominated by one huge defense enterprise that essentially supported the entire town. Primor’ towns such as Arsenev (1991 population of 71,200), home to Progress, the manufacturer of Black Shark helicopters, and Bol’shoy Kamen, home to the Zvezda nuclear submarine plant, which produced 99.8 percent of the town’s 1991 industrial production, illustrate this phenomenon.8

In sum, the structure of Primorskii krai’s economy in 1991 was bifurcated: On the one hand geography, infrastructure, human resources, and developed shipping and fishing industries provided potentially fertile ground for the rise of export-oriented industries and a favorable policy towards FDI. On the other, a strong defense sector would be unlikely

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to support pro-FDI policies. In examining the krai's stance towards foreign investors, this chapter will consider how the interests of these different sectors played out.

**Vladimir Sergeevich Kuznetsov: developing pro-FDI policies**

The krai’s first post-Soviet governor, Vladimir Sergeevich Kuznetsov, was an enthusiastic supporter of market reforms. He had spent ten years at the Institute for the World Economy and International Relations (IMEMO) in Moscow and moved to Vladivostok in 1987 as deputy director at the Economic Development Institute of the Russian Academy of Sciences. Inspired by Gorbachev’s 1986 Vladivostok speech—in which the General Secretary declared the Soviet Union an "Asian country," Kuznetsov dedicated himself to expanding the krai’s international economic ties, particularly relations with South Korea. In 1990, he mounted a successful campaign in elections to the regional soviet. By 1991, Kuznetsov was the chairman of the Krai Soviet Executive Committee (kariispolkom). In October, with the formal separation of regional executive and legislative branches, Boris Yeltsin appointed him Head of Administration—*de-facto* governor of the krai.

Kuznetsov's administration was highly decentralized and his approach to economic affairs, laissez-faire. The governor provided little oversight to divisions within his administration; he did favor two divisions in particular—the regional Privatization Committee and the Natural Resources Division—both of which he encouraged to develop policies on their own. By 1993, Primor'e's privatization drive was among the most

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10 On Kuznetsov's appointment to "head of administration" on October 8, 1991, see "Yeltsin
successful in the country and the krai had the most comprehensive procedures for natural resource use in Russia.\textsuperscript{11} Kuznetsov delegated a great deal of decision-making authority to his vice-governors, and devoted much of his own energy to trips abroad in search of foreign investors for the krai.

The primary thrust of Kuznetsov's policies focused on bringing foreign investment into Primore. An energetic 37-years-old at the time of his appointment, Kuznetsov envisioned regional economic development predicated on an influx of foreign capital. One of his first actions upon election to the soviet in 1990 was to offer foreign investors special incentives to construct assembly plants in Vladivostok.\textsuperscript{12} By integrating the krai into the East Asian economies, Kuznetsov hoped to revitalize the regional economy to make Primore a "growth point" for the Russian economy. Kuznetsov presided over the opening of Vladivostok in January 1992. This accomplished, Primore, Kuznetsov believed, was prime for prosperity: Primore's geographic location, comparatively developed infrastructure, and relatively dense population, the governor reasoned, placed the krai in a uniquely advantageous position. If economic integration with East Asia were to take place at all—and Kuznetsov believed that it would—Primore should be the first to benefit.

Kuznetsov devoted the bulk of his energies to attracting foreign investors. During his brief tenure, he traveled abroad extensively, actively promoting the krai as an attractive new investment opportunity. In 1991, he put together a team of legal specialists to hammer out the details of a free economic zone: providing government guarantees for

foreign investors, and formulating new legislation to support the zone. In particular, Kuznetsov embraced plans for a "Greater Vladivostok," a project which began in 1991 and underwent several subsequent incarnations, all proposing the establishment of free economic zones, the development of export industries, and measures to attract foreign investment. He worked with the United Nations Industrial Development Organization (UNIDO) to conduct feasibility studies for the project, which subsequently attracted technical and financial support from Japan's Ministry of International Trade and Industry (MITI). During his tenure as governor, Kuznetsov supported several variations of this plan, even suggesting at one point that the entire krai be designated a free economic zone.

Kuznetsov put particular emphasis on establishing good relations with Northeast Asia: He negotiated with Japan for financial and technical assistance in infrastructure development, proposed the establishment of an "open border" with China's neighboring Heilongjiang province, and brought Northeast Asian dignitaries to Vladivostok on a regular basis. He also supported a proposal for trilateral development at the mouth of

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14 The initial UNIDO-financed report, entitled *Pre-Investment Study for the Establishment of a Free Economic Zone in the Primorsky Region*, was completed in December of 1991. The Vladivostok City Soviet countered with a proposal entitled *Greater Vladivostok: A Concept for the Economic Development of South Primore*, completed on June 25, 1993. In May 1994, yet another formulation of the project, entitled *The Strategic Plan for Economic Growth in Primorsky Krai* was put out by the Japan Development Institute's Engineering Consulting Firms Association (ECFA), under contract from the Association for Trade with Russia and Central-Eastern Europe (ROTOBO), a Tokyo-based MITI-sponsored institute.
the Tumen River—a project called the Tumen River Area Development Program (TRADP), sponsored by the United Nations Development Program (UNDP). The TRADP envisioned joint port development at the intersection of Russia, China, and North Korea. In 1992, Kuznetsov hosted an international conference on regional economic cooperation in Northeast Asia, which focused in large part on the TRADP. Here, the governor declared his support for the project: "Vladivostok is the doorway of Russia and Europe to the Pacific coast... Our common task is to open that doorway wider. Of great significance is enhancing economic and cultural cooperation with the northern provinces of China and the People's Democratic Republic of Korea. We will support the project establishing an international free-trade zone...which will make the Sea of Japan accessible to both China and Mongolia."\(^{17}\)

Even as the governor made strides in bringing foreign investment into the krai, a local opposition began to organize against him. Opposition to the governor arose among the krai's powerful economic elite—the managers of the large Soviet-style enterprises that dominated the krai's economy. In 1990, a group of the krai's largest enterprises came together to form the Red Pine Association, an organization designed to facilitate information and resource sharing during the transition to a market economy, and also to shield those enterprises from the vagrancies of market economics and privatization.\(^{18}\) The krai's economic strongmen cultivated close ties to political power: By the summer of

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\(^{18}\) On Red Pine's resource sharing role see Mark Clifford, "Permafrost is melting: Capitalist seedlings begin to appear," \textit{Far Eastern Economic Review}, August 15, 1991, pp. 43-44; the protectionist role of Red Pine was explained to the author in an interview with one of the original
1991, Valerii Federovich Lutsenko, former head of the krai's Communist Party apparatus (kraikompartii) and later head of the Primorskii krai Property Fund, and Vladimir Alekseevich Kolesnichenko, former head of the kraikom's economic apparatus, cooperated with enterprise managers to expand Red Pine into a union of industrialists which they called Zolotoi Rog. Industrialist power continued to grow, and by August 1992, 213 enterprise directors came together to organize a new financial-industrial structure—the Primorskii Manufacturers Shareholders Corporation, or PAKT. PAKT’s stated purpose was to provide a financial safety-net for member enterprises within which they could conduct privatization in a measured and controlled fashion. PAKT bought up controlling shares in its member enterprises and attempted to create a closed system in which PAKT members were to supply essential inputs for other members.

Vladimir Kuznetsov was PAKT’s primary political target. PAKT cultivated a strong following in the krai soviet and made several unsuccessful attempts to remove Kuznetsov from power. As early as March 1992, a group of PAKT-affiliated krai deputies appealed to Moscow to remove Kuznetsov from office. The deputies complained that Kuznetsov spent too much time abroad and too little time addressing the krai’s economic difficulties. By May 1993, PAKT had acquired sufficient political clout in the krai soviet to oust Kuznetsov, citing a regulation "On Administration Heads," which obliged the Russian President to consult the krai soviet on the appointment of the governor. In his stead, the krai soviet supported the appointment of Evgenii Ivanovich

founders, September 27, 1997, Vladivostok.
Nazdratenko, a staunch industrialist with extensive ties to PAKT. Nazdratenko had worked at two of the krai’s largest mining enterprises, Dal’polimetal and Bor, and by 1988, headed up a mining enterprise, and PAKT member, Vostok, in the northern Primorye town of Dal’negorsk. On May 24, 1993, Nazdratenko was officially appointed governor of Primorye by Presidential Decree. Kuznetsov was exiled to the Russian Consulate in Seattle, where he served as Consul General for the remainder of the decade.

Evgenii Ivanovich Nazdratenko: resisting FDI

Foreign investment did not figure prominently in the new governor’s agenda. Instead, Nazdratenko focused on gathering the reins of political and economic power in the hands of the regional administration. To that end, the governor used his powers of appointment to staff the administration with his own supporters, manipulated electoral processes in the krai to his political advantage, and directly interfered in the affairs to regional enterprises to ensure regional government control over economic reforms.

Foreign investors did not excite the new governor’s interest. Over the course of his tenure, Nazdratenko employed a variety of levers—legal and increasingly extra-legal—to block the efforts of foreign investors to make inroads into the krai economy. A culture of fear and xenophobia arose in Primorye which soon sent foreign investors scuttling from the krai.

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22 Biographical data from The Political Elite of Primorskii Krai, (Enkaishu chihonokuro seijiteki erito), Occasional Papers on Changes in the Slavic-Eurasian World, no. 4, Slavic
Establishing Political Control

Nazdratenko began his tenure by dismantling Kuznetsov's administrative apparatus, replacing the bulk of the top regional government officials with his own supporters: Vladimir Kolesnichenko, the General Director of PAKT, became Vice-Governor in charge of Economic Reform. Evgenii Leonov, the General Director of a defense enterprise called Varyag, became Vice-Governor in charge of Industry. Anatolii Pavlov, the President of PAKT, became the Vice-Governor in charge of Financing and Planning. Vladimir Shkrabov, a founding member of PAKT and editor-in-chief of the regional newspaper Krasnoe Znamya, became head of the committee for mass media. Igor Lebedinets, former deputy head of the regional tax inspectorate and deputy director of PAKT enterprise Vladivostok Trawler and Refrigeration Fleet (VBTRF) became Nazdratenko's Vice-Governor.

In addition to administrative appointments, Nazdratenko skillfully manipulated the electoral process in Primore to his advantage. Absolute control over the local media, combined with directives to enterprise directors and town mayors to turn out the vote, assured the governor growing control over elected offices. In December 1993 he ran for the Federation Council and won. His administration also fielded candidates in the State

Research Center, Hokkaido University, December 1995, Sapporo.

23 Pavlov had also served as head of the foreign trade division of the krai soviet executive committee when Kuznetsov was chairman in 1991. Author's interview with Pavlov, Vladivostok, October 8, 1997.

24 Lebedinets also had experience working as an engineer in the krai's defense sector for Dalzavod, a ship-repair enterprise located in Vladivostok. Reported on local television program, Mestnoe Vremya, December 8, 1995.

Duma races, and although his power was insufficiently consolidated to win his candidates office in 1993, by 1995, two of the three single-mandate seats went to Nazdratenko's designated candidates. (The third went to a well-known Communist Party candidate, Svetlana Goryacheva, who had little interest in Nazdratenko's regional policy machine). 26

Those regional players most involved in krai politics, however, were much more interested in elections to regional positions—the governorship and the regional legislature—than national ones. 27 Nazdratenko was no exception. Soon after his appointment to the governorship, he began to lobby hard for gubernatorial elections. As in many Russian regions, the regional soviet had been dissolved in the fall of 1993, but in Primorskii krai, the governor made it his explicit policy to hold-off on elections to the legislature until gubernatorial elections could be organized. He did his best to foil attempts to hold regional duma elections throughout the spring of 1994. Instead, plans to hold gubernatorial elections in October 1994 went forward; however, three days before the set date, the election was unexpectedly canceled by Presidential decree. After the failed attempt to hold gubernatorial elections in early October, regional duma elections were at last held on October 23. On election day, many voting stations inexplicably experienced unusually long black-outs. Due to low voter turnout, only 20 of the 39 local Duma seats were filled, an insufficient number to form the legislative body. A second round of voting to fill the remaining seats was held on January 15, 1995, and 11 deputies were elected, at last enough to form a regional legislature. Of the 31 deputies, nine were

26 Author's interview with Goryacheva, Vladivostok, December 20, 1995.
27 With member of the Vladivostok city administration, Vladivostok, December 12, 1995.

With exception, the most politically active krai residents preferred to run for regional office rather than participating in national elections. One local power broker who ran successfully for the regional legislature explained that he had no interest in running for a seat on the national legislature because "the State Duma representatives have no influence in the locality." Author's
held by appointed heads of cities or districts, three by deputy-heads of cities or districts, and nine by enterprise directors. Nazdratenko's power of appointment over a majority of duma members guaranteed him virtual control of the legislature. His own efforts to win electoral mandate bore fruit on December 17, 1995 when Primorskii krai was one of only five regions permitted to hold gubernatorial elections. After successfully orchestrating the removal of viable opposition candidates from the ballot, Nazdratenko won the race with 68.6 percent of the vote. He used the same tactic again in 1999, when he won the gubernatorial race with 70 percent of the vote. Nazdratenko retained his position until his effective removal by President Putin in February 2001.

Nazdratenko's tenure was marked by almost constant political strife. The governor's local nemesis was Viktor Ivanovich Cherepkov, who won the Vladivostok mayoral election in June of 1993. An avowed PAKT opponent, Cherepkov became the immediate target of the Nazdratenko team. Formerly an officer in the Pacific Fleet, Cherepkov had neither the credentials nor the experience of the PAKT bosses. His main claim to fame was his electoral mandate, of which he took full advantage in his caustic criticism of krai administration power politics. So intense was the conflict between the city mayor and the governor that it eclipsed the first elections to the national legislature in December 1993. In March 1994, two members of Nazdratenko's administration showed up in the mayor's office, charged him with taking bribes, and forcibly evicted him from the premises. In his place, they installed Nazdratenko supporter Konstantin Tolstoshein—

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28 List of regional legislature members provided to the author.
29 Three weeks before election day, Nazdratenko forced the removal of his prime opponent from the race. Author's interviews with opposition supporters: former krai administration member, December 4, 1995; opposition member, December 12, 1995.
who had won less than 1 percent of the vote in the 1993 mayoral election. Cherepkov was cleared of the charges against him in December 1994, but was then formally removed from office by Presidential decree. Cherepkov took his case to the Moscow courts arguing that his removal was the result of Nazdratenko's corrupt political intrigues and that dismissal of an elected official was unconstitutional;\textsuperscript{31} after nearly two years of legal wrangling, he won his case and was returned to office in September 1996. In December 1998, however, he was again removed from office and replaced by Nazdratenko appointee Yurii Kopylov. In addition to fighting for mayoral position, Cherepkov ran for a seat on the State Duma in single-mandate races in 1995 and 1999, and also challenged Nazdratenko in the gubernatorial race. (In the 1995 gubernatorial election, Cherepkov won only 17.2 percent of the vote, to Nazdratenko's 68.6 percent).

In addition to the conflict with Cherepkov, dissent and factionalism led to an almost constant state of internal strife among Nazdratenko's early supporters. Leonov, Pavlov, and Shkrabov left the administration and fell into opposition within a year of Nazdratenko's appointment as governor. Kolesnichenko was dismissed soon thereafter. In 1995, Anatolii Vasyanovich, the director of Primorskugol, (the regional coal enterprise), and supporter of Nazdratenko's 1993 bid for the governorship, gathered the "democratic" forces in the krai and mounted a campaign to challenge Nazdratenko in the gubernatorial race. With less than two weeks to go before election day, Vasyanovich withdrew from the race under pressure from Nazdratenko and his allies, took sick leave, and closeted

\textsuperscript{31} Author's interview with Cherepkov, Moscow, March 13, 1996.
himself at home.\textsuperscript{32} Thus ended the first and only serious electoral challenge to governor Nazdratenko.

Nazdratenko's relations with the krai's Presidential representatives were likewise conflictual. Primorskii krai had four Presidential Representatives in the 1990s. The first, Valerii Butov, sided with Cherepkov in 1993 and came under immediate fire from the governor. In January 1994, Butov was replaced by Nazdratenko ally, and krai vice-governor, Vladimir Ignatenko. In May 1997, with growing realization of Primorskii krai's problems in Moscow, Yeltsin replaced Ignatenko with the chief of the krai's Federal Security Service (FSB), Viktor Kondratov. Within a few short months, Kondratov lost enthusiasm for the job—he found himself unable to regulate the governor's actions or to deal with the regional energy crisis\textsuperscript{33}—and fell into line with the krai administration. In October 1999, he was replaced with krai vice-governor Valentin Kuzov.

Economic Policies

Nazdratenko's economic policies could not have been more different from those of his predecessor. Where Kuznetsov adopted a laissez faire approach to economic affairs, Nazdratenko's administration set up new levers of control over the regional economy—stalling the progress of privatization, interfering in new market structures, and instituting regional price controls, particularly in energy.\textsuperscript{34} Nazdratenko especially targeted the previous administration's foreign economic policy and made a point of

\textsuperscript{32} Author's interview with Vasyanovich, December 15, 1995.
\textsuperscript{33} Author's interview with Kondratov, September 20, 1997.
\textsuperscript{34} Prokop, pp. 234-240 and 400-412, and Peter Kirkow Russia's Provinces: Authoritarian Transformation versus Local Autonomy? MacMillan Press Ltd., 1998, pp. 113-170, provide a detailed overview of Nazdratenko's economic policies. Here I provide a few salient points to
dismantling those projects which Kuznetsov had brought to the krai—especially the
Tumen River Development Project, which is discussed in a separate section below.

The new governor began by attempting to stop and even reverse the privatization
process in Primor. In August of 1993, the regional administration halted voucher
privatization and decided to hold onto its shares in a number of critical enterprises—a
category which encompassed a total of 172 enterprises.\textsuperscript{35} In August 1994 the governor
set up a commission for securities which was designed to regulate activity on
Vladivostok's stock exchange. A month later he instructed the head of the regional
property fund to stop the free sale of privatized enterprise shares on the exchange;
instead, the governor favored trading of shares in non-public auctions to which only
select regional executives had access.\textsuperscript{36} Nazdratenko openly equated privatization with
the "theft of the nation's resources," and called market experiments "foolish."\textsuperscript{37} He argued
that "Chubais' privatization quickly ruined [Primor] enterprises,"\textsuperscript{38} and admitted that his
policies went beyond the law, "but only...to protect the regions' industries from
disastrous moves by bankruptcy judges, greedy foreign shareholders and their Russian
business allies."\textsuperscript{39} Besides opposing privatization, the governor also worked to control
regional energy prices—a policy which contributed to a severe crisis in which krai
residents were regularly deprived of electricity for long periods and in the dead of winter;

\textsuperscript{35} Vacroux, 1995.
\textsuperscript{36} Kirkow, p. 119.
\textsuperscript{37} Interview with Evgenii Nazdratenko in Michael Specter, "Old-Time Boss Rules Russia's
\textsuperscript{38} Vladimir Kucherenko, "Primorski krai: disaster zone," \textit{Rossiiskaya Gazeta}, September 28,
1994, pp. 1,7.
\textsuperscript{39} Sharon LaFraniere, "A Crisis of control in the Russian Far East," \textit{Washington Post}, May 2,
he set up a new energy department within the administration and froze electricity rates at 40 rubles/kWhr for industrial enterprises. (In comparison, energy prices for industrial enterprises on Sakhalin in mid-1994 were 218 rubles/kWhr). Nazdratenko vowed that: "If the price of a kilowatt hour goes above 40 rubles, it won't be with me as governor." From the beginning, Nazdratenko took particular exception to the previous governor's laissez faire approach to foreign economic affairs. The new administration developed a "Strategic Plan for the Economic Development of Primorski krai in the Context of the Geostrategic and Economic Interests of Russia in the Asia Pacific Region, 1994-2000," which placed heavy emphasis on regional government control of the economy. Directly criticizing Kuznetsov's internationalist approach, he stated: "Naturally we won't stand for this any longer. We shut down the channels through which [raw materials] flowed abroad...and took measures to put privatization in order...Here and there we replaced a local administrator...Let them give traders and entrepreneurs concrete tasks: 'You—buy potatoes, you—macaroni or something else.'" In addition to establishing official levers of control to regulate the local economy, Nazdratenko's team employed a variety of extralegal methods. In 1995, for example, the krai administration declared the local airport bankrupt when airport management refused to grant a 50 percent reduction in airport use fees to Orient-Avia—a local airline largely owned by the

40 Prokop, p. 235 and Kirkow, p. 150.
42 For a discussion of the Plan see Prokop, pp. 238-239.
krai administration and run by Vladivostok mayor and Nazdratenko appointee, Konstantin Tolstoshein.44

The events which most obviously set the tone of Nazdratenko's approach to foreign economic affairs focused on the krai's relations with China. When Nazdratenko came to power in 1993, over half the joint-ventures in the krai were with Chinese partners, and Chinese laborers and traders constituted the most conspicuous foreign presence in the krai, contributing to a flourishing international trade as well as to the local labor market. In 1992—the year prior to Nazdratenko's advent to power, the China trade accounted for over 45 percent of the krai's total trade turnover. Loosened border restrictions gave rise to a vibrant shuttle trade which allowed both Russian and Chinese traders to ply their goods, and led to the establishment of a dynamic Chinese marketplace on the outskirts of Vladivostok. At the same time, Chinese laborers poured into the krai, providing the muscle behind a growing construction business.

Nazdratenko's administration objected to these activities. The administration argued that Chinese laborers took jobs away from Russians and that Chinese traders constituted a sinister plot to undermine the regional economy by selling substandard goods. Soon after the governor won a seat on the Federation Council in December of 1993, the krai administration initiated "Operation Foreigner," closing down entry points along the Russian-Chinese border, enforcing new visa regulations, and stopping anyone who looked Asian in the street to demand documentation.45 By 1994, as a result of

44 For a more detailed discussion of this issue see Katherine G. Burns, "Battling for Foreign Capital in Primorsk krai," Transition, September 22, 1995, pp. 18-23. The author attended a meeting of airport employees on May 26, 1995, at which the airport General Manager, Vladimir Saibel, defended the financial integrity of his company and accused the krai administration of attempting to use the local airport to subsidize the airline.
45 Operation Foreign really got underway in the summer of 1994. It beginnings were in evidence,
leadership efforts to curtail interaction with China, krai trade volumes with China dropped precipitously, so that they accounted for only 14 percent of total trade. The steep fall in trade with China, and the accompanying new restrictions on Chinese citizens in the krai also had an indirect effect on overall krai industrial productivity; until 1994, Chinese workers accounted for a growing percentage of labor in the krai, and the administration's policies severely curtailed the flow of Chinese labor into Primor'e, amounting to an effective slowdown in the local construction business.46

Explaining Kuznetsov's fall and Nazdratenko's rise

Why did Kuznetsov and his internationalist policies fail to take root in Primorskii krai? And why did Nazdratenko and the politics of isolationism dominate the krai for the bulk of the 1990s? One of the most compelling explanations for these events derives from an analysis of Primor'e's economic factors. By this analysis, Kuznetsov's undertaking in the early years of the decade was simply untenable: Primorskii krai's economy was heavily biased towards large state-owned enterprises with a significant military component, and it was those enterprise directors who, through their organization PAKT, unseated Kuznetsov. Nazdratenko, by this argument, was the expression of the organized interests of large enterprise directors.

While this explanation appears compelling, there are several reasons to doubt its veracity. First, if the appointment of regional governors reflects underlying economic

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46 Even in 1996, Chinese nationals accounted for the bulk of construction workers. As of January 1996, the construction industry in Primor'e employed nearly 5,000 foreigners, the bulk of whom were Chinese. See "Employment of foreigners in Primor'e regulated," Vladivostok News, January 25, 1996, p. 2.
interests, and those interests support isolationism, how can those same economically-derived interests also explain Kuznetsov's appointment in 1990? In other words, explanations which derive from the structure of the regional economy cannot explain both the appointment of Kuznetsov and that of Nazdratenko.

Second, leaving aside the appointment of Kuznetsov, economic structure alone cannot account for Kuznetsov's fall from grace. An argument based on economic interests would hold that Kuznetsov lost his position because his policies ran counter to the interests of the krais' economic elite. Because Nazdratenko came to power through the PAKT organization, it is tempting to see the new governor as an expression of economically-derived interests, which Kuznetsov's internationalist policies failed to address. However, the empirical record shows that the enterprise directors who formed PAKT and opposed Kuznetsov, were not opposed to Kuznetsov's policies per se, and in particular, they were not opposed to foreign investment. Indeed, part of PAKT's original platform included measures to attract foreign investment into krai enterprises. PAKT enterprise directors' primary objections to Kuznetsov focused on poor implementation. For example, PAKT leaders complained that Kuznetsov failed to follow through on negotiations with UNIDO to implement portions of the Tumen Project in Primorskii krai. A 1993 report jointly issued by regional council deputies and PAKT enterprise directors stated that "little has been done to carry out the projects of regional programs such as the Nakhodka Free Economic Zone, Bol'shoi Vladivostok, and Tumangan. At the same time, an analysis of the current situation indicates that the work of the administration has been unsystematic and has lacked a system of priorities. There has been a tendency to replace

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practical work with endless resolutions and decisions. On average, up to four different
documents were adopted every day."48

Kuznetsov's ineffective work habits drew broad criticism from PAKT directors
and from the regional soviet where enterprise directors were well represented. An often
cited complaint was his near absence from the krai—traveling abroad to negotiate with
foreign partners, or simply vacationing.49 Frequent absences lead to poor coordination
with regional power structures: Kuznetsov virtually ignored the regional legislature
which passed a large number of market-supporting bills that the governor failed to
implement. Kuznetsov made no effort to coordinate with enterprise directors, and did not
make a single visit to the largest krai enterprises during his tenure as governor.50 In sum,
there is plenty of evidence that economic and political leaders in the regional legislature
and in PAKT enterprises themselves were broadly supportive of Kuznetsov's policy
direction. However, the governor's failure to engage in the business of politics—
coordinating with enterprise directors, interacting with regional legislators, even
following through on his duties—caused the krai elite to lose confidence in the governor's
ability to do his job.

Third, because Nazdratenko came to power on the shoulders of the PAKT
organization, it is tempting to see the new governor as the expression of regional
economic interests. Here again, however, the empirical record suggests otherwise. For
one thing, Nazdratenko remained in power throughout the 1990s, but PAKT fell apart by
the middle of 1994. In fact, PAKT included a large number of diverse enterprises, many

49 Author's interview with PAKT founder, Vladivostok, April 26, 1994; also see Kirkow, 1998,
of which were actively interested in working with foreign investors, so that it is difficult to view the PAKT organization as representing any kind of unified interest. Already in December 1993, PAKT enterprises such as Spassk Cement broke with Nazdratenko to support non-administration candidates in the State Duma elections.\(^1\) Spassk Cement—25 percent owned by PAKT members in 1993,\(^2\) worked closely with foreign investors in an explicit effort to boost exports.\(^3\) As PAKT crumbled, PAKT's founders defected, often complaining about the governor's anti-foreign policies. Evgenii Leonov quit the krai administration some few months after Nazdratenko came to power, citing differences in opinion on economic policy;\(^4\) his enterprise, a defense plant which produced nautical instruments for the Pacific Fleet subsequently engaged in a number of successful joint-ventures.\(^5\) Anatolii Pavlov, one of PAKT's founders, left the krai administration in 1994 and focused the energies of his company, Kommersant, on building foreign trade linkages.\(^6\) Vladimir Shkrabov, formerly Nazdratenko's trusted media manager, lost his position, and his newspaper, Krasnoe Znamya, fell into opposition. Like his fellow defectors, Shkrabov complained of the governor's failure to focus on foreign sources of investment and criticized Nazdratenko for an excessive focus on Moscow sources of

\(^{50}\) Tikhii Okean, June 26, 1993.

\(^{51}\) Spassk Cement, a huge cement factory in the north of the krai, refused to support the governor's candidate of choice in the Arsenyev single-mandate district. Author's interview with enterprise director at Spassk Cement, Spassk, December 7, 1993.

\(^{52}\) Author's interview with PAKT co-founder Vladimir Shkrabov, Vladivostok, April 26, 1995.

\(^{53}\) Author's interview with Andrew Fox, one of Spassk Cement's largest foreign investors, Vladivostok, April 24, 1995.

\(^{54}\) Author's interview with Evgenii Leonov, Vladivostok, December 3, 1993.


\(^{56}\) Author's interview with Anatolii Pavlov, Vladivostok, October 8, 1997.
financing. Igor Lebedinets, left the administration to become speaker of the local Duma, but, in June 1995, lost his position as Duma chair when he criticized the governor's position on energy and supported an inquiry into the administration's finances.

If Nazdratenko's anti-foreign policies were to represent the interests of any sector, it should have been defense. Yet here again, the empirical evidence shows otherwise. First, Primor'e's defense sector was fairly diversified. A number of defense enterprises in the krai were designed to service the Pacific Fleet—producing nautical instruments or repairing ships. These enterprises were comparatively easy to convert to civilian production, and a number of them began to provide services for commercial vessels. Thus, for example, Dalzavod, a PAKT-affiliated shipbuilding and ship-repair enterprise based in Vladivostok, built a successful business providing ship repairing services to the fishing industry; as early as 1993, Dalzavod managers expressed dissatisfaction with PAKT and its backing of Nazdratenko. At least those enterprises which had greater difficulty in the conversion process should have supported the governor, but even they did not. The Arsenev aviation plant, Progress, is a case in point. Progress was an important member of PAKT in 1993. By 1996, Progress' efforts at conversion had proven unsuccessful and enterprise directors appealed to the krai administration for assistance in securing federal government subsidies to help pay beleaguered workers. Nazdratenko refused to support the enterprise, and Progress instead joined forces with other PAKT defectors to secure new military orders from Moscow, and permission to sell

57 Author's interview with Vladimir Shkrabov, Vladivostok, September 23, 1997.
58 Author's interview with Igor Lebedinets, Vladivostok, September 27, 1997.
their wares abroad.\textsuperscript{60} One by one, PAKT enterprises—both those that sought foreign investment and those that did not—broke from the fold and many entered into direct opposition to the krai governor. It seems clear, therefore, that the governor's policies were not a direct derivation of regional economic interests.

Economically-derived interests also cannot adequately explain Nazdratenko's hostile policy towards foreign investors. His move to stem economic interaction with China, described above, is a case in point. Chinese traders and investors provided the krai valuable services: importing food and consumer products and supplying labor. The 1994 official krai statistics show a total of 40 thousand Chinese crossing the border into the krai.\textsuperscript{61} There is no evidence to suggest that they posed a threat to the interests of the krai economic elite. Indeed, during the entire decade of the 1990s, no enterprise director raised complaints about Chinese economic activities in Primorskii krai. Instead, the administration's policy towards China was a product of the governor's xenophobic view of Asians. His comments about "slanty-eyed foreigners," accompanied a barrage of propaganda about the dangers of Chinese presence on Russian territory.\textsuperscript{62} In defiance of the facts, Nazdratenko claimed that up to 2 million Chinese nationals had "infiltrated" the Russian Far East, and that illegal Chinese immigrants were settling permanently on Russian soil in an "economic invasion."\textsuperscript{63} He went on to warn that Chinese migration

\textsuperscript{60} Author's interview with Progress director, Vladivostok, September 23, 1997.


\textsuperscript{62} Author's interview with Evgenii Nazdratenko, Niigata, Japan, January 30, 1997.

\textsuperscript{63} See Viktor Larin, China and the Far East in the first half of the 1990s: problems of regional interaction (Kitai I Dal'nii Vostok v pervoi polovine 90-kh, problemy regional'nogo vzaimodeistviia), Dal'nauka, Vladivostok, 1998, cited in Mikhail Alexseev, "Chinese Migration in
threatened to turn the Far East into an "Asian Balkans." The media picked up on the
trend, and by one count, in the first 2 years of Nazdratenko's reign, more than 150 press
articles appeared warning of the dangers of a new "yellow peril."64 One prominent local
analyst in Vladivostok wrote of: "the threat of Chinese expansion, the essence of which
appears to be the peaceful settlement and economic assimilation of the [Russian Far
East]. Eventually the Russians will be squeezed out."65 Some even claimed that the
movement of Chinese into Russian territory was part of a premeditated program initiated
by Beijing to relocate excess population from Northeast China to the Russian Far East, (a
claim which remains completely unsubstantiated).66

Nazdratenko was a master politician, a facet of his personality that PAKT's
leaders failed to recognize or appreciate. Once in office, he took full advantage of the
new powers which the Russian federal structure granted regional executives. From this
vantage, he was able to expertly translate his beliefs into isolationist policies, and retain
political control of the krai despite the dissolution of his initial power base. In fact,
PAKT's leaders had never intended Nazdratenko to remain in office for so long. Their
plan had been to bring Nazdratenko in as a transitional figure, and later replace him with
Anatolii Pavlov—a figure they believed would more accurately represent their interests.

Nazdratenko's political skills and personal charisma soon put an end to these plans. Less

64 The article count was conducted by Viktor Larin at the Far Eastern Institute of History, and cited in Alexseev, "Chinese Migration in the Russian Far East."
66 Shcherbakov, "Big Brother reaches out," (Velikii brat' k nam tianet ruki), Vladivostok, September 1, 1993, p.5.
than a year after Nazdratenko's appointment, Pavlov was out and Nazdratenko was lobbying Moscow for the right to hold gubernatorial elections. Thus, although the original intent of the PAKT organization had been to find political voice by placing their man in office, the power of regional executive office coupled with Nazdratenko's own considerably political skill, allowed the new governor to redefine the rules of the game. Rather than economic interests dictating regional policy, the powerful new governor reshaped regional policy to his own liking, molding and defining the interests of the krai electorate so that he successfully retained office and dictated policy to his former supporters.67

The Tumen River Area Development Program

The Tumen River Area Development Program was one of governor Kuznetsov's pet projects. The project involved participants from China, Japan, Korea, and Mongolia. Sponsored by the United Nations Development Program, the TRADP was an ambitious multilateral undertaking which explicitly promised economic benefits to Primor'e as a whole and in particular to the krai's underdeveloped southern ports—Khasan, Posyet, and Zarubino. The TRADP planned to extend rail links between northeast China and Zarubino to facilitate Chinese exports via the Russian port system, and promised to bring billions of dollars in foreign investment to Primorskii krai's derelict port facilities. Numerous studies conducted by Japanese government think-tanks and international institutions projected enormous economic benefits for Primor'e, and explicitly stated that foreign investment would go towards expanding Primor'e's existing port infrastructure.

67 Boris Nemtsov has called this phenomenon "managed democracy:" the process by which political leaders shape public opinion. Seminar at Harvard University, March 14, 2003.
Nazdratenko objects

Nazdratenko's administration vehemently opposed the project. In plain language, the governor stated: "We will never allow this project to happen."68 Asked whether the krai administration supported the TRADP, one vice-governor responded: "Absolutely not!"69 The governor's objections to the project were three fold: First, he argued that the TRADP would undermine the viability of the krai's entire existing port system; second, he claimed that the project would specifically undermine the krai's three main ports—Vladivostok, Nakhodka, and Vostochnyi; third, he argued that the project threatened the territorial integrity of the Russian Federation.

Primore's leader concentrated the bulk of his criticism on a TRADP proposal to construct an inland port at the Chinese city of Hunchun on the Tumen River. This proposal, put forth in 1990 and 1991, involved port construction on Chinese territory and regular dredging to allow large cargo vessels to navigate the river. By 1993, China, Japan, and the UNDP all abandoned the inland port proposal in favor of developing the existing Russian port system. Nonetheless, throughout the 1990s, Nazdratenko's administration focused on the inland port proposal, arguing that it would severely undermine the krai's existing port system. In 1995, Nazdratenko announced that he himself had devised a plan for developing Russian ports and claimed to be lobbying the Chinese government to abandon the inland port plan.70 Subsequent publications in the local press continued to claim that China favored an inland port, and claimed that "the

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68 Author's interview Evgenii Nazdratenko, Niigata, Japan, January 30, 1997.
69 Author's interview with Primore vice-governor, Niigata, Japan, January 29, 1997.
70 Nazdratenko statement on Vladivostok television, June 20, 1995.
Tumen project is a dangerous competitor to the ports of Vladivostok and Nakhodka."\textsuperscript{71} An article published in 1997 similarly claimed that the "construction of such a port [inland] will lead to the death of Vladivostok and Nakhodka, and even the entire Trans-Siberian Railroad."\textsuperscript{72}

In conjunction with objections to a Chinese port, the krai administration argued (somewhat illogically) that TRADP development of Primore's small southern ports threatened the krai's large ports of Vladivostok, Nakhodka, and Vostochnyi. The administration argued that development of the southern ports would divert cargo shipments from the krai's largest ports and projected dire consequences for the entire krai economy. The fact that the administration's two main objections—one, that China was planning to build its own port, and two, that the Tumen project would develop the krai's southern ports—were mutually exclusive, did not merit mention in the local press. The Tumen documents indicated that any projected shipments out of southern Primore ports would consist of cargo currently shipped through the Chinese port of Dalian—not, in other words, diverting cargo from Russian ports. Moreover, throughout the 1990s, Primore's main ports were operating well below full capacity, so that an increase in cargo shipments would certainly have been beneficial to the krai's port system and economy in general.

Nazdratenko also argued that the Tumen project posed a direct territorial threat to the krai and the Russian Federation. The krai leadership drew a connection between the TRADP and the controversial issue of territorial demarcation along the Sino-Russian

\textsuperscript{72} "Byt' li kimaiskomu portu v yst'e Tumannoi?" ("Will there be a Chinese port at the mouth of
border. The territorial controversy hinged on a 1991 agreement between the Soviet Union and China which ceded some 1300 hectares (15 square kilometers) of Primorje territory, along the banks of the Tumen River, to the People's Republic of China. Most controversial of all was the territory to be ceded in the southern Khasan district of Primorskiy krai which gave 330 hectares of land on the Russian side of the Tumen River, to China. Nazdratenko and his administration vehemently opposed the cession of this territory, claiming that the acquisition of this land by China would allow the Chinese to construct an inland port on the Tumen River and gain direct access to the Japan Sea, thereby directly undercutting Primorje's ports. The governor took concrete measures to block implementation of the border agreement, in direct opposition to Moscow: In May 1995, he handed the disputed area over to the administration of the local Cossack community, a move explicitly designed to foil implementation of the border agreement and block progress on the Tumen project. As one local report explained: "The chief of Ussuriisk Cossacks, Vitalii Polyanov, has vowed to send teams of Cossacks to the Chinese border to prevent the placing of the nine last posts, demarcating the frontier with China. The new border gives 1,500 hectares of Primorje land to China under a 1991 treaty. If they can't prevent the demarcation process, old Cossacks have pledged to chain

73 The agreement between China and the Soviet Union was signed on May 16, 1991. It was ratified by the Supreme Soviet of the RSFSR on February 13, 1992, and came into force on March 16, 1992. See "Byt' li kimaiskomu portu v yst'e Tumannoi?" ("Will there be a Chinese port at the mouth of the Tumen?) Dal'nevostochnoo Uchyennyi, June 11, 1997, No. 14 (1092), p.6.
74 "Nazdratenko opposes 'Chinazation' and Foreign Minister on border issue," Komsomants-
themselves to previous border posts. Cossacks were the first Russians to settle in the Far East."\(^76\)

By the end of the 1990s, TRADP supporters outside Russia grew tired of the administration's hostility to the project. Plans to develop Russian port facilities were shelved. Instead TRADP sponsors turned to an alternative plan to develop port facilities in North Korea, and extend and upgrade railway links through North Korea to the South.\(^77\)

**Explanations for Nazdratenko's opposition to the TRADP**

Why did Nazdratenko and other krai leaders oppose the Tumen project? Why did they argue that TRADP development plans in the krai threatened the regional economy? No regional enterprises had similar development plans themselves, nor did the regional economy command the resources to undertake infrastructural development on the scale proposed by the TRADP. The welfare of the regional economy was closely linked to port development, so that the expansion of port facilities and therefore trading capabilities would have actually benefited regional enterprises. It is therefore difficult to envision a set of economically derived interests in the krai which would have been threatened by Tumen project development. Indeed, no enterprise directors in the krai expressed opposition to the project. The effort to oppose the TRADP came from the krai administration itself and from regional administrators appointed by Nazdratenko.


The governor's opposition also cannot be explained in terms of strategic interaction with central powers. Moscow explicitly directed the governor to cooperate in the project and to comply with the border demarcation agreement with China. Nazdratenko's unwillingness to cooperate in both instances won him the enmity of important Moscow figures. On the border issue, Sergei Filatov, the head of the Presidential Apparatus, wrote in response to the Primor'e governor's noncompliance: "The position of the President of the Russian Federation, B. N. Yeltsin on the question of the Russian-Chinese border is clearly reflected in the declaration signed between Russia and China on September 3, 1994 and is in agreement with sections 'B,' 'K,' 'N,' paragraph 71, and paragraph 80 of the Constitution of the Russian Federation. The President of the Russian Federation, as guarantor of the Constitution of the Russian Federation, cannot allow the ability and readiness of Russia to meet its international obligations to be called into question."\(^{78}\) It seems clear, therefore, that Nazdratenko's opposition to the TRADP was not the product of strategic manipulation on the part of central authorities.

The krai administration did provide its own set of explanations for opposition to the project. The governor explained economic crisis in the krai as the product of a "foreign plot" and viewed the TRADP as an element of that plot. First, the administration emphasized economic imbalances between the krai and the People's Republic of China. Krai leaders argued that the project was designed to primarily benefit China, and would exacerbate economic imbalance between China and Primor'e which would endanger the krai. Frequently raising the specter of "yellow hordes" overrunning the krai territory, Nazdratenko and his administration portrayed the Tumen project as an underhanded

\(^{78}\) Internal memo from Sergei Filatov to Evgenii Nazdratenko, 1995. (Specific date not indicated).
attempt by local and central Chinese government to unfairly benefit from Russia's strategically located ports on the Japan Sea. Thus, although Primore leaders did recognize some potential benefits to their region, they preferred no economic gain to the possibility that China, too, would benefit from the project.

Second, conflating concepts of nationalism and democracy, Nazdratenko argued that allowing the project to proceed would simultaneously threaten Russia's territorial integrity and democratization in Russia. In a speech published in the local press, Nazdratenko portrayed himself as the defender of Russia's national interest and therefore a true democrat, claiming: "America has always defended its territorial integrity; it would be highly democratic of Russia to do likewise."79 This suggestion—that the governor was both a patriot and a democrat, came as a direct criticism of the Russian Ministry of Foreign Affairs, whose position on border demarcation, Nazdratenko claimed, could "hardly be considered correct."80 Inflammatory articles with titles such as "The Demarcation: who is really profiting?" or "Battle for Territory in Southern Primore," portrayed the krai as a victim of simultaneous violation by both a disinterested federal leadership and rapacious "yellow hordes."81

Third, the most consistent criticism of the project focused on issues of race. In discussing the Tumen project, Nazdratenko clearly stated his distaste for "people with slanty eyes."82 This view extended to krai officials in the southern Primore ports directly

80 Ibid.
81 "Bitva za territoriyu na yuge Primor'ya," (Battle for Territory in Southern Primor'), Vladivostok, March 7, 1995; "Demrakatsiya: komu ona vygodna?" (Demarkation: who is really profiting") Vladivostoskoе vremya, April 8, 1995.
82 Author's interview with Evgenii Nazdratenko, Niigata, Japan, November 8, 1994.
slated for TRADP investment. Defending his opposition to the project, one port official explained that he "did not want to be caught between Japanese money and Chinese workers" and expressed fears of being "overrun by Asians."83

In sum, Nazdratenko explained economic crisis in the krai as the product of foreign intervention, interpreted the TRADP as a plot to undermine the regional economy and threaten territorial integrity, and redefined "democracy" to mean defense of national borders. On the basis of this interpretation, he argued that opposing the TRADP was the only legitimate policy for true Russian democrats. His policies effectively undermined the project and forced TRADP supporters to give up their development plans in the krai.

The Shipping Business

"Nazdratenko sees the region's shipping and fishing industries as his special province, and though he portrays himself as their savior, his critics say Primorye's economic promise has been squandered." Report from the Washington Post.84

Primorskii krai is home to the Russian Federation's two largest shipping companies: The Far East Shipping Company and Vostoktransflot. Both stood to benefit from increasing exports following the collapse of the Soviet Union and the lifting of government restrictions on foreign trade. Over the course of the 1990s, the fortunes of both companies waned. This section traces the experiences of the two companies since 1991, and examines explanations for their failure to capitalize on post-Soviet opportunities in the export business.

83 Author's interview with Deputy Director of Zarubino Port, August 25, 1995.
84 Sharon LaFraniere, "A Crisis of control in the Russian Far East," Washington Post, May 2,
The Far East Shipping Company (*Dal'nevostochnoe morskoe parakhodstvo*)

In 1991, leaders at the Vladivostok-based Far East Shipping Company (FESCO), looked forward to reaping new gains from an economic opening to the outside world. FESCO was the largest company in the Russian Far East and the largest dry cargo shipping company in the entire Russian Federation. It boasted a long and venerable history dating back to April of 1880, when it was first established as the eastern branch of the Tsarist *Dobrovolniy Fleet*. In December 1992, FESCO became a privatized "open joint-stock company" with 80 percent of stock going to private and corporate individuals, and the government retaining 20 percent. At the time, FESCO employed some 53,000 people, commanded a fleet of 169 cargo vessels and 9 icebreakers, and held a monopoly on the krai's major shipping routes. Since 1986, the company had been headed by Viktor Mikhailovich Mis'kov, a former member of the krai's Communist Party apparatus and a krai resident for over 50 years.

Despite its stature, in the 1990s, FESCO's fleet was aging and in need of repairs, and therefore in dire need of capital investment. To meet this need, in the early post-Soviet years, FESCO officials actively courted foreign investment. FESCO's managers

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89 *The Political Elite of Primorskii Krai*, (Enkaishu chiho ni okeru seijiteki erito), Occasional Papers on Changes in the Slavic-Eurasian World, no. 4, Slavic Research Center, Hokkaido University, December 1995, Sapporo, p.45
were enthusiastic about privatization and looked forward to reaping the benefits of greater openness to the outside world. They believed that their experience dealing with foreign markets under the Soviet regime would allow them to successfully navigate the waters of the new Russian market economy.\textsuperscript{90} As domestic trade dried up in the wake of Soviet collapse, they expanded their international trade routes. By 1994, domestic trade accounted for only 10 percent of FESCO business, and the company opened new trading routes to Japan, North America, Taiwan, and Australia, as well as 16 company offices overseas.\textsuperscript{91} In conjunction with the new routes, FESCO contracted abroad for new container ships to expand its fleet,\textsuperscript{92} and secured its largest ever loan—$93.5 million from the European Bank for Reconstruction and Development (EBRD)—to pay for the new ships as well as for repairs on existing vessels.\textsuperscript{93} The company also turned its attention to attracting foreign shareholders to finance renovation of its aging fleet. By 1994, foreigners held 10 percent of FESCO stock, with Citicorps and CS First Boston as its major shareholders. To further expand foreign stock purchases, FESCO executives began to search for ways to offer FESCO stock on foreign exchanges and hoped, by 1995, to have foreigners on the Board of Directors.\textsuperscript{94} As a result of these efforts, foreign-owned stock in FESCO rose to nearly 32 percent by 1996, and by mid-1997, foreigners owned nearly 40 percent of the stock and two foreigners sat on the company's board.\textsuperscript{95}

\textsuperscript{91} "Blue-Chip FESCO Stock Split Heats Up Market," \textit{Vladivostok News}, June 23, 1995, p.3.
\textsuperscript{92} FESCO contracted for seven new container ships—six Polish and one German.
\textsuperscript{95} Hashi Syedain, "Fesco results hit by high taxes," \textit{Vladivostok News}, May 30, 1996; "Foreign
In 1995, FESCO's policy towards foreign investors began to change. First the company began to make efforts to attract more Russian investors. To that end, they effected a stock split designed to increase the liquidity of the stock, while still maintaining the percentages held by current stock owners. By lowering the price of FESCO stock, company managers hoped to give more Russian buyers the opportunity to buy into the company.96 This strategy did not prove successful, however, and foreign stock in the company continued to grow.

When the stock split failed to undermine foreign control of the company, FESCO officials embarked on a second strategy: direct appeals to Moscow. These came in the autumn of 1995 in conjunction with a new "loans-for-shares" program, by which the federal government planned to sell its shares in select enterprises. The government identified twenty-nine enterprises across the Federation for the loans-for-shares program and FESCO was included on the list. Under this program, the government invited tenders from Russian banks for government shares—in FESCO's case 19.8 percent held through the privatization fund by the Ministry of Transportation. In return, the government received a low-interest bank loan, and retained the right to buy back the shares, at the original price, up until a deadline of September 1, 1996. Many enterprises on the list objected to the plan, principally out of fear that the government would never buy back the shares and that therefore, bank-owned government shares would eventually be sold to the highest—and therefore foreign—bidder.97 In short, enterprise objections to loan-for-shares were predicated on fears of foreign takeover, and FESCO was no exception.

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FESCO managers made numerous statements to this effect, starting with the General Director, Mis'kov, who openly accused the federal government of compromising Russian national security. In response, FESCO effectively lobbied Moscow, sending multiple delegations to the Ministry of Transportation, and succeeding, with only days to spare before the scheduled auction, in having the company removed from the list of companies subject to loans-for-shares. While the strategy of appealing to Moscow spared FESCO listing in the loans-for-shares program, it did not stem the acquisition of company stock by foreign buyers. The percentage of company stock in foreign hands continued to grow.

In the aftermath of loans-for-shares, with foreign ownership continuing to rise, FESCO moved on to a third tactic: placing company officials in influential Moscow positions. Sergei Frank, FESCO's Vice President for Finance and Planning, moved to the Ministry of Transportation in 1995; by 1997 he held the powerful position of First Deputy Minister of Transportation, where he sat on FESCO's supervisory council. From this vantage, he worked to keep foreign investors at bay. As FESCO's resistance to foreigners mounted, the foreign business community began to take note. Articles in the foreign press reported FESCO management's resistance to foreign shareholders holding seats on the board, noting that "management and workers...prefer to keep [foreigners]...

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97 Author's interview with FESCO manager, September 20, 1997.
98 Viktor Mikhailov, "FESCO will not be a hostage to banks" (interview with Viktor Mis'kov), ("DVMP založnikom bankov ne budet") Vladivostok, October 25, 1995.
99 "FESCO share auction suspended," Vladivostok News, December 15, 1995, p.5. FESCO was not the only Primorje enterprise to secure a last minutes reprieve from loans-for-shares. In the northern Primorje town of Arsenyev, a military aviation plant and PAKT member, Progress, was similarly removed from the loan-for-share list for national security reasons, following active lobbying by its management. See "Will Progress win to right to see its Black Shark abroad?" ("'Progress' poluchaet pravo prodam' za rubezh 'Chernuyu akul'?"), from the BBC, reprinted in Vladivostok, December 5, 1995, p.1.
at arms' length."\textsuperscript{101} With powerful Moscow allies, FESCO management grew noticeably less willing to respond to foreign shareholders' concerns. However, the percentage of stock in foreign hands continued to swell, reaching 43 percent by 1999.

In 1999, when FESCO was unable to stem the flow of foreign investment into the company, FESCO leaders formed a strategic alliance with the krai administration. In return for the governor's assistance in dealing with foreign investors, FESCO leaders agreed to help finance the governor's bid for re-election. In July 1999, Nazdratenko summoned Andrew Fox, a British national who chaired Tiger Securities—the most active foreign investment fund in the krai—to the krai administration. Fox had been working in the krai since 1992, when he participated in voucher privatization and later acquired stock in a number of key enterprises, including those in the PAKT fold.\textsuperscript{102} The krai's most enterprising foreign investor, Fox had brought some $35 million in foreign investment to Primor'e in the course of less than a decade.\textsuperscript{103} At the 1999 meeting, Nazdratenko demanded that Fox hand over 7 percent of foreign owned shares in FESCO, and threatened Fox with detention. According to Fox, "Nazdratenko's threats...were made more pointed by the presence in the room of a general from the Federal Security Service, the new name for the old KGB, and the deputy [FSB] chief of Primor'e province."\textsuperscript{104} The governor's goal was to retain a controlling percentage of FESCO shares in the krai through the Krai Property Fund.\textsuperscript{105} At the same time, FESCO elected a new chairman,

\textsuperscript{101} Reported in "Vladivostok Man: Andrew Fox," \textit{Economist}, October 26, 1996, p. 86.
\textsuperscript{102} Author's interview with Andrew Fox, Vladivostok, April 13, 1995.
\textsuperscript{104} Ibid. For more on the Fox incident also see "Battle for Russian shipping line," \textit{Shipping Times} (Singapore), September 27, 1999.
\textsuperscript{105} Russell Working, "Russia: Fox says he's still consul, calls for governor statement,"
after the retirement of 70-year-old Mis'kov. The new chairman, whose candidacy Fox and other foreign shareholders opposed, was Deputy Transport Minister Alexander Lugovets, whose bid for power received extensive support from former FESCO Vice President Frank. Soon thereafter, Fox and his family fled Vladivostok for England, even as Nazdratenko directed the Federal Security Services to begin an investigation into the affairs of FESCO's foreign shareholders. FESCO paid all its taxes to the krai for the year 2000 in advance, just in time to help finance the governor's successful re-election bid in December 1999.

The alliance between FESCO management and krai governor effectively deprived FESCO of much-needed capital and had a crippling effect on the company. The size of its fleet shrunk rapidly: In 1995, the average age of FESCO ships rose to 17 years, and the company was obliged to retire nine vessels; eleven more went by the end of 1997. By 1998, the fleet shrunk to 110 ships. Lay-offs became endemic. By 1995, FESCO employees numbered fewer that 16,000 and the company was laying off employees at the

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rate of approximately one thousand annually.109 In 1999, when FESCO paid its 2000
taxes in advance, company losses hit US$200 million, and the company was obliged to
start selling off ships to meet its debt obligations.110

Vostoktransflot (VTF)

When the Soviet Union collapsed, Vostoktransflot (VTF) was the second largest
shipping enterprise in the Russian Federation, commanding a fleet of 132 ships.111 VTF
was part of the PAKT fold, and when privatized, the lion's share of VTF stock was
purchased by PAKT structures.112 The company's fortunes waned over the course the
1990s, and by the end of the decade, VTF was heavily indebted and its fleet stood at only
38 ships.113 VTF's managers were hostile to foreign investment, and that antipathy for
foreign participation in company affairs fueled an internal power struggle and provided
the foundation for an alliance with the krai's governor. As in the case of FESCO, krai
administration involvement proved decisive in determining the outcome of that
struggle—the eviction of foreign investors from the company.

For the first half of the 1990s, VTF was headed by Viktor Mistyuk, but in
November 1995, Vladivostok's prosecutor's office levied criminal charges against the

109 FESCO First Half 1995 Update: Steady As She Goes, Tiger Securities, Vladivostok, August
1995, p.3. Tiger Securities, headed by Andrew Fox, was the main vehicle for foreign direct
investment in the krai during the 1990s. The report cited here also noted that FESCO staffing
levels were "around 150% of international levels, but that overall operating costs are lower."
111 Figures given in Russell Working, "Judge calls Vostoktransflot demonstrations illegal,"
Vladivostok News, October 8, 1999; and Nonna Chemyakova, "Vladivostok: Audit cites VTF
2, (re-print from Rossiiskaia Gazeta, October 20, 1994).
113 Russell Working, "Ostapenko refuses to budge from Vostoktransflot," Vladivostok News,
VTF president for non-payment of salaries to company employees. VTF sailors had not received any salary payments for up to 12 months, and the prosecutor's office estimated the value of unpaid wages at some $2.4 million. Meanwhile, Mistyuk and his lieutenants awarded themselves hefty bonuses.\textsuperscript{114} Mistyuk fled Vladivostok for New York, in defiance of a court order, but returned some five months later claiming that illness had detained him in the United States.\textsuperscript{115} Upon his return, Mistyuk was indicted for non-payment of employee salaries, lost his position as president of VTF, and was replaced by VTF's vice-president Viktor Ostapenko.\textsuperscript{116}

The new president actively opposed foreign investment in his company. Soon after his appointment, Ostapenko swung into action, directly opposing foreign investors and wiping out foreign sympathies among the company's Russian shareholders. VTF held its first shareholders meeting under Ostapenko's leadership in June 1996. By then, foreign investors held 30 percent of company stock through a Moscow investment firm called \textit{AbsolutInvest}. At that meeting, ousted president Mistyuk made a bid to regain control of the company by allying himself with \textit{AbsolutInvest}. Ostapenko decried foreign influence in VTF and Mistyuk's traitorous alliance with foreign investors, bringing the company's Russian shareholders along with him in a drive to evict the foreigners and the former company president along with them. According to one report of the meeting, "armed

\textsuperscript{114} "Shipping bosses get rich as sailors wait for back pay," \textit{Vladivostok News}, December 15, 1995, p.5.


\textsuperscript{116} "High drama hits Vostoktransflot," \textit{Vladivostok News}, July 11, 1996.
policemen stood guard throughout the meeting while angry shareholders heckled and stamped their feet against Mistyuk and his...[foreign] allies."\textsuperscript{117}

After \textit{AbsolutInvest}'s aborted attempt to seize control of the company, Ostapenko and VTF's top managers renewed their pledge to keep the company free of foreign influence: Bonding together, they vowed to hold onto their shares—over 50 percent of the company—at all costs. The new company president argued that foreign investors planned to take over the company and sell off its ships.\textsuperscript{118} In addition, Ostapenko allied himself with a Vladivostok-based investment firm, \textit{Partnerstvo}. \textit{Partnerstvo} acquired the VTF stock held by \textit{AbsolutInvest}, and by the end of 1997, held over 60 percent of VTF stock. Ostapenko reasoned that with \textit{Partnerstvo}'s support he could control both foreign stockholders and the bulk of VTF stock. Ostapenko's plan backfired, however, when \textit{Partnerstvo}'s 29-year-old General Director, Analolii Milasheovich, was elected president of VTF in Ostapenko's stead at a November 1997 stockholders' meeting. The new team under Milasheovich was of a different generation—its average age was 27 years old. Dynamic, highly educated, and unafraid of foreign investment, they hoped to turn the ailing shipping giant around.\textsuperscript{119} In retaliation, Ostapenko enlisted governor Nazdratenko's support to obtain a court order removing Milasheovich from office. Upon receiving the court order, Ostapenko initiated police action and physically seized control of the company offices.\textsuperscript{120}

\textsuperscript{117} Ibid.
\textsuperscript{118} "Vostoktranslot managers appeal for staff loyalty," \textit{Vladivostok News}, December 12, 1996.
\textsuperscript{119} Nonna Chernyakova, "VTF removes old guard," \textit{Vladivostok News}, December 11, 1997.
\textsuperscript{120} Anatolii Medetskii, "Stranded ship appeals to Primorskii governor," \textit{Vladivostok News}, October 22, 1999.
When Ostapenko reclaimed VTF leadership, the struggle against foreign investors and Russian sympathizers grew violent. Upon receiving the court order which evicted him from VTF office, Milashevich obtained a new order from a higher court—the Primore Arbitration Court—stating that Ostapenko should resign. However, when Ostapenko refused to comply, Milashevich, was unable to implement that order. VTF employees supported Ostapenko and wrote threatening letters to the Arbitration Court’s Chief Judge, Tatyana Lektionova, mounted protests outside the court building, and even blamed the court for all the krai’s economic ills.121 The violence escalated in September 1999, when a former VTF legal advisor—an opponent of Ostapenko and ally of the Arbitration Court was killed in a bomb explosion hours before she was to depart for Moscow to present legal evidence of Ostapenko’s wrong-doings.122

As the battle to evict foreign investors and retain control of the company raged, VTF’s financial affairs languished: By the end of 1999, all but four of its ships had been taken over because of company debts.123 As VTF foundered, Nazdratenko justified his own actions and those of VTF’s leaders by claiming that he was "protecting the commercial fleet from greedy managers and foreign shareholders who sold off or reflagged Russian ships and looted the proceeds."

Explaining outcomes in the shipping business

The opposition of Russian enterprise directors to acquisition of company stock by "outsiders" is well documented. According to the partial reform argument outlined in chapter 2, directors in privatized export-oriented industries benefited especially from the loosening of export controls, and should be particularly unwilling to cede control over their companies to outsiders. It should therefore be no surprise that directors at FESCO and VTF were hostile to large acquisitions of their stock by outside investors. The studies of these two companies, however, reveal three interesting additional facts. First, some enterprise directors were actively interested in attracting foreign investors and a lively debate about the merits of foreign investment took place among enterprise managers. Second, although both companies were generally uneasy about outside investors, they were far more amenable to outside Russian investment than to foreign investment. Third, resolution of the debate about foreign investment took place only once the krai administration became involved: In both companies, the eviction of foreign investors took place only after an agreement was struck between those managers who opposed foreign investment and the krai administration. In other words, enterprise directors' antipathy to outside investors alone did not result in the eviction of foreign investors; only the combined forces of enterprise directors and regional government officials resulted in enterprises gaining controlling shares of their companies—and that control came at the price of providing a level of financial support to the regional governor which crippled the enterprises.

Why were enterprises directors interested in expelling foreign stockholders? The privatization process had delivered control over enterprises into the hands of managers
across Russia, and Primore's shipping bosses similarly sought to retain controlling shares of their enterprises. The structure of the privatization process itself—namely "option 2" privatization and the tradability to vouchers—insured manager control, and the partial reform argument explains why managers in export-oriented industries should be particularly unwilling to cede that control. This, however, does not explain why Primore's shipping bosses were more willing to work with outside Russian investors than with foreign investors. FESCO, for example, welcomed a Muscovite director onto their board, but vehemently opposed acquisition of company stock by foreign investors. Both FESCO and VTF were willing to concede considerable control over their enterprises to the regional administration, but were not willing to allow foreign shareholders a say in company affairs. This happened despite the fact that alliances with the krai administration proved highly unprofitable—in fact very destructive—for both enterprises, and enterprise directors were aware of the financial cost of their alliance.

Thus, arguments which explain enterprise directors' behavior in terms of the structure of privatization and the effects of partial reform do offer some insight into the activities of Primore's shipping bosses, but they leave many questions unanswered. To understand why directors focused on expelling foreign investment in particular, and why they were willing to risk the viability of their enterprises to do so, we must examine the motivations which drove their actions. At both FESCO and VTF, enterprises directors explained their aversion to foreign investment in nationalistic and xenophobic terms: At FESCO, management issued dire warnings of "foreign takeover" and new "threats" to national security. Vice President Sergei Frank, warned that FESCO would mount its "best
defense against a takeover."\textsuperscript{125} Frank also evinced ambivalence towards foreign creditors, expressing regret at Russian banks' inability to finance ship renovations and concluding dolefully: "There is nothing left but to turn to foreign credit."\textsuperscript{126} FESCO President Mis'kov went even further, issuing a warning that it was "very possible...things could come to the point where the reins of power at FESCO could be turned over to foreign hands."\textsuperscript{127} He also warned darkly of murky "alien" (i.e. non-Russian) forces plotting to undermine his enterprise and threaten Russian national security.\textsuperscript{128} At VTF, Ostapenko openly blamed foreigners for Russia's economic woes and characterized foreigners as "enemies."\textsuperscript{129} He later accused Milashevich of attempting to destroy the fleet by selling it off to foreigners.

This belief among some enterprises directors—that foreign investors were responsible for Russia's economic woes or threatened Russia's national security—is not, in and of itself, sufficient to effect the expulsion of foreign capital. This is because that belief was not ubiquitous. Indeed, a vigorous debate took place within the enterprises themselves about the desirability of foreign investment. Milashevich's brief tenure at VTF is symptomatic of that debate. Indeed, at different points throughout the 1990s, the directors of Primore's shipping enterprises evinced considerable support for foreign investment. The key to winning the debate over foreign investment lay in forming an alliance with the regional administration. Once directors solidified their relationship with

\textsuperscript{125} S. Frank, Deputy Director of FESCO, "Money for Fleet Renovations," Dal'nevostochnyi Morryak, No. 37 (9743), September 13, 1995.
\textsuperscript{126} Ibid.
\textsuperscript{127} Larissa Beloivan, "The government runs aground, the fleet sails away from its home shore," ("Gosudarstvo na meli, flot plyvet s rodnoi zemli,") Argumenty i Fakty, No. 44, November 1995.
\textsuperscript{128} Viktor Mikhailov, "FESCO will not be a hostage to banks" (interview with Viktor Mis'kov), ("DVMP zalozhnikom bankov ne budet") Vladivostok, October 25, 1995.
the regional governor, their position in the enterprise was secure and foreign investors
were ejected. The price of that alliance was the viability of the enterprise itself. In other
words, in order to rid themselves of foreign investment, the directors of Primore's
shipping enterprises struck a Faustian bargain with the regional administration which,
while it did result in the eviction of foreign capital, extracted a crippling price which did,
in fact, threaten the viability of their enterprises.

In sum, the ultimate determining factor in internal enterprise debates about the
merits of foreign investment was the position of the regional governor on the issue of
foreign investment. Primore's governor was more than willing to support the anti-foreign
investment camp. Questioned about his role in the eviction of foreign investors from
FESCO, Nazdratenko explained: "I can't watch indifferently how rapaciously and
uncontrollably our fishery companies, sea transport and mining industries are robbed [by
foreigners]."130 Similarly, in the case of VTF, Nazdratenko argued that the company was
illegitimately headed by foreigners, accused Milashevich of being "the friend of
foreigners,"131 and pushed through the court decision which removed Milashevich from
his elected position as company president.132 Referring to his opposition to foreign
investment in VTF, Nazdratenko explained: "As the governor of the region, who is

130 Jonathan Manthorpe, "Opinion: Fox incident hurts Primorskii krai's prospects," *Vancouver
131 Nonna Chenyakova, "Vladivostok: Audit cites VTF management for ruining shipping
132 "Vladivostok businesswoman killed under suspicious circumstances," RFE/RL Newsline,
September 23, 1999; and Russell Working, "Ostapenko refuses to budge from Vostoktransflot,"
*Vladivostok News*, October 1, 1999.
responsible for the well-being of more than 2 million people, I am outraged by the
cynical, merciless and purposeful robbery of industry."\textsuperscript{133}

\textbf{The Fishing Business}

The experience of recent years has shown that foreign investors enter the Russian fishing industry with one goal: to get access to Russia's marine biological resources and supply seafood products to the international market. In doing this foreigners are not in the least interested in the preservation of our resources, or in the life of our villages, and less so in Russia's food security. And although we continue to work with foreign investors, trying to find mutually profitable alternatives, basically we rely on our own capabilities.

—Evgenii Nazdratenko, Governor of Primorye, speaking at a government hearing on fisheries, December 9, 1999.\textsuperscript{134}

The fishing industry was critically important to the entire Russian Far East and was most developed in Primorskiy krai. Properly managed, it could have provided the engine for economic revitalization in the krai through exports and development of local fish processing capabilities. During the 1990s, however, Primorye's fish catch dropped precipitously, the fish export business fell into confusion and moved into illegal trading, and major fishing enterprises folded. This section argues that isolationist antipathy towards foreign involvement was responsible for the inability of Primorye's fishing industry to grow and mature during the first post-Soviet decade. It begins with an introduction to the krai's fishing business which shows that an escalation in illegal fish trading during the 1990s was interpreted by the krai administration as an effort by foreign powers to undermine Russian security interests. Next, it turns to foreign investment in krai fishing enterprises. Focusing on the Vladivostok Trawler and Refrigeration Fleet

\textsuperscript{133} Quoted in Russell Working, "Arbitration judge at center of murderous battle," \textit{Vladivostok News}, October 8, 1999.

(VBTRF), it shows how a combination of krai leadership's antipathy for foreign
investment and VBTRF's own hostility to foreign investors led to that enterprise's demise.

The State of the Fishing Business

Primorski krai is home to the Far East's main fishing ports and accounts for 70
percent of the Far Eastern fishing fleet.135 The fishing business contributes one third of
the krai's budget and the fleet catches two thirds of all the fish caught in the Russian Far
East and one third of the entire catch of the Russian Federation.136 In 1999, the fishing
industry accounted for 17 percent of all Primore's employed industrial workers.137 In the
1990s, the industry faced two main challenges: First, the dilapidated state of krai
enterprises, combined with a fall in fish stocks, meant that the industry's catch was in
steady decline. In 1990, the Far Eastern fishing business caught five million tons of sea
products. Five years later, that number was less than half.138 By 1994, volumes of canned
fish produced in Primorski krai fell to 1967 levels.139 After the nadir of 1994, the fishing
catch recovered somewhat to almost 3 million tons annually for the remainder of the

135 Anatolii Vetrov, deputy director of Dalryba, talks about the state of the fishing industry in the
136 BISNIS Vladivostok representative Svetlana Kuzmichenko, Primorski Krai Overview, US &
137 Goskomstat figure cited in Tony Allison, "The Crisis of the Russian Far East Fishing
Industry: Sources, Prospects and the Role of Foreign Interests," in Security Implications of
Economic and Political Developments in the Russian Far East, National Bureau of Asian
Statistics from the American Embassy in Moscow show that the Far East fishing fleet caught 4.9
million tons in 1990, and only 2.2 million tons in 1994. Overview of the Russian Far East fishing
industry and Dalmoreprodukt, American Embassy Moscow, April 27, 1995.
139 Vladimir Kucherenko, "Primorski krai: disaster zone," Rossiiskaya Gazeta, September 28,
1994, pp. 1,4.
decade, but then dropped again by 350,000 tons in 1999.\textsuperscript{140} Second, what fish the industry did catch was increasingly exported abroad. As one industry analyst explained: "Revenues from [seafood] export shipments roughly doubled from the late 1980's to 1992, and then doubled again by 1996. This should be viewed in the context of a fall in harvests of approximately 40% over the first period, and another 10% over the second."\textsuperscript{141} The export increase was the result of a complex set of factors. These included a radical drop in the purchasing power of Russian consumers, the lifting of legal restrictions on exports, and the rise in railroad tariffs which made shipping to European Russia prohibitively expensive. As a local analysis explained the dearth of fish on the local market: "It is cheaper to deliver [fish] around the world to Germany than to ship it to Moscow via railroad."\textsuperscript{142}

The most serious problem to face the fishing industry in the 1990s was the escalation of illegal exports. Illegal sale of fish products took place on the high seas beyond Russia's territorial waters, and proceeds from those sales went unreported to Russia tax authorities. Because foreign buyers—mainly Japanese—could pay more than domestic consumers, exports rose precipitously. Their unreported nature meant that Russian enterprises did not pay taxes, depriving the state of tax revenues. While, by virtue of its extra-legal status, it is not possible to compile accurate figures on the volume of over-fishing and illegal seafood exports, a comparison of trade figures across countries provides some insight into the scope of the problem. One Japanese study conducted on


\textsuperscript{141} Ibid.

\textsuperscript{142} V. Bratchikova, "Declining fishing industry," Priamurskie vedomosti, April 8, 1995, p. 2.
Hokkaido did just this, by comparing Japanese figures for crab imports from Russia with Russian figures for crab exports to Japan. Trade in crab is particularly lucrative and almost all Russian crab trapping is conducted by Russian companies which own the special equipment needed to trap crabs. In 1995, the Japanese study found a trade data discrepancy of nearly 50 thousand metric tons of crab—worth nearly $540 million.

**Crab Trade Between Russia and Japan (1994 & 1995)**

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<tr>
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<th>1994</th>
<th>1995</th>
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<tr>
<td>Exports to Japan (Russian Statistics)</td>
<td>90,476 (7,285 metric tons)</td>
<td>85,585 (7,316 metric tons)</td>
</tr>
<tr>
<td>Imports from Russia (Japanese Statistics)</td>
<td>510,973 (38,688 metric tons)</td>
<td>622,000 (56,782 metric tons)</td>
</tr>
<tr>
<td>Difference</td>
<td>420,497 (31,403 metric tons)</td>
<td>536,415 (49,466 metric tons)</td>
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Estimates of actual tonnage and value of illegally exported crab vary wildly, although all agree that the problem is substantial. The Hokkaido study found that some $536 million worth of crab was illegally exported to Japan in 1995. In 2000, the Chairman of the State Committee for Fisheries, Yuri Sinelnik, claimed that "$320 million worth of crab per year is taken illegally to Japan."143 Other studies, conducted by Russian experts, found that king crab catches in the Russian Far East between 1994 and 1999 exceeded quotas by an annual average of 58 percent, and that the problem got

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143 Interview with Chairman of the State Committee for Fisheries, Yuri Sinelnik, "We will Put Primore Under Special Control," *Zolotoi Rog*, March 14, 2000, cited in Tony Allison, "The Crisis of the Russian Far East Fishing Industry: Sources, Prospects and the Role of Foreign Interests," in
progressively worse as the decade progressed: Between 1996 and 2000, the harvests exceeded quotas by an average of 78 percent. Other studies found that between 1996 and 1999, 44 percent of the crab caught in the Russian Far East was illegally harvested, and that the average annual value of illegally exported king crab between 1996 and 1999 was $188 million.\footnote{Studies cited by Tony Allison, "The Crisis of the Russian Far East Fishing Industry: Sources, Prospects and the Role of Foreign Interests," 2000.} While substantially lower than the Japanese findings, this figure still represents a significant problem. There was also broad recognition of the problem, and the fact that it was getting worse, in the Russian press. One typical account in 1995 stated that: "No one knows the amount of overcatch compared to the amount of allowable catch, as well as the amount of fish and seafood sold on the high seas (outside of the 12-mile zone), as this trade is exempt from export tax and thus customs surveillance. According to Japanese statistics, the amount of seafood purchases from Russia was 50\% more than the average of the past two years."\footnote{Security Implications of Economic and Political Developments in the Russian Far East, National Bureau of Asian Research, 2000.}

During the 1990s, responsibility for regulating the fishing industry—and controlling fish exports—fell largely to regional authorities. A system of quota allocations and licensing was established, and regional government bodies created to administer it. The Primorskii krai administration set up a new Fishing Committee mandated to support the local fishing enterprises and interact with foreign investors. However, the committee made no headway in curtailing illegal fish exports which continued to rise throughout the decade. Why did the krai administration fail to crack down on illegal fish exports? The most obvious explanation for regional government tolerance of illegal fish trading would suggest that the krai administration benefited from
the illegal trade in some fashion. There is, however, little evidence to suggest that this was the case, and significant evidence to suggest that the regional government suffered a financial loss as a result of the illegal fish business. A great deal of the illegal fishing activities were carried out by small business entities who bought or rented a limited number of fishing vessels. Big enterprises were more closely regulated by federal customs authorities, and when illegal trades took place they were contingent on corruption in the customs office—in other words any financial benefits from illegal fish trading by large companies directly benefited the company itself or else the customs office. Thus the regional administration had little opportunity to benefit from the illegal trade. More importantly, illegal fish trading deprived the regional budget of much needed funds, a fact that the governor himself deplored.

An analysis of the governor's understanding of the roots of the problem suggests why the regional administration failed to address it effectively. On multiple occasions, the administration argued that the illegal fish trade was the result of a foreign plot to undermine Russia's national security. The governor argued that the increasing exports volumes were symptomatic of an attack on the krai's, and on Russia's, food security, and routinely portrayed the shift to exports as an international plot designed to line foreign pockets at Russia's expense. Thus the administration blamed foreign influence for the drop in availability of seafood for Russian consumers. In a parallel argument, Nazdratenko charged foreign buyers with the "deliberate under-pricing of Russian fish."

146 Indeed, local fishing analysis for 1995 showed that "of the slightly less than 1 million tons of seafood produced last year, just 200,000 tons landed on Russian tables." V. Bratchikova, "Declining fishing industry," Priamurskie vedomosti, April 8, 1995, p. 2.
an unfair tactic he claimed was designed to further impoverish the Russian economy.\(^{147}\)

The krai administration also blamed foreign fishing vessels for over-harvesting—thereby depleting Russian fish stocks, accused foreigners of avoiding Russian taxes, and attributed local budget deficits not to the illegal activities of Russian fishing enterprises, but to illicit earnings by foreign traders. One typical report argued that: "Foreign firms and joint ventures that fish in Russian waters do not consider it their obligation to pay taxes and duties to the Russian government."\(^{148}\) At a federal government hearing in 2000, Nazdratenko claimed that internal administration analysis had found that foreign fishing vessels caught five time more than their allocation, and had not paid taxes on the extra fish.\(^{149}\) (Multiple reports in both the Russian and Japanese press suggest, however, that over-fishing was more a problem of the Russian fleet than foreign vessels). Because the krai administration defined the problem of illegal fish exports as one of foreign aggression, it focused its attention on curbing foreign activities within the krai territory, and did not direct its efforts to regulating the regional fishing industry.

The Vladiivostok Trawler and Refrigeration Fleet

When the Soviet Union collapsed, VBTRF was the largest fishing enterprise in the Russian Federation.\(^{150}\) During the 1990s, the general decline in the fishing industry

\(^{147}\) "Russia: Nazdratenko again slams official fish policy," RFE/RL Newsline, August 1, 2001.


and the accompanying rise of corruption in that business, adversely affected the enterprise's fortunes. Despite the decline, in the mid-1990s, VBTRF employed 10,000 people and had an annual turnover of 200 million dollars. By early 1998, however, with $500 million of its assets stripped, the company stood on the brink of bankruptcy.\textsuperscript{151} It completely disintegrated later that year.

VBTRF was a prominent member of PAKT and actively supported Nazdratenko's bid for governor. When the Soviet Union collapsed, the enterprise was lead by Igor Lebedinets who later became krai vice-governor, and Nikolai Nikitenko, VBTRF’s general director. When VBTRF began the privatization process, Lebedinets and Nikitenko devised a variety of schemes to cope with enterprise privatization: In April 1992, they created 14 spin-off companies, and Nikitenko was listed as the official founder for eight of them. VBTRF directors assumed positions of power in all of the companies.\textsuperscript{152} The scheme allowed spin-offs to reap large profits which went directly to those VBTRF directors. One particularly successful spin-off was a company called Shelf. In 1992, Shelf leased four ships from VBTRF at prices considerably below the market rate. The ships remained the official property of VBTRF, which was responsible for all refitting and upkeep costs. The income from the fish caught by these ships, however, went to the owners of Shelf—Nikitenko and four of his closest deputies. In addition, Shelf directors transferred a portion of VBTRF’s export quota to Shelf, free of charge. A subsequent inspection by the Tax Bureau found that Shelf did not pay taxes on nearly

\textsuperscript{152} "Primorskii krai procurator brings criminal case against VBTRF," Utro Rossii, February 8, 1994, p. 2
half of its earnings.\textsuperscript{153} The spin-off scheme allowed Shelf to earn over 500 million rubles in the first five months of 1993 alone.\textsuperscript{154} Nikitenko's efforts to siphon off profits from a major enterprise through the use of spin-off companies was common practice among the PAKT enterprises, and was in fact a PAKT-sanctioned activity.

When Nazdratenko assumed the governorship in May of 1993, VBTRF's prospects looked good. Igor Lebedinets, one of PAKT's founders, became vice governor and the new governor's right-hand man. But in the fall of 1993, a federal investigation into corruption in Primore ruled that public officials were barred from holding positions in the private sector.\textsuperscript{155} As a result, PAKT's most prominent members—Pavlov and Shkrabov—resigned their positions in the krai administration and returned to their businesses. Lebedinets did not. The powerful vice-governor harbored gubernatorial ambitions. Instead, Lebedinets chose to resign his position at VBTRF, taking the precaution of retaining his 15 percent share of the enterprise by transferring ownership of the stock to his wife.\textsuperscript{156} With Lebedinets no longer on the board, Nikitenko and VBTRF were no longer willing to cooperate with PAKT and the krai administration. VBTRF was doing well—in 1995 the enterprise held 30 percent of the krais' fishing quota—and Nikitenko's unwillingness to share company profits with the regional government drew


\textsuperscript{156} Author's interview with Igor Lebedinets, Vladivostok, September 25, 1997.
the ire of the administration. Together, Lebedinets and Nazdratenko initiated a drive to regain control over VBTRF and remove Nikitenko from office. In the spring of 1994, they called a shareholders meeting and attempted to remove Nikitenko from office. When this effort did not prove successful, PAKT sold its 20 percent holding in VBTRF to a New York based investment firm called Hermes Imperial.

In December 1994, Hermes Imperial cooperated with the krai administration to call a shareholders meeting to discuss removal of VBTRF's management team. At the time, the krai administration controlled 11 percent of the stock through the local branch of the Property Fund, and promised to stand along side the New York investment firm in its bid to remove Nikitenko. The meeting took place on January 11, 1995, but in dramatic last-minute action, the Federal Property Fund ordered its Primore branch to withdraw krai administration control over VBTRF's government stock, rendering the krai administration powerless and leaving Hermes Imperial with insufficient clout to remove Nikitenko. As a result, VBTRF's Director retained his position.

After the January shareholders meeting, both Nikitenko and the krai administration turned their attention to limiting foreign control over VBTRF. To that end, Nikitenko threatened a second stock offering, stating: "If we fail to achieve understanding with Hermes Imperial and our adversaries, we will make a second stock offering and

157 Author's interview with Vladimir Kolesnichenko, Vladivostok, April 18, 1995.
160 Vadim Bratukhin, "Nikolai Nikitenko gotov sravzhat'sya," ("Nikolai Nikitenko is prepared to join battle"), Vladivostok, December 27, 1994, p. 6.
161 Dmitrii Chernov, "VBTRF and Hermes Imperial to Become Partners," Vladivostok News,
devalue their share of the company."¹⁶² In the krai administration as well, antipathy to foreign stock holdings gathered steam. When the federal government planned to sell its shares of VBTRF stock in 1996, the krai duma voted to prevent that sale and lobbied to have the stock transferred to regional authorities.¹⁶³ The regional duma warned that the acquisition of government stock by foreign investors would turn control over fishing enterprises such as VBTRF over to hostile forces who planned to undermine the local consumer market by boosting enterprise exports.¹⁶⁴ In response to these pressures, the federal government handed 16 percent of VBTRF stock over to krai administration control.¹⁶⁵ Soon thereafter, Hermes Imperial folded. In 1998 VBTRF's board at last removed Nikitenko from office, but later that year the company initiated bankruptcy proceedings;¹⁶⁶ VBTRF subsequently disbanded and was broken up into its component enterprises.¹⁶⁷

After VBTRF imploded, the krai administration pursued VBTRF's spin-off companies in a destructive process which led to the demise of VBTRF's most powerful spin-off, a company called "Super" Joint Stock Company. When VBTRF disbanded, all company assets were transferred to Super.¹⁶⁸ The conflict between Super and the krai administration involved control over eleven Russian supertrawlers which caught half of

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July 7, 1995, p. 3.
¹⁶² Cited in Ibid.
¹⁶³ Russian Far East Update, June 1996, p. 3.
the North Pacific white fish consumed worldwide—from British supermarkets, to fish-and-chip stands, to McDonald's deep fryers. The supertrawlers were originally ordered by the Soviet government a few years prior to Soviet collapse. The Soviet government paid 20 percent of the $450 million construction costs, and fourteen trawlers were constructed in Spanish shipyards between 1992 and 1993. When the Russian national fleet privatized, the trawlers passed to a Russian enterprise, Bergen Industries and Fishing Company, which leased eleven of them to VBTRF. Supertrawlers are "sophisticated vessels capable of processing, packaging and freezing the entire fish, from fillets to caviar." In one day, a trawler can catch 300, and process 150, tons of fish. After the January 1995 stockholders meeting, at which Hermes Imperial unsuccessfully attempted to unseat Nikitenko, VBTRF transferred control of the trawlers to Super. Nikitenko also allocated a portion of VBTRF's lucrative Alaska pollock quota to Super free of charge.

The krai administration took great exception to Super's lucrative trawler business. At issue was a joint-venture between Super and a Seattle-based company called Far East Maritime Services. Far East Maritime had been doing business with Super since 1995, and was headed by Nikitenko's son. The Russian Committee on Fishing authorized the joint venture in May 1999, and under the terms of the joint-venture agreement, the Seattle company would "sell Super's catch, provision Super's ships and pay an annual fee to the

171 "Far Eastern fishing fleet to be equipped with Spanish trawlers," TASS, June 4, 1994.
Russian Government to help cover the Soviet debt on the ships."\textsuperscript{174} Far East Maritime sub-contracted work out to another Seattle company, Sunmar Shipping Corp., which was responsible for removing packaged fish from the trawlers at sea and delivering the fish to various ports for sale. Sunmar, however, formed an alliance with another Primorskii krai enterprise, \emph{Dalmoreprodukt} (which has a Seattle office) and the Primorskii krai administration, designed to undermine Far East Maritime (and therefore Super) control over the trawlers. In June, 1999, the three-way alliance between Sunmar, \emph{Dalmoreprodukt}, and the krai administration, successfully convinced the Russian Committee on Fishing to void Super's contract for the Supertrawlers, and hand the trawlers over to \emph{Dalmoreprodukt}.\textsuperscript{175} This brought an end to VBTRF's last successful spin-off company.

\textbf{Explaining outcomes at VBTRF}

VBTRF's demise appears to be a straightforward case of struggles among regional actors for a piece of the lucrative fishing business. Certainly, the personal enmity between Nikitenko and Lebedinets played no small part in initiating the krai administration's bid to take over control of the company. Both the krai administration and VBTRF management were clearly interested in winning control over company assets. However, the story also raises some puzzling questions: Why, for example, was the krai

\begin{flushright}
\textsuperscript{174} Mike Eckel, "VBTRF nears bankruptcy," \emph{Vladivostok News}, July 10, 1998; and Arthur C. Gorlick, "Russia, US Companies fight over ownership of fishing boats," \emph{Seattle Post-Intelligence}, September 3, 1999.

\textsuperscript{175} On Nazdratenko's support for Dalmoreprodukt's bid see "Disputed Trawlers ordered to stop fishing," \emph{Vladivostok News}, February 25, 2000; on the June 29, 1999 decision to hand the trawlers over to Dalmoreprodukt see Russell Working, "Russian Dispute Roils Fishing Industry," \emph{The New York Times}, Wednesday, August 18, 1999; and Arthur C. Gorlick, "Russia, US Companies fight over ownership of fishing boats," \emph{Seattle Post-Intelligence}, September 3, 1999.
\end{flushright}
administration willing to work with Hermes Imperial in 1995, but by 1996, opposed foreign acquisition of government-held VBTRF stock? Were these simply strategic moves to gain control over the company? If so, why did the administration, through PAKT, elect in 1994 to sell a large packet of VBTRF shares to foreign investors? A closer look at the decision-making process shows that, while the struggle among regional actors was an important part of the story, the primary struggle for both VBTRF management and the krai administration was to eliminate foreign control over regional enterprises.

Hermes Imperial was an unusual "foreign" investor: Although based in New York, it was composed exclusively of Russian citizens. Its dealing with VBTRF were conducted through its Moscow-based Hermes Capital Management. When Hermes called the stockholders meeting in January 1995, Nikitenko interpreted this action as an effort by foreign investors to take control of Russian assets. Hermes' representative in Vladivostok expressed surprise at Nikitenko's reaction, explaining: "Usually problems do not occur because we do not think of ourselves as foreigners or outsiders, but as Russians. All of the partners in Hermes Capital Management, for instance, are Russians." 176 Nikitenko, however, consistently portrayed Hermes' activities as a ploy by foreigners to undermine his enterprise and the krai economy in general. Asked about Hermes Imperial's stake in a December 1994 interview, he bluntly stated: "We do not need foreign shareholders." 177 The krai administration, however, decided to work with Hermes

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177 Interview with Nikitenko reported in the Russian Far East Update, December 1994, p. 5.
specifically because they saw Hermes as a Russian, not foreign, investor. Thus, while the impetus to interfere in VBTRF's affairs was initially a struggle among regional actors, the krai administration's decision to ally itself with Hermes did not constitute an endorsement of foreign investment into regional enterprises. Indeed, when the possibility of actual foreign stock purchases did arise in 1996, the krai administration made every effort to ensure against foreign acquisition.

The krai administration's successful bid to undo VBTRF spin-off company, Super, similarly appears to be a simple strategy to gain control over lucrative resources. This, however, cannot explain why the administration agreed to team up with another krai enterprise, Dalmoreprodukt (DMP) in this effort. The krai administration exerted no particular leverage over Dalmoreprodukt, nor did it control a significant portion of DMP stock. Dalmoreprodukt's general manager, Yuri Didenko, was a savvy businessman with a powerbase that exceeded the governor's grasp. There is no evidence to suggest that the transfer of Super's assets to DMP was the product of a strategic move on the part of the krai administration to gain control over those assets. Instead, the krai administration explained its decision to oppose Super and to work with DMP in terms of an anti-foreign policy. Krai leaders accused Super of threatening Russian national security and playing into the hands of foreigners. According to one report, krai officials accused Super of "giving its Seattle partner too much control...The actions of the 'shadow' management of the company, which is located in the United States, in Seattle, can lead to big financial

178 Author's interview with former krai administration official, Vladivostok, September 28, 1997.
179 Author's interview with Yuri Didenko, Vladivostok, December 15, 1993.
losses and the loss of the ships for Russia..."180 Dalmoreprodukt's leaders echoed these arguments, claiming that the transfer of the trawlers to their company would "preserve your vessels for the Russian Federation, which have been under threat of alienation and resale, with the goal of saving your workplace and making more effective use of the fleet."181

In sum, while the struggle over VBTRF was partly one for control over enterprise assets, key decisions—such as the krai administration's decision to cooperate with Hermes Imperial and the subsequent alliance with Dalmoreprodukt to undo Super—were the product of anti-foreign isolationist thinking in the administration. These decisions, combined with Nikitenko's identification of Hermes Imperial as a "foreign" investor, eventually brought an end to Russia's largest fishing enterprise.

Conclusion

This chapter has examined Primorskii krai's interaction with foreign investment during the 1990s. In it I ask why the krai's first governor, Vladimir Kuznetsov, favored a policy environment receptive to FDI, while for the bulk of the 1990s, the krai's second governor, Evgenii Nazdratenko, worked to cut the krai off from foreign investors. To explain policy outcomes and variation, the chapter considered the distribution of economic factors in the krai, the impact of institutional arrangements such as the Soviet institutional legacy and the effects of partial reform—in reference to privatization, and the power of networks—especially the relations between political and economic elites. In

181 Russell Working, "Russian Dispute Roils Fishing Industry," The New York Times,
addition, it has discussed the level of political polarization within the krai, the role of central policy, and the historical legacy of Soviet and pre-Soviet times. This conclusion lays out the chapter's findings in these areas, showing both the ways in which these variables can address regional policy outcomes, and the questions which they leave unanswered. It then summarizes the ways in which ideational factors worked to drive policy outcomes in the krai.

Economic Factors

Primorskii krai has a large number of Soviet-style enterprises with a heavy military component, and it is tempting to interpret the rise of isolationist policy in the krai as the product of those economic interests. In this chapter, I argued that economic structure cannot, however, explain either isolationist policy or the variation in policy outcomes across the two administrations. Primore's economic structure did not change significantly between 1990, when Kuznetsov was appointed, and 1993, when Nazdratenko came to power, so that focusing on economic variables alone cannot explain the variation in policy outcomes under these two administrations. Nazdratenko's rise to power does, on the face of things, appear to be the result of organized economic interests under the PAKT umbrella, and in the beginning, this was indeed the intention of PAKT's top leadership. However, PAKT's objections to Kuznetsov did not constitute a fundamental rejection of the governor's policies but rather a rejection of the man himself. Furthermore, PAKT disintegrated shortly after Nazdratenko's appointment, yet the governor remained in power and went on to sweep two gubernatorial elections. Thus, while an organization of economic actors, namely PAKT, did contribute to Nazdratenko's

Wednesday, August 18, 1999.
appointment as governor, PAKT itself was neither cohesive nor an advocate of the isolationist policy which the governor espoused. For this reason, economically derived interests alone cannot explain Nazdratenko's rise to power or the subsequent rise of isolationist policies in the 1990s.

Furthermore, a look at the position of PAKT enterprises on FDI, both at the time of Nazdratenko's appointment and during his tenure shows that a number of important enterprise directors opposed the administration's drive to evict foreigner investors from the krai. Some, such as defense enterprises Varyag and Dalzavod, broke with the administration within months of Nazdratenko's appointment. Both went on to develop successful joint-ventures with foreign partners and moved increasingly into civilian production. In other enterprises, such as the two shipping enterprises discussed in this chapter, a debate broke out within management about the desirability of working with foreign investors. That debate was resolved only once those managers who opposed foreign investment allied themselves with the krai administration. That coalition of forces led to the eviction of foreign investors from enterprises, but also extracted a crippling price from the enterprises themselves. This suggests that there was no set of fixed economic interests which dictated an aversion to foreign investment in Primore's enterprises. Rather, policy outcomes in the enterprises were a result of the krai administration's enthusiasm for supporting those factions which opposed foreign investment. Without krai administration involvement, there it no reason to believe that enterprise directors who opposed foreign investment would have been successful in their quest to eject foreign shareholders. In fact prior to krai administration involvement, enterprise directors opposed to foreign investment were fighting a losing battle. As the
chapter on Sakhalin will show, where regional governors did encourage foreign investment, the outcome of similar internal enterprise debates supported an influx of foreign capital.

**Institutions and Policies**

As discussed in chapter 2, a number of studies have argued that the remnants of Soviet institutions affect policy outcomes. Stoner-Weiss' study of regional FDI argued that a concentrated regional economy—namely a prevalence of mono-industrial "company towns"—would create a pro-FDI business environment. Conversely, a number of other studies, such as Hanson's study of "Leninist" institutions, argued that Soviet institutional holdovers exerted a negative impact on economic reform; this led me to hypothesize that Soviet holdovers might also have a negative impact on regional FDI policy. The evidence presented in this chapter suggests that neither argument holds up. The directors of Soviet-style enterprises in Primorskii krai exhibited a range of responses to FDI and advocated a variety of policies towards foreign investment. Some directors, such as those at *Varyag* and *Dalzavod*, sought out foreign investors, others, such as FESCO and VTF, rejected foreign investment. In other words, the legacy of Soviet institutions in and of itself did not produce particular policy outcomes.

The evidence presented in this chapter shows that Joel Hellman's partial-reform argument does provide some explanatory muscle for policy outcomes on FDI. According to the partial-reform approach, directors who gained controlling shares of their enterprises through privatization were likely to resist the acquisition of significant share packets by investors from outside the company. This indeed took place across Russia,
and in Primorski krai, and is especially likely in export-oriented industries which benefited from the lifting of restrictions on foreign trade. The fact that privatization in Russia preceded the formulation of a legal framework to accommodate foreign investment lends further credence to the partial reform argument. In a comparison of FDI in China and Russia/Eastern Europe, Mary Gallagher has argued that the Soviet Union's decision to focus on reform in state-owned enterprises prior to initiating reforms in FDI created vested property rights which were later threatened by foreign investment. In China, Gallagher points out, FDI reform took place prior to enterprise reform, so that foreign investment did not threaten powerful groups such as enterprise managers.\textsuperscript{182} Privatization in Primorski krai's enterprises certainly empowered manager-owners who then felt threatened by outside investors, as Gallagher and Hellman suggest. However, the evidence presented in this chapter shows first, that enterprise directors were considerably more willing to allow Russian investment into their enterprises than foreign, and second, that not all enterprise directors opposed foreign investment. As noted above, the critical element which determined enterprise policy outcomes on foreign investment was the position of the regional governor, and that position was not driven by economically-derived interests.

**Networks**

The literature on networks discussed in chapter 2 suggests that the strength and durability of network connections—particularly those between government and business—has an important effect on policy outcomes. Stoner-Weiss argued that close

cooperation between economic and political elites at the regional level lead to "good governance" and was likely to coincide with pro-FDI policies. Most other studies argued that interactions between business and government were likely to be collusive and would therefore not produce policies favorable to FDI.

In Primorski krai, collusive relations between political and economic elites led to policy outcomes that did not support FDI. In the cases of FESCO and VTF, collusion between the krai administration and enterprise directors drove foreign shareholders out of those enterprises. In the case of fishing enterprise VBTRF, the krai administration first strove to unseat management and gain control of the business, and later cooperated with Dalmoreprodukt to undermine VBTRF's spin-off company Super, a tactic which both DMP and the administration portrayed as an effort to insure Russian control over Super's assets. These cases provide examples of business-government action geared to limit foreign investment, but do not prove that such networks must necessary lead to anti-foreign policies. As noted above, the position of political elites in determining policy outcomes in the krai was critical. Later chapters will show that while business-government relations play an important role in other regions, the policy outcomes such networks generated varied widely. The way in which networks operated in the Russian regions, and the outcomes they produced, depended, in other words on the policy position of regional governors.

The Federal Center

As discussed in chapter 2, studies of Russian federalism divide roughly between those that see the central state engaged in strategic interaction with the regions, and those
that see a central state too weak to engage in strategic interaction with the periphery. While it would be inaccurate to claim that central players held no sway over Primor'e's FDI policies, the general picture which emerges from the analysis of FDI policies in the krai is one in which the central government played a peripheral role. For the most part, central government officials, from President Yeltsin down, were dissatisfied with Nazdratenko's policies, and several attempts were made to remove the governor from office. If Yeltsin did not force Nazdratenko from office, it was not because the President endorsed the Primor'e governor's policies, but because Moscow feared that forcible removal of an elected regional official would undermine the democratic project in Russia.  

A great deal of central criticism focused on Nazdratenko's energy policies and the energy crisis in Primor'e was well-known across Russia. The governor's distaste for foreign investment was also a point of contention in Moscow. One Yeltsin aide complained of Primorskii krai: "Investors are refusing to go there. At the same time, the Koreans have opened an automobile assembly plant in Kaliningrad Oblast and the Japanese have installed oil refining facilities in Yaroslavl Oblast. But there is no money pouring into Primorskii krai, because the style of administration that has taken shape there has rendered it an unfavorable zone for international investments." Another report noted in reference to Vladivostok: "It is not for nothing that the head of the Central Bank, V. Gerashchenko, called the most promising city in Russia, the gate to the

183 Author's interview with Leonid Smirnyagin, Moscow, October 4, 1997.
prospering Asia Pacific region, an 'economic wasteland.'185 In short, Moscow officials were clearly displeased with Nazdratenko's policies on FDI, but were unable to change them. Not until President Putin came to power was Nazdratenko forcibly "convinced" to resign his position. Thus, under the Yeltsin administration, if not perhaps under President Putin, strategic interactions between the center and the periphery played only a minimal role in determining policy outcomes in Primorskii krai.

Political Polarization

Studies such as Timothy Frye's inquiry into economic growth in post-communist countries argue that high levels of political polarization lead to unstable policy outcomes which undermine economic growth. Low levels of polarization, therefore, lead to higher economic growth rates. In chapter 2, I drew on Frye's analysis to hypothesize that high levels of political polarization might lead to unstable policies which would not support FDI. Data presented in chapter 2 suggested no correlation between polarization—measured as Frye does by communist and anti-communist voting patterns—and FDI policy outcomes in the Russian Far Eastern provinces, but polarization at the regional level—conflict between supporters and opponents of the regional administration, may have an impact on policy outcomes, such as FDI policy. Under Nazdratenko, struggle between the krai administration and a range of political opponents was consistently high. It began with the conflict between the governor and the Vladivostok mayor, but as members of PAKT defected, the level and complexity of the conflict escalated. At times conflict was a product of straightforward power struggle—as, for example, that between

Nazdratenko and his former lieutenant, Igor Lebedinets. Often, however, political polarization in the krai arose as a direct result of disagreement over the governor's policies—such as the controversial question of energy pricing. Thus, in Primorskii krai, policy outcomes were not the result of political polarization; rather, polarization arose as a result of policy directives. In the case of Primore's policy on FDI, there is no evidence to suggest that the krai's isolationist stance and poor performance were a product of political polarization; instead, the governor's polices themselves gave rise to political polarization.

Historicist Arguments

Historicist and path dependent approaches argue that policy outcomes are the product of particular historical experiences or of institutional and organizational constraints that "lock-in" power configurations or modes of operating. Like the arguments which focus on economic factors discussed above, a path dependent analysis has difficulty explaining the variation in policy outcomes between Kuznetsov and Nazdratenko's administrations. If historical experiences or institutional arrangements lock in power configurations which generate policy outcomes, it is difficult to explain why one set of constraints would produce two such different outcomes.

It is tempting, however, to view Nazdratenko's policies as the product of Primorskii krai's Soviet-era experience and the institutional arrangements to which that experience gave rise. Soviet Primore was, after all, isolated from the outside world—with Vladivostok a closed port and the seat of the Pacific Fleet. The source of Primore's isolation under the Soviets was its military significance. In the post-Soviet era, those
institutions most likely to lock-in policy outcomes, therefore, are those associated with military power: the defense sector and the Pacific Fleet itself. However, the evidence presented in this chapter suggests that the defense sector was internally divided on the question of foreign economic interaction, that a number of defense enterprises broke with the governor over his isolationist policies, and that even those defense enterprises least able to benefit from FDI—those unable to covert to civilian production—did not support the Nazdratenko administration. Arsenev’s aviation plant, Progress, for example, overcame the governor’s objections and began exporting its Black Shark helicopters to China in the late 1990s. Finally, the Pacific Fleet, which occupied an important place in Soviet Primorski krai, did not play an important role in post-Soviet regional politics. Its leadership’s attention was focused primarily on Moscow, in an effort to obtain central funding for its aging fleet. In general, members of the military were politically alienated, as evidenced by the unusually high percentage of military voters selecting the "against all” option on voter ballots in the State Duma elections.Ironically, the only krai political figure associated with the Pacific Fleet was Vladivostok mayor Viktor Cherepkov—Nazdratenko’s most vocal regional opponent, and critic of the administration’s isolationist policies. Cherepkov was a former officer in the Pacific Fleet.

The Impact of Ideas

The this chapter, I have presented a number of ways in which the ideas of top regional officials—notably those of governor Nazdratenko—drove FDI policy outcomes

186 Author’s interview with Pacific Fleet officer, December 12, 1993.
187 In the 1993 elections to the State Duma, voters in one predominantly military voting district, Skotovo-17, cast the highest percentage vote against all parties (30.65 percent), against all single
in Primorskiy krai. I argued that racism and xenophobia—not institutional structures or economically derived material self-interest—drove the governor's policy. The governor's belief that FDI was synonymous with a foreign plot to seize control of Russia's wealth and territory explains the governor's violent crackdown on trade with the People's Republic of China and also his hostility to the Tumen River Area Development Program which promised billions of dollars of foreign investment in the krai's infrastructure. I argued that the governor's alliance with like-minded shipping bosses drove foreign investment out of that lucrative business, and that hostility to foreign investors contributed to the administration's ineffective response to illegal fish exports and brought about the demise of the krai's largest fishing enterprise.

Here I return to the five part model of ideational causation which I laid out in chapter 2. The first step, I argued, is to identify the way in which governors defined the crisis in their regions and the priority they placed on different aspects of that crisis—economic, political, or regional. Primore's first governor, Vladimir Kuznetsov, focused his attention overwhelmingly on the economic aspects of the crisis, contrasting the krai's natural wealth and favorable geographic location with the poverty of the regional economy in both Soviet and post-Soviet eras. Nazdratenko's emphasis was quite different. As was the case elsewhere in Russia, Nazdratenko's administration deplored the state of economic affairs and condemned Moscow for its lack of financial support to the regions, but in personal interviews and public statements, the governor emphasized one crisis above all: that of political change, in short—democratization. The problem with Russia, Nazdratenko maintained, was a lack of "unified government" and the solution, he

mandate candidates (14.57 percent), and against all Federation Council candidates (30.61 percent)—this when Nazdratenko ran for the Federation Council.
contended, was the institution of a "unified government of Slavic people." The governor's ceaseless efforts to consolidate political power in his own hands—setting up an authoritarian system akin to a "fiefdom," and his simultaneous support for a Russian President dedicated to the democratic process—two tendencies which on the face of things appear mutually contradictory, can readily be understood within the context of the governor's interpretation of the state of affairs in Russia. If the problem with Russia was a lack of unified government, as the governor believed it was, then the solution was both to consolidate regional power—effectively do away with the democratic process at the regional level—and simultaneously pledge allegiance to a strong Russian President—the man, if not his policies.

Addressing the genesis of Russia's crisis, the second step in my model, Kuznetsov blamed the legacy of irrational Soviet planning and the exploitative "colonial" nature of Moscow's relation's with the krai under the Soviet system. Nazdratenko, conversely, placed the blame for Russia's weakness squarely on the shoulders of foreign powers and their Russian collaborators. The collapse of the Soviet Union, he believed, was a "tragedy for the Slavic race (slavyanskii narod)." This explanation for the crisis—couched in terms of race—permeated Nazdratenko's thinking on matters related to FDI. As the cases presented in this chapter illustrate, Nazdratenko consistently explained the actions he took to rebuff foreign investors in terms of xenophobic nationalism and race. The two governors' disperate diagnoses of post-Soviet crisis were closely related to their

190 Any antagonism between the krai and Moscow, Nazdratenko thus reasoned, was the doing of disloyal Moscow bureaucrats who had sold out to the West.
interpretations of the krai's history in Soviet and pre-Soviet times. In the section above on
historicist explanations, I argued that an absence of "lock-in" mechanisms precluded a
path dependent explanation for policy outcomes. Yet the fact remains that Nazdratenko's
isolationist policies bore a striking resemblance to the krai's profound isolation from the
outside world as a closed military port under the Soviets. The explanation for this
continuity, despite the dearth of institutional or organizational lock-ins, I argue, is
ideational. Nazdratenko openly admired the the powerful men who controlled Siberia
under the Tsars—such as Nikolai Muravev, Eastern Siberia's visionary governor-general
under Tsar Nicholas I—and exhausted Vladivostok's strength and aggressive military
might under the the Soviet system. Thus his belief that alien forces were responsible for
the krai's post-Soviet plight. Kuznetsov, conversely, consistently referred back to those
pre-Revolutionary years in which Vladivostok was a vibrant, international, and
multicultural trading port. Thus his placed the blame for Primors's post-Soviet crisis on
the Soviet system which did away with Vladivostok's pre-revolutionary vibrance.

Third, the governor offered his own set of definitions for key concepts in the post-
Soviet world: reform, democracy, Subject of the Federation, and patriotism. Kuznetsov
believed economic reform to represent progress and the quest for economic enrichment
through foreign capital on the part of the krai to serve the national interest. To
Nazdratenko, however, economic reform—especially privatization—and democratic
institutions, constituted much more than a potential threat to the governor's power. To the
governor's way of thinking, economic reform and democratization were in fact a betrayal

192 Boris Laputin, "Ispytanie Vlast'yu," ("Trial of Power") Boevaya Vakhta, December 2, 1995, p. 3.
of the Russian people, perpetrated by foreign powers and their Russian collaborators with the express purpose of undermining the Russian people, exploiting Russia's natural wealth, and taking unfair advantage of Russia's temporary weakness. On this basis, the governor went on to define patriotism as the defense of Russia's territorial integrity—thus his opposition to the border agreement with China—and interpret foreign economic ventures as a threat to Russia's national security—the basis for his criticism of the fish export business.

Fourth, ideas provided the underpinnings for legitimate policy in Primorskii krai. The governors' policies were in line with their beliefs about the nature of the crisis facing Russia, their understanding of the genesis of that crisis, and their interpretation of the key concepts of reform, democracy, the role of the region in the national whole, and patriotism. Kuznetsov put his beliefs into action by actively seeking to draw foreign investment to the krai. Nazdratenko, conversely, believed that the source of Russia's problems lay outside the borders of the Federation and that therefore the solution to the crisis was to ensure that control over Russian resources remained in the hands of "the Slavic race;" on the basis of this reasoning, he sought to evict foreign investors from the krai. Indeed, Nazdratenko explicitly and consistently explained his opposition to FDI in terms of threats to national security posed by foreign economic incursions. To the governor's way of thinking, in short, eviction of foreign economic influence—forceably curbing foreign acquisition of enterprise shares, curbing foreign trade, opposing large-scale multilateral projects such as the TRADP—was the only legitimate policy alternative.
Fifth and finally, the extent to which the governor took steps to "embed" his policies into regional institutions had a direct bearing on the longevity of his policies. I have argued that Kuznetsov made almost no effort to "sell" his policies in the locality, despite the fact that powerful PAKT members and the krai soviet were broadly sympathetic to his policy position. Kuznetsov's failure to even attempt to embed his policies at the regional level was the primary reason for the governor's dismissal. Nazdratenko, on the other hand, took concrete steps to ensure that his policies took hold in the locality—despite the fact that prominent members of PAKT, as well as a tenacious opposition centering around the Vladivostok mayor, opposed them. While the fluidity of institutional arrangements throughout the 1990s precludes concrete "embedding" of ideas, Nazdratenko used his extensive connections in the krai, the power of executive office, and manipulation of the electoral system to perpetuate his policies throughout his tenure and beyond. It is an interesting fact that despite frequent factional infighting and defections from the governor's camp, Nazdratenko successfully maintained a stranglehold on political power in the krai throughout the 1990s, and was removed only under duress after Vladimir Putin assumed the Presidency. Even after his removal in February 2001, politics in Primorskii krai changed very little. The new governor, Sergei Darkin, elected in July 2001, was a Nazdratenko protégé,¹⁹³ and in a race which resembled a soap-opera re-play of Nazdratenko's own 1999 gubernatorial victory, the new governor's main opponent, the erstwhile former mayor of Vladivostok, Viktor Cherepkov, was removed from the race under suspicious circumstances, seventy-two hours before voting began.¹⁹⁴ After Cherepkov's removal from the 2001 race, Darkin went on to beat a Kremlin-backed

candidate put forth by Putin's new representative to the Far East "macro-region,"
Konstantin Pulikovskii. It appears, therefore, that even after his effective removal from
power, the long arm of former governor Nazdratenko still reaches into the heart of
Primorskii krai politics.

Khabarovskii krai
Chapter 4

Nationalism: The Case of Khabarovskii krai

The processes arising today in neighboring territories—in Primorskii krai and Khabarovskii krai—are totally dissimilar. In Primorskii krai there is unending boiling of political passions... In Khabarovskii krai the daily ritual of work continues....—Boris Reznik, State Duma Representative from Khabarovskii krai.

Khabarovsk was the epicenter of the Soviet Far East. In Soviet times, Khabarovsk was the administrative center for the entire Far Eastern region—a geographic expanse larger than the continent of Australia. It was the seat of the Far Eastern military command. It was the place where foreign business set up shop. When the Soviet Union collapsed, Khabarovsk appeared poised to take the lead in the brave new era. The krai lacked the infrastructural development and prime southern location of Primorskii krai, but it made up for these shortcomings in leadership experience and exposure to the West. When Khabarovsk’s governor Viktor Ishaev was appointed in 1991, he predicted a bright future for the krai—at the head of the entire Far Eastern region—predicated on foreign trade and foreign direct investment. As the decade of the 1990s progressed, however, these expectations went unfulfilled. Rather than turning to the world outside Russian borders, Khabarovskii krai turned in on itself. Indeed, from the moment the Soviet Union collapsed, Khabarovsk’s leadership devoted all its energy to preserving the status quo, in a vain attempt to retain the economic and political relationships of its Soviet past.

Khabarovsk’s leaders did not evince the animosity towards foreign business which characterized their counterparts in Primore, but neither did they embrace it. Rather than actively engaging the foreign businesses that came to the region—drawn primarily by Khabarovsk’s rich timber reserves—the krai administration increasingly turned to
Moscow in search of direction and financial support. Foreign projects languished and many expired.

Why did Khabarovsk's leaders persist in turning to the federal center rather than taking advantage of the new opportunities offered by foreign investment? This chapter will consider the range of possible explanations for policy outcomes introduced in chapter 2. It will argue that explanations based on economic structure, institutions and policies, business-government networks, and center-periphery relations cannot adequately explain FDI policy outcomes in Khabarovskii krai. Instead, the chapter will introduce and defend an ideational explanation for the krai's Moscow-centric approach to FDI. I argue that Khabarovsk's governor was animated by a nationalist cause: He believed that decisions taken at the local level should rightly take national interests into account, so that localities should not take actions which could compromise national interest; and conversely, that it was the duty and responsibility of central power to consider local needs and effectively address them, in a paternalistic relationship akin to Tsar and serf, or Soviet overseer and dutiful provincial appointee. In the governor's view, national economic and political integrity must be preserved at all costs, in a holistic entity in which provincial and central concerns were inseparable. The chapter begins with an historical introduction to the krai, followed by a discussion of the post-Soviet governor's approach to krai politics and the regional economic policy. Next the chapter analyses Khabarovsk's most important policy initiative in the area of FDI: The Far East and Trans-Baikal Association and its Program for economic development of the Far East. Finally, the chapter examines FDI in Khabarovsk's most important industry: the timber business.
A concluding section sums up the chapter's findings and presents a five-part model of ideational causation for FDI policy outcomes in Khabarovskii krai.

**Historical Background**

Khabarovskii krai's capital, the city of Khabarovsk, was founded in 1858 as a military outpost by the Governor General of Eastern Siberia, Count Nikolai Muraviev. It was named Khabarovka, after an explorer, Erofei Khabarov, who headed the first Russian expedition down the Amur River in 1651. Khabarov's methods were so brutal that the natives reportedly appealed to the neighboring Chinese to protect them from the Russian menace. The Tsar had Khabarov arrested and demanded an accounting of his actions, but Khabarov was later cleared of any wrongdoing and his activities portrayed as "isolated excesses" necessary in "uniting" the Amur region with Russia. Muraviev secured the territory of Khabarovskii krai in 1858 with the Treaty of Aigun. In 1884, the territories of Transbaikal, Amur, Maritime, and Sakhalin were detached from Eastern Siberia and placed under separate administration under a newly created Priamur governor-generalship, headquartered at Khabarovka. The Priamur governor-generals wielded enormous power. They "commanded police and military forces, administered justice, collected taxes, oversaw economic development, and conducted diplomacy with neighboring countries."

In 1893 Khabarovka's population swelled to 15,000 and the town was renamed Khabarovsk.

Soviet power reached Khabarovsk in 1922, and in 1924, the city was designated the capital of the Soviet Far Eastern Region. From 1926 to 1938, the Far East formed one

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province called Dalnevostochnyi krai—Far Eastern Region—under Khabarovsk's leadership. In 1938, Stalin became concerned about separatism in the Far East, and divided the region into two parts—Primorskii krai led by Vladivostok, and Khabarovskii krai. Even then, Khabarovsk governed the territories north to Kamchatka and Chukotka, west to Amurskii oblast, and east encompassing the island of Sakhalin. Between 1938 and 1953, the other Far Eastern provinces were separated out from Khabarovsk's direct control: Sakhalin detached in 1947; in 1948 the Amur region was created out of parts of Khabarovskii krai and the neighboring Chita district; Magadan and Kamchatka were divided from Khabarovsk in 1953 and 1956 respectively. The Jewish Autonomous oblast was also originally under Khabarovsk's jurisdiction. Created by Stalin in 1930, it became a separate entity only in 1991. Although Khabarovsk lost direct control over these territories, it continued to play an important role in Far Eastern affairs throughout the Soviet period. Khabarovsk was, for example, the headquarters for the Soviet Far Eastern Military Command, a position which it retained in the post-Soviet period.

The important position which Khabarovsk occupied under the Soviet system meant that the city was well connected both to the rest of Russia and to the world outside. The first direct air service between the Far East and Moscow opened in 1961, and connected Khabarovsk to the capital. Until 1991, Khabarovsk was the only major Far Eastern city open to foreigners, and the only one in which foreign businesses could open offices. Because of this, when the Soviet Union collapsed, foreign business already had a

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3 Foreigners could travel to some other parts of the Soviet Far East, but this required special permission. Also the Primorskii krai port of Nakhodka was opened to foreigners in the mid-
foothold in the krai, and this familiarity meant that when foreign traders and investors came to the Russian Far East, it was often to Khabarovsk that they came first.

**Geography, Infrastructure and Economic Structure**

A long narrow region, Khabarovskii krai runs north from the border with Primore up to Magadan—just 430 km below the Arctic circle. To the south and west it borders the People’s Republic of China (265 km), the Jewish Autonomous oblast, Amur oblast, and the Republic of Yakutia (Sakha). Sakhalin oblast lies just off-shore to the east. Khabarovsk’s extensive coastline stretches 3390 km along the Sea of Japan north to the Sea of Okhotsk. Khabarovsk is one of the larger Far Eastern regions, occupying a territory of 825 thousand square kilometers—nearly five times the size of Primorskii krai. When the Soviet Union collapsed, the krai’s population stood at nearly 2 million, or 2.2 inhabitants per square kilometer. Most of its inhabitants live in the southern portion of the krai and are concentrated in 7 urban centers which together account for 68 percent of the population. The krai’s capital, the city of Khabarovsk, located on the banks of the Amur River, had a population of 624 thousand in 1993, and is the second largest city in the Far East—after Vladivostok. Khabarovskii krai’s climate is notably less hospitable than that of its southern neighbor; in the capital city winter temperatures regularly dip below minus 40 degrees.⁴

Infrastructure in Khabarovskii krai is less developed than in Primore. The krai has one large commercial port—Vanino, which is the third largest Far Eastern Port. Smaller

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¹⁹⁶⁰s, but Nakhodka was not a major city, and travel beyond the city boundaries, and particularly to Vladivostok, was strictly controlled.
port facilities operate at Sovetskaya Gavan and Nikolaevsk-na-Amure. Khabarovsk and Komsomolsk-na-Amure have river ports. The Trans-Siberian Railroad traverses the krai, as does the Baikal-Amur Mainline (BAM) which ends at Vanino. Vanino port also provides a ferry link to Sakhalin. The northern portion of the krai, which is largely covered by forests, has no railroad and few roads. Khabarovsk's international airport, however, is the largest in the Russian Far East with links to Northeast Asia and points in Siberia and European Russia.⁴

Post-Soviet Khabarovsk inherited an economic structure which was relatively industrialized, compared to the rest of the Russian Far East: When the Soviet Union collapsed, the krai accounted for a quarter of the Far East's industrial production. The bulk of the economy was concentrated in machine-building (which accounted for 28.7 percent of industrial production in 1991), and the production of other finished or semi-finished products such as oil distillates, chemicals and petrochemicals, and food processing. The krai is home to the Far East's only oil refineries—one in Khabarovsk and the other in Komsomolsk-na-Amure. A pipeline connects the Komsomolsk refinery to Sakhalin island.

One of the krai's most important industries—and one which is both export-oriented and attractive to FDI—is the timber business. In 1991, actual logging accounted for 11.7 percent of industrial production, but Khabarovsk also produced finished goods such as furniture and semi-finished goods such as pulp. Vanino port provides the main point of departure for Khabarovsk's timber exports, which in 1991 already accounted for

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⁴ This discussion based on *Guide for Businessmen, Khabarovsk* 1993, published by the Committee for the Economy, the Department of Foreign Economic Relations, and the Department for Natural Resources of the Khabarovsk krai Administration.
30 percent of timber output. Most of the krai’s timber exports went to Japan. For 20 years under the Soviets, compensation agreements concluded between Japan and the Soviet Union provided the capital for equipment purchases—such as trucks and earth-moving equipment to build roads into the taiga—and financed Japanese companies to develop logging in the region for export to Japanese markets. When Russia lifted export restrictions, timber exports came to play an increasingly important role in the regional economy. Khabarovsk’s rich timber reserves and developed forestry industry with a history of links to Japan suggests an economic structure well-suited to export-oriented FDI.

Other aspects of Khabarovsk’s industrial structure, however, appear less amenable to FDI—notably the krai’s large military-industrial component. In 1991, defense enterprises directly employed nearly a quarter of the krai’s population and accounted for 22.5 percent of Khabarovsk’s industrial production—considerably more than neighboring Primore’s 13.6 percent. Moreover, unlike Primore, where many defense enterprises were able to convert to civilian production servicing the region’s large fishing industry, no such option was available to the Khabarovsk defense plants. The defense business in Khabarovsk was largely focused on aviation, and production was concentrated at the Gagarin Aircraft Manufacturing Association in Komsomolsk-na-Amure, which produced Su-27 fighter planes. Over the course of the 1990s, production in the krai’s converting military enterprises dropped precipitously—falling, by 1997, to 7 percent of 1992 levels. The Gagarin plant was not allowed to privatize and its failure to effect conversion led the


enterprise to lobby hard for increased military exports, an effort which bore fruit when Vladimir Putin won the presidency. The presence of an important military-industrial sector with no interest in FDI suggests an economic structure unlikely to yield pro-FDI policies.⁸

In sum, Khabarovsk's economic structure, like that of Primore, is bifurcated: On the one hand, a large and increasingly important timber industry suggests the rise of economic interests well-disposed to FDI; on the other, the prominent place of ailing defense enterprises suggests economic interests which have little use for foreign investors. In examining FDI policy outcomes in Khabarovsk, this chapter will consider the interests of these two sectors.

**Viktor Ivanovich Ishaev: Neglecting FDI**

For the decade of the 1990s, Khabarovskii krai was lead by one man: Viktor Ivanovich Ishaev. A krai resident since the age of 16, Ishaev had lived nearly three decades of his life in the krai at the time the Soviet Union collapsed. For twenty-four years, he worked his way doggedly up the ranks of the Khabarovsk Shipbuilding Factory, beginning as a lowly apprentice until he attained the rank of deputy director. Between 1988 and 1990, he worked as an assistant director at the Khabarovsk factory for aluminum construction materials. In 1990, he was elected to the krai soviet, where he directed the Economic Planning Division. On October 24, 1991, just before the Soviet Union collapsed, Boris Yeltsin appointed him Head of Administration for the krai. Ishaev

⁷ Minakir, p. 218.
went on to win a seat on the Federation Council in the December 1993 elections, garnering 54 percent of the vote in a field of four candidates. He ran on the slogan: "The people of Khabarovsk deserve a good life." Ishaev went on to win the krai’s first gubernatorial election on December 8, 1996, when he won 77 percent of the vote. On December 10, 2000, Ishaev was re-elected governor with a whopping 88 percent of the vote.

Governor Ishaev held regional power in a vice-like grip and would not tolerate dissent, but his rule was more benign than that of the Primorsky governor, and politics in Khabarovsk lacked the conflict and drama of its neighbor to the south. Foreign economic cooperation figured prominently in the governor’s economic agenda, but the governor emphasized the legislative dimension of FDI—producing the right legal "conditions" for foreign investment, rather than actively negotiating with foreign investors themselves. He focused his energies primarily on lobbying Moscow for federal-level legislative support as well as for the financial support he deemed necessary to create the appropriate conditions for foreign economic activity in the krai. Unlike Primorsky’s first governor, Vladimir Kuznetsov, Ishaev did not embrace ambitious international projects or interact extensively with potential foreign investors. Khabarovsk’s formulaic legalistic approach to FDI did not produce the scandals which plagued Primorskii krai, but neither did it win

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10 Interview with Khabarovsk krai Governor Viktor Ishaev, Tikhookeanskaya zvezda, no. 24, February 5, 1998, pp. 1, 2.

Ishaev's administration many friends among foreign investors. If foreign investors fled Primore in fear, in Khabarovsk, they left out of frustration and neglect.

Consolidating Political Power

Like his counterpart in Primore, Ishaev wielded decisive political power in the krai, but unlike Nazdratenko, Ishaev made a point of establishing good working relations with other institutional players in the krai. Thus the Khabarovsk executive's relations with the regional legislature, Khabarovsk city mayor, Presidential Representative, and regional enterprises where all comparatively smooth. At times the governor achieved consensus by wielding his power of appointment, but often he cooperated in establishing mutually agreed upon "rules of the game" designed to facilitate coordinated decision-making among the krai's power brokers. Only when dissent grew overly vocal did he resort to removing opponents from office—a tactic which he employed with a restraint which stands in stark contrast to the Primore governor.

Ishaev established a dominant position in krai politics quickly and with relative ease. Even in the early years of the federal era, extensive debate and dissent did not figure prominently in the krai. In the first year and a half, however, friction—focusing on divergent approaches to regional development—did develop among members of the regional administration. As a result, prominent members left the administration under duress: Pavel A. Minakir, Ishaev's First Deputy Head of the Administration, left his post in May 1993, followed soon thereafter by Head of the krai Committee for the Economy, Viktor Tikhonov. Despite the break with the governor, such former members of the administration continued to work with the governor in an advisory capacity. Pavel
Minakir, for example, while he never held a political post again, continued to advise the administration on economic affairs throughout the 1990s. Thus, while Ishaev did purge political figures whose views he found unsavory, the process of political consolidation in Khabarovsk lacked the acrimony of the processes in neighboring Primore.

The Khabarovsk legislature worked in concert with the governor, and serious conflicts of the type that plagued Primorski krai were not in evidence. As in most regions across Russia, Khabarovsk held elections to the krai duma in March 1994; in a total of 25 races, 19 representatives were successfully elected—enough for a quorum. A second round of voting took place on December 17, filling all but one seat. The regional duma representatives came overwhelmingly from independent "business" backgrounds, and only two were appointed officials. The duma was headed by Viktor Alexeevich Ozerov, who both supported the governor and shared his reverence for proper procedure, and the necessity of its application across the Far East. For example, when the Primorye duma voted to remove Igor Lebedinets from his post as speaker in June 1995, Ozerov sent a written complaint criticizing his Primorye counterparts for taking the vote in the speaker's absence; the rules require that the speaker be present for a vote of no-confidence. In Khabarovsk, duma deputies upheld measures for close coordination between legislative and executive branches. Early on, several deputies even proposed reverting to a Soviet-type system whereby governors would be elected by the legislature, and some proposed measures that would grant the legislature power of appointment over vice-governors as well. These measures did not go into effect, but the duma did introduce measures which

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12 Author's interview with former krai official, December 28, 1995.
13 Author's interview with Viktor Ozerov, December 27, 1995.
14 Author's interview with krai duma deputy, December 28, 1995.
allowed the governor to participate in duma deliberations before a vote is taken—a move
designed to preempt any potential conflicts.

Relations between the governor and the mayor of Khabarovsk were likewise
harmonious. The first post-Soviet mayor of Khabarovsk was appointed by the governor
and took office on April 5, 1994. Pavel Filippov was the chairman of the krai property
committee when Ishaev appointed him mayor of the regional capital.\(^{15}\) He ran for the post
in December 1996 and won with 46 percent of the vote.\(^{16}\) The governor’s relationship
with Presidential Representatives were also conflict free. Khabarovsk had two
Representatives in the 1990s: Vladimir Desyatov until November 1993, followed by
Kondrat Yevtushenko, formerly a member of the Amurskii krai administration.\(^{17}\)
Relationships between the krai administration and regional enterprises also lacked the
confrontational nature of those in Primorskii krai.

Ishaev also established close working relations with the krai’s representatives to
the State Duma. Unlike Primore, where the key political elites focused their attention on
regional races, political leaders in Khabarovsk were actively involved in both regional
and national electoral races. For example, Ishaev and Ozerov worked together to support
Boris Reznik, the regional Izvestiia correspondent, in a successful bid for a seat on the
national legislature in 1999. In Moscow, Nikolai Kamyshinskii, who won a seat in the
State Duma in 1995, worked closely with Ishaev to establish a State Duma Working

\(^{16}\) Jeffrey W. Hahn, "The development of political institutions in three regions of the Russian Far
East," in Cameron Ross ed., Regional Politics in Russia, Manchester and New York: Manchester
Group designed to push through a Program for the Economic and Social Development of the Russian Far East and Provinces East of Lake Baikal.\textsuperscript{18}

Good relations with the national capital were also an important priority for Ishaev—again a stark contrast with Primorskii krai. In April 1996, he negotiated a power-sharing agreement with the federal government—the first of any Far Eastern region.\textsuperscript{19} In March 1998, Ishaev met with members of the Presidential apparatus to propose that Khabarovsk be designated the center of a new federal subdivision.\textsuperscript{20} When Vladimir Putin was elected in 2000, Khabarovsk—not Vladivostok—became the administrative center for the new Far East "macro-region," and the Presidential Representative to the Far East, Konstantin Pulikovskii, took up his duties in Khabarovsk. Ishaev also assured himself a place in the presidential entourage and a role in formulating foreign policy: He became Chairman of the Russian National Committee on Cooperation with Pacific Rim Countries,\textsuperscript{21} and in the fall of 2000, personally accompanied President Putin to the Asian Pacific Council (APEC) meeting in Brunei, acting as spokesman for the entire Russian Far East.

Economic Policies

Over the first year and a half following Soviet collapse, a debate developed within the krai administration about market reform and the role of foreign capital in regional development strategies. The central point of contention concerned the appropriate role of

\textsuperscript{18} Author's interview with Nikolai Kamyshinskii, Moscow, March 14, 1996.
\textsuperscript{19} The Republic of Sakha (Yakutiya) had already signed such an agreement, but Khabarovsk was the first \textit{region} in the Russian Far East to do so.
the central government in regional economic reform. Some members of the administration, centered around the First Deputy Head of the Administration Pavel Minakir, argued that restructuring the krai economy was predominantly a regional affair; an appropriate legal and regulatory infrastructure in the region would attract foreign investment, which would then act as a stimulus to regional economic development. In a 1992 interview with a local reporter, Minakir expressed his lack of faith in Moscow's support, saying, "Moscow gives the krai nothing, and cannot, so it is useless to go there with open hands." Rather than looking to Moscow for hand-outs, Minakir argued, the administration should put together an economic stimulus package for regional enterprises. For example, Minakir spent the better part of 1992 trying to push through regional tax breaks for promising enterprises, an effort which was effectively frustrated by the administration's Finance Department whose members argued that tax breaks would compromise the regional budget. He also attempted to set up a strong regional banking system which he argued would significantly increase the region's financial autonomy. One of Minakir's primary proposals was the establishment of a special economic zone in the krai which would offer tax breaks and other privileges to participating enterprises. The envisioned zone would allow wholly-owned foreign enterprises, joint-ventures, and also domestic capital investment, but explicitly did not offer special breaks to foreigners. As Minakir explained: "Foreign investment will be protected and will not be treated any worse than local capital investment. In other words, there will be no discrimination in the zone." It was thus dedicated as much to the development of regional enterprises as to

the attraction of foreign investment. Minakir and his team from the Institute for Economic Research (Russian Academy of Sciences Far Eastern Branch), envisioned the development of industries geared to processing the krai's abundant natural resources, particularly timber.24

Governor Ishaev had different ideas about regional development and foreign investment. In April and May 1993, Minakir and his supporters were dismissed from the administration. As the governor explained in his analysis of economic development in the krai: "Hopes that foreign investment would prove the catalyst for market reform were unjustified. During the reform years, the effort to attract outside investment seems untenable."25 Instead, Ishaev focused his attention on wresting subsidies from Moscow to support regional industry. In fact, many of the administration's early efforts bear the stamp of the governor's Moscow focus: Already in June 1992, the krai administration established a representative office in Moscow, specifically mandated to lobby the central government for subsidies. In 1992 Ishaev also successfully lobbied the Russian Supreme Soviet for the right to sell SU-27 fighter planes produced at the Gagarin plant, to China.26 Ishaev was enthusiastic about privatization, (by February 1992 the administration compiled a comprehensive list of state enterprises to be privatized—totaling 1,319), however, Khabarovsk's privatization policy banned foreigners from participating in voucher privatization of existing krai enterprises without explicit written approval from the State Property Committee in Moscow.27 Ishaev enshrined his own development

24 Russian Far East Update, June 1992, p. 3.
27 Ibid. p. 7.
strategy in a region-wide development plan which he articulated through the Far East and Trans-Baikal Association.

**The Far East and Trans-Baikal Association**

*The primary goal underlying the program is the stimulation of foreign economic activity and international business cooperation in the Far East and Trans-Baikal region through integration of the region into the international division of labor, for the overall support of the economy of the entire Russian Federation.*

The Far East and Trans-Baikal Association replaced an earlier grouping, the Far Eastern Association for Economic Cooperation, which comprised the Soviets of People's Deputies. Known variously as The Far Eastern Association of Soviets and the Far Eastern Association of People's Deputies, the earlier Association was founded in the summer of 1990. Headed by Nikolai Danilyuk, chairman of the Khabarovsk krai soviet, the Association was the most active and organized among a number of Far Eastern regional organizations, and received official recognition in an article in *Izvestiya* on June 3, 1991. Initially, the association aimed to "secure food and consumer goods for, and promote economic development of the Far East." In an interview on Moscow television in December 1991, Danilyuk later stated that the Association aimed to address "the destruction of the centrally administered system of dominance over atomized krai and oblast territories" and recognized "the necessity of developing some kind of regulatory

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organization to fill the void.\textsuperscript{32} To that end, the Association began work to coordinate the activities of the chairmen of all Far East soviets.\textsuperscript{33}

The new Far East and Trans-Baikal Association was composed of representatives from all the Far Eastern provinces, along with those Siberian provinces which lie east of Lake Baikal. It formally registered on December 28, 1993. Headed by Viktor Ishaev, it constituted Khabarovsk's most important post-Soviet foreign economic policy initiative. The Association aspired to bring together all the provinces of the Russian Far East, as well as several from Siberia, in a coordinated development effort. The Association portrayed itself as "Russia's bridge to the Asia-Pacific Region."\textsuperscript{34} Over the course of the 1990s, the bulk of the Association's effort went to formulating, promoting, and attempting to implement its Program for the Economic and Social Development of the Russian Far East and Provinces East of Lake Baikal. This undertaking bore legislative fruit in the spring of 1996, when President Yeltsin visited the krai, met with Association leaders, and formally endorsed the "Federal Program for the Economic and Social Development of the Far East and Transbaikal for 1996-2005."

\textbf{Region-Wide Cooperation}

The Association and its Program identified coordination among the Far Eastern regions as the key element to successful development and "integration" with East Asian economies: "Over the past 5 years, about 70 programs for the stabilization of the region have been worked out by krais, oblasts, sectors and even large enterprises. However, it

\footnotesize{\textsuperscript{32}FBIS, 2 January 1992, p. 75.}
\footnotesize{\textsuperscript{33}Far Easterners Join Ranks,} \textit{Problemy Dalnega Vostoka}, no. 6, 1990, pp. 3-5.
\footnotesize{\textsuperscript{34}E. Galushko, "Most Rossi v Strany ATR," ("Russia's Bridge to the Countries of the Asia-Pacific Region"), \textit{Dal'nii Vostok}, No. 30, February 15, 1995, p. 6.}
has become clear that individual programs will not work. There must be a single large-scale program for the revival of the entire region. Such is the federal program for the economic and social development of the Far East and Trans-Baikal for 1996-2005.\textsuperscript{35} The Association thus dedicated a great deal of effort to coordinating the interests of the Far Eastern regions—a task which proved exceedingly difficult. Indeed, inter-regional strife was more often a feature of Association deliberations than inter-regional cooperation. As one observer noted, "the heads of administration are interested in watching over the interests of their own provinces..."\textsuperscript{36} The effort at inter-regional cooperation in oil projects on Sakhalin is a case in point. The Association proposed constructing a gas pipeline between Sakhalin and Khabarovsk, a project which failed to elicit support from other Far Eastern regions, such as the northern province of Chukotka, where leaders did not see an immediate benefit for themselves. In discussing this project in particular at an Association meeting, A. Popov, the Far East representative of the Ministry of the Economy, commented: "if the provinces do not see themselves in the program in sufficient manner, then it [the Program] is not necessary."\textsuperscript{37} The Association attempted to compensate for friction of this nature by including as many proposals as possible and striking a "balance of interest in the projects and their attractiveness to Moscow."\textsuperscript{38} This tactic rendered the Association's proposals overly broad, and did little to elicit support from uncooperative regions.

Another source of friction arose as a result of the administrative structure of the Association itself. The Association was dominated by political elites from Khabarovsk.

\textsuperscript{35} "Far East Development Program," \textit{Business Moskovskie Novosti}, no. 17, April 24, 1996, p. 3.
\textsuperscript{37} Ibid.
and therefore tended to strengthen Khabarovsk's position vis-à-vis the other Far Eastern provinces. Tensions about this issue ran particularly high between Khabarovsk and Primore leaders. Primore leaders interpreted the Association and particularly Khabarovsk governor Ishaev's leadership, as an attempt to usurp power from the other Far Eastern regions. Such suspicions were compounded by Ishaev's obvious distaste of his Primore counterpart. In fact, Ishaev was reportedly prepared to work with all the Far Eastern governors with the explicit exception of Primore's governor Nazdratenko.\(^39\) In one interview Ishaev, in a thinly veiled snipe at Nazdratenko, commented that "some administrators...to suit their own populism...will start acting with impunity...seizing and appropriating other people's cargo, dictating whatever terms they like to Moscow, making decisions to suit their own territories...This will do nothing but create chaos and anarchy."\(^40\) As a result, Primorskii krai was only marginally involved in Association activities, despite the overall importance of Primore's economy for the entire Far Eastern region.

**Financing Development**

As noted above, the Program's primary goal was the "stimulation of foreign economic activity," but the architects of the program saw foreign investment as the end result of Russian Far Eastern development, not the financial force driving regional development. Instead, financing for the Program was to come from Moscow. As a result, one of the Association's main activities was petitioning the central government for

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\(^{38}\) Ibid.

\(^{39}\) Author's interview with Mikhail Glubakovsky, State Duma Representative from Primorskii krai, Moscow, March 12, 1996.

\(^{40}\) Khabarovsk Governor Discussed Decentralization," Izvestiya, November 29, 1995, pp. 1,2.
funds. The Program documents indicate heavy reliance on Moscow for financing. The official plan estimates the cost for 1996-2005 at 371 trillion rubles, and states that funding was to come from "the federal budget, Far Eastern provincial government budgets, and other non-budgetary sources." Since all the provincial government budgets in the Far East were highly subsidized by the federal government, and any non-budgetary support also came from federal government coffers, the Program de facto saw the bulk of its financial support coming from the federal government. After the Program received Presidential endorsement, it became almost immediately clear that endorsement was not synonymous with actual financial transfers. At a meeting in October 1995, Association leaders expressed their frustration that of all the Moscow ministries that had promised funding, only the Ministry of the Economy had transmitted funds—and that only in the amount of 300 million rubles. Things did not improve. In December Association leaders complained that Moscow had met only 20 percent of its obligation and that implementation would not be possible. In 1996, Association members proposed the establishment of a Fund for Reconstruction and Development, with the lion's share of funding to come from federal coffers. At a meeting with the Presidential Assistant for National Security, Association leaders expressed their frustration at Moscow's failure to come up with the money: "The Far Eastern and Trans-Baikal provinces have already managed to put up 50 percent, but the state—Committee on Industry, Ministry of Labor

41 Author's interview with Anatolii Grigor'evich Buryi, Head of the Foreign Economic Relations Department of the Far East and Trans-Baikal Association, Khabarovsk, December 26, 1995.
44 Author's interview with the deputy director of the Association, Khabarovsk, December 28, 1995.
and Ministry of Foreign Economic Relations cannot even pay for the design work."45

Despite such repeated failures to secure federal funding, the Association did not change
tactics to seek out alternative sources of funding—such as foreign investment.

Looking for foreign capital?

Direct relations between the regions and foreign partners were not a central focus
of Association activities, but when the Association did address this issue, it invariably
turned to Moscow for direction. Rather than devising local strategies for foreign
economic interaction, Association leaders lobbied the center to establish a legal and
regulatory framework which would facilitate local-international economic interaction.
Association members proposed government regulation of transportation tariffs—a matter
of grave concern for all the Far Eastern regions. Under the Soviet system, tariffs on the
trans-Siberian railroad were regulated and shipments subsidized, but with the collapse of
the Soviet Union and the onset of privatization, the cost of shipment to and from
European Russia soared to astronomical proportions. As a result, by 1996, shipping
volumes to the Far East along the trans-Siberian fell to under 1,000 freight cars a day,
down by a factor of 10 from levels in the 1980s.46 Other regulatory requests to Moscow
included a proposal that the federal government establish a single electricity market
across the Federation. Another federal regulation which the Association targeted was the
payment of customs duties. Russian law required that customs duties on Russian exports
be paid in advance of sale, a virtual impossibility for cash-strapped Far Eastern
enterprises. The Association lobbied to have this requirement lifted and also for the

retention of all, or at least a portion, of customs duties in the locality. Regulatory changes such as these, Association leaders argued, would "create the conditions for the attraction of foreign capital." The Association claimed that this approach actually decreased Moscow's financial obligation to the region because, it "only demanded from federal authorities the creation of the appropriate conditions for the normal development of the economy and the regions;" and, they argued, this would prove "cheaper and more effective" for Moscow.

The Association's policy on economic cooperation with the People's Republic of China provides an illustrative example of the Moscow-centric trend, and an interesting comparison with Primorskii krai—where leaders actively thwarted Chinese trade and investment. The Association evinced vocal enthusiasm for the development of ties with the People's Republic and even created a special division in charge of foreign economic relations geared specifically to China. Association leaders spoke of an economic "re-orientation...towards the neighboring countries of Asia-Pacific and most of all, China." They identified specific areas of cooperation including energy, automobiles, and chemicals. Association leaders, however, made little effort to develop these ties directly at the provincial level. Instead, they sought to gain support for their ideas in Moscow. Thus, asked how the new ties with China would develop, Association leaders pointed to a

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47 Author's interview with the deputy director of the Association, Khabarovsk, December 28, 1995.
48 Program, p. 34.
50 Ibid.
51 E. Galushko, "There will be a second wind," (interview with A. Buryi, Head of the Foreign Economic Relations Division of the Far East and Trans-Baikal Association), *Dal'nii Vostok*, no. 35, August 14, 1995.
range of measures to be effected in Moscow. These included new federal level laws on foreign labor, foreign exchange, border crossings, as well as broader measures such as "the development of a banking system" in Russia.52 In sum, economic exchange with China would take place only within the context of federal regulatory and legislative support. Regional development, in other words, would not be the result of international economic exchange. Rather, foreign trade and investment would develop as a result of federally supported development in the regions—and it was the responsibility of the federal government to insure that regional development took place.

**Explaining FDI policy outcomes under Ishaev**

Why did Governor Ishaev gear his policies on FDI to extracting financial and regulatory-legal support from Moscow, rather than working on "home-grown" strategies to interact with foreign investors directly? Why did he reject the proposals of members of his administration who advocated local solutions to economic problems and wanted to use FDI to stimulate the regional economy? Materialist approaches to these policy outcomes would look to some aspect of the regional economy—a set of economically-derived interests—to explain Ishaev's policy. One likely source of such interests is Khabarovsk's military-industrial complex which stood to gain little from foreign investment itself—many of the krai's military enterprises were not allowed to privatize or were involved in technologies which were not dual-use—and was traditionally suspicious to foreign involvement. Governor Ishaev was supportive of the krai's military enterprises—the Gagarin Plant discussed above for example—however, there is no indication that the krai administration was captured by the military-industrial sector, and

52 Ibid..
certainly, those who formulated the Far East Association's development plans had no links to military-industrial enterprises. Another set of influential economic interests would focus on the krai's timber industry, but as discussed in the section on timber below, there is no indication that the timber sector favored handouts from Moscow over foreign investment, as the governor and his Far East Association did.

Was Ishaev's FDI policy the product of directives from a strategically motivated central state, as some analyses of Russian federalism would suggest? Quite the contrary it would seem. While Boris Yeltsin exhorted the regions to take as much autonomy as they could swallow, Viktor Ishaev worked to rebuild center-periphery relations along the lines of the Soviet era—focusing in on the krai's financial dependency on the central government rather than devising local strategies to increase regional financial autonomy. Similarly, Ishaev's initiative in setting up the Far East Association and attempting to coordinate the activities of the Far Eastern regions focused on extracting funding from Moscow, and in this way constituted a throw-back to Soviet times. It was certainly a regional initiative, not the product of a strategic central state. Steven Solnick has argued that the collapse of regional associations in Russia is due to the strategic activities of a central state bent on disrupting the development of cohesive bonds among regions. The evidence from Khabarovsk suggests that this argument does not apply to the case of the Far East Association. The Far East Association was not particularly cohesive, but there is no evidence to suggest that central meddling was responsible for divisions among the Far Eastern provinces. Infighting was an activity at which the Far Eastern provinces proved well adept, all on their own.
Governor Ishaev and the other leaders of the Far East Association explicitly articulated an explanation for their policies: They believed that their policy was in the national interest. Explaining his position on regional development in a 1994 interview with the national newspaper, Izvestiya, Ishaev stated: "As leader of the territory, it seems more advantageous to bring grain from America or Canada than from Stavropol or Krasnodar. It is much cheaper and better quality. But as a citizen of Russia, it troubles my conscience that in the price of that grain is prosperity, and without the prosperity of the foreign producer, we would buy from poor Russian farmers and thus give them the opportunity to make a living."53 The Association's Program favored federal subsidies because, Association leaders argued, Russia needed to develop a viable economy prior to interaction with foreign capital. This would ensure Russia its rightful place in international economic dealings and prevent foreign business from taking control of Russian wealth. As the deputy director of the Far East Association explained it: "If Yeltsin does not sign the Program, the Far East will be swallowed by East Asia."54

Association leaders clearly believed that combining forces across provincial boundaries would increase their leverage vis-à-vis Moscow, but the coordination effort was much more than a simple political ploy. Rather, this was a conscious effort to strengthen the fabric of the Federation—an endeavor which the Association leadership believed was in the best economic and political interests of the Russian Federation as a whole.55 Politically, Association leaders argued that their program would support Russian

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53 Viktor Ishaev, interviewed by Boris Reznik, "Khabarovsk krai governor on 'how to live in the future,'" Izvestiya, re-printed in Tikhookeanskaya zvezda, October 14, 1994, p. 2.
54 Author's interview with deputy director of the Far East Association, Khabarovsk, December 28, 1995.
55 Author's interview with Anatolii Grigor'evich Buryi, Head of the Foreign Economic Relations Department of the Far East and Trans-Baikal Association, Khabarovsk, December 26, 1995.
Federal integrity by drawing a large number of provinces together under one umbrella organization—"regulating horizontal linkages," as their literature put it. From an economic standpoint, Association leaders believed that only a coordinated effort could bring economic stabilization and development to the Far East, and further that the success of such a program would both depend on federal endorsement, and also benefit the Federation. In defending the Far East Program, Ishaev bolstered his appeal for Moscow support by saying: "Part of the economy of the Far East could, with great advantage for Russia, reorient to mutually advantageous cooperation with Japan, the United States, Korea, Singapore, Malaysia, Hong Kong, and other countries of the Asia-Pacific region." In short, by the governor's argument, only financial support from Moscow could bring about the type of integration with global economies that would benefit the Far East and the entire Russian economy.

The Timber Industry

Timber was Khabarovsk's biggest export commodity—accounting in the mid-1990s for over 45 percent of total exports and providing about half of the krai's foreign currency income. Under the Soviet system, the bulk of the krai's timber was shipped to domestic markets, but after Soviet collapse, export volumes rose along with opportunities for foreign investment into regional timber enterprises. This section examines the krai administration's policies on FDI in the regional timber business. It begins with an

57 Interview with Khabarovsk krai Governor Viktor Ishaev, Tikhoookanskaya zvezda, no. 24, February 5, 1998, pp. 1,2. Emphasis added.
overview of Khabarovsk's timber industry in the 1990s. Next it outlines the
decentralization of control over timber production in the post-Soviet system. Third, it
examines the Khabarovsk administration's response to FDI in the timber business.

Overview of Khabarovsk's Timber Industry

Khabarovsk accounts for more than one third of the Russian Federation's total
timber production, and for over 40 percent of all timber output in the Russian Far East. In
1996, the krai's resources were estimated at five billion cubic meters, and the valuable
northern coniferous species constituted more than three quarters of that reserve. In the
mid-1990s, timber production accounted for nine percent of Khabarovsk's industrial
output and employed 20 percent of the regional workforce.\textsuperscript{59}

Throughout the 1990s, Khabarovsk's timber output fell precipitously. In 1994
alone, the krai's timber industry dropped by a staggering 49 percent.\textsuperscript{60} By the middle of
the decade, the industrial capacity of the krai's wood processing enterprises fell by 30
percent. This was due to rising transportation, energy, and production costs, and a dearth
of capital investment in processing industries. In addition, Khabarovsk timber enterprises
lost their traditional domestic markets. Prior to 1993, Khabarovsk shipped round timber
and sawn lumber to Siberia, Central Asia, and Ukraine—in 1990, the krai sold more than
920,000 cubic meters of timber on these markets. In 1994 and 1995 combined, however,

\textsuperscript{59} Overview of the timber and wood processing industry in Khabarovsk krai, Russian Far East,
American Embassy Moscow, November 25, 1996; Dal'ni Vostok Rossi: ekonomicheskii
potencial, Institute of Economic Research, Russian Academy of Sciences, Vladivostok:
Dal'nauka, 1999, pp. 115-120.

\textsuperscript{60} "Focus on the Russian Far East's Timber Industry," Russian Far East Update, July 1994, pp. 7-10.
the krai shipped a total of only 200 cubic meters to these markets.\textsuperscript{61} Construction, pulp, and paper industries in the Russian Far East might have taken up some of the slack in the market, but by the mid-1990s, they too were in crisis.\textsuperscript{62} By 1996, Khabarovsk's wood processing enterprises had lost some 400,000 cubic meters of annual demand and timber harvesting enterprises curbed production by 1.1 million cubic meters.\textsuperscript{63}

\begin{table}
\centering
\caption{Timber Exports 1995: Khabarovsk dominates the Far East}
\begin{tabular}{|l|c|}
\hline
PROVINCE & THOUSAND CUBIC METERS \\
\hline
Khabarovsk & 2445 \\
Sakhalin & 670 \\
Primore & 469 \\
\hline
\end{tabular}
\end{table}


Khabarovsk dominated the Far East's timber exports (Table 1). Japan was the largest consumer of the Russian Far East's timber—in 1993, Japan purchased 87 percent of Russian Federation timber. Other export destinations included China, South Korea, the United States, Germany, and Vietnam. Evidence suggests, however, that nearly half of the krai's actual timber exports went unreported, a situation which enriched illicit Russian timber traders, but also bypassed tax obligations and deprived the krai of much needed revenue (Table 2). The bulk of krai exports was shipped in its raw state. In stark contrast to Japanese practices in other countries such as China—where Japanese joint-ventures produce finished and semi-finished products for export—Japanese joint-ventures in

\textsuperscript{61} Overview of the timber and wood processing industry in Khabarovsk krai, Russian Far East, American Embassy Moscow, November 25, 1996.

Khabarovsk shipped raw product—round logs—for processing in factories at home; ninety-five percent of Japan’s timber imports from Russia were in the form of round logs.  

### Table 2

**Timber Trade Between Russia and Japan (1994)**

<table>
<thead>
<tr>
<th>Exports to Japan (Russian statistics)</th>
<th>382</th>
</tr>
</thead>
<tbody>
<tr>
<td>Imports from Russia (Japanese statistics)</td>
<td>619</td>
</tr>
</tbody>
</table>

*Source: Goskomstat, MITI*

While timber is Khabarovsk’s most important export commodity, foreign investment in the krai’s timber business was limited. Throughout the 1990s, most timber production and export was conducted by Russian companies. Two joint stock companies—*Dallesprom* and *Dalnory*—together accounted for almost two-thirds of the krai’s timber production. *Dallesprom*’s export wing, *Dalles*, handled 70 percent of the krai’s timber exports. The most popular form of foreign investment in the krai’s timber business was the joint-venture (JV). Joint-ventures worked well in the timber business because they provided immediate inflows of capital, offered opportunities for technology transfer, and often focused on the production of finished or semi-finished products—precisely the areas which suffered the most in the post-Soviet period. By the middle of the 1990s there were 35 timber joint-ventures registered in Khabarovsk: 14 in production.

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63 Overview of the timber and wood processing industry in Khabarovsk krai, Russian Far East, American Embassy Moscow, November 25, 1996.
65 Overview of the timber and wood processing industry in Khabarovsk krai, American Embassy Moscow, November 25, 1996.
and export of round commercial timber and 21 in sawmilling, furniture manufacturing, and export of finished products.\textsuperscript{67}

Over the course of the 1990s, those joint-ventures that focused on export of raw product did markedly better than those in processing. One of the more successful JVs was Sovgavanles, an American joint-venture which was 50 percent owned by Global Forest Management Group, a consortium of 10 American forest-production companies from Oregon, Washington, and Northern California. The American partners provided the equipment for harvesting timber, an arrangement which allowed the Russian side to log more rapidly and in more challenging terrain. The JV employed 50 people and an American technician worked for six months training the Russian staff to use foreign machinery. The joint-venture's harvest was exclusively destined for export: According to the Global Forest Management Group, the goal of the project was to "bring lumber and logs to the [US] Northwest to replace the traditional sources dramatically reduced by public policy decisions."\textsuperscript{68} The joint-venture began business in 1994, and in 1995 exported 14.5 thousand cubic meters of round wood to the United States.

Most joint-ventures with Japanese companies similarly focused on export of unprocessed timber. The Vanino-Tairiku Joint-Venture, for example, formed with Japan's Tairiku-Boeki, logged round wood and exported 78 percent of its product back to Japan. One Japanese joint-venture which did attempt to produce finished products was the Lidoga Joint-Venture, established in 1989 and 49 percent owned by the Itochu.

\textsuperscript{66} Author's interview with Dalles manager, Khabarovsk, December 27, 1995.
Corporation. The JV purchased hardwood from Russian timber enterprises (lespromkhozi), which it sawed into hardwood lumber and woodchips for export. It also brought in furniture-making equipment to produce semifinished furniture parts. In 1991 the JV employed 94 people and by 1995 that number rose to nearly 130. However, production fell between 1993 and 1995 in part due to power outages at the local diesel power station, but also because the Russian timber enterprises were unable to meet the JVs needs—and simultaneously demanded higher prices. As a result, in 1995 Itochu reduced its stake in the JV by 90 percent citing dissatisfaction with the quality of the furniture parts the JV produced, and the JV effectively fell apart.69

In sum, Khabarovskii krai has some of the richest timber reserves in the Russian Federation. In the post-Soviet era, however, overall timber production decreased and while exports played an increasingly important role in the krai economy, they consisted primarily of raw products; as a result, the krai’s wood processing business, as well as related industries such as pulp and paper, stagnated. Foreign investors were more active in the krai’s timber industry than in any other sector, but still accounted for only a fraction of timber production; foreign involvement in the production of finished or semifinished timber products was extremely limited and fell off as the decade progressed.

69 A.S. Sheingauz, V.P. Karakin, and V.A. Tyukalov, Forest Sector of the Russian Far East, pp. 42-44; and Josh Newell and Emma Wilson, The Russian Far East: Forests, Biodiversity Hotspots, and Industrial Developments, p. 79.
Decentralization in the Timber Industry

Under the Soviet system, a Ministry of Forestry was responsible for all aspects of forest management: From Moscow, Ministry bureaucrats determined production goals and dispatched orders for cutting and shipment to provincial and district agencies. The Ministry was divided into two vertical structures: The Ministry of Forest Industries (Minlesprom), in charge of industry functions such as cutting, distribution, and sales, and The Forest Service (Minleskhoz), in charge of forest protection and also responsible for regulating Minlesprom. At the provincial level, Conglomerates (obedeneniya) operated under Minlesprom, and Regional Forest Services (upravleniya lesami) operated under Minleskhoz. Below the provincial level, in the counties (raion), state-owned timber enterprises (lespromkhozi) subordinate to the Conglomerates, did the actual logging. Forest Service Units (leskhozi) subordinate to the Regional Forest Service, regulated an average of five timber enterprises, determining how much to cut, and where to replant. 70

The 1990s witnessed a rapid devolution of decision-making and regulatory power to local government structures. The winter of 1992 saw the dissolution of the Soviet Ministry of Forest Industries (Minlesprom), and its replacement with the Russian Ministry of Forest Industries (Roslesprom), a federal government agency which took over some, but not all of its Soviet predecessor's functions. The change signaled the end of Moscow's monopoly control over the forest industry as many of the Soviet ministry's responsibilities devolved to local authorities. 71 In March of 1993, Boris Yeltsin signed a new Forest Law specifically designed to decentralize control over forest resources. Under

70 This paragraph based on Lisa Tracy, The Deforestation of Siberia: Economic and Environmental Problems in Russian Forest Management, Forest Industry Lecture No. 32, The University of Alberta, Edmonton, Canada, April 25, 1994, pp. 4-5.
the new law, federal, provincial, and district government structures could all levy taxes—the former centralized system gave all proceeds from timber to the central government. The Forest Law also gave provincial and district officials unprecedented authority over timberland management including the right to conduct timber sales, allocate logging rights, and monitor compliance.\(^{72}\)

The Forest Law left the local structures of the Soviet era intact, but granted new rights to regional and district legislatures and government structures. Often, regional timber structures held joint-jurisdiction with government structures over forest resources. The regional forest services, for example, shared responsibility with regional governments over forest inventory, monitoring, regulation, and allowable cut. Similarly, at the district level, Forest Service Units shared responsibility with district legislatures, which determined the processes and criteria for choosing which enterprises would lease forest land. In conjunction with district government administrations, the Forest Service Units also granted forest lands to enterprises (according to the terms laid down by the legislature), and conducted all forest inventory, monitoring and regulation of timber enterprises, and fire and pest protection.\(^{73}\)

The new power-sharing arrangements between industry structures and local governments made for a confusing and at times conflictual situation, because it left jurisdiction over a number of areas unclear. Jurisdiction over leasing decisions and procedures, for example, went undefined. Compounding these problems, the law provided no mechanism for the resolution of disputes arising from the new joint-

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\(^{72}\) Ibid.

\(^{73}\) This paragraph based on Lisa Tracy, *The Deforestation of Siberia*. pp. 6-7.
jurisdiction system. Privatization provided further opportunities for informal linkages which eroded and complicated the system; Forest Service Units, for example, could own shares in the very forest enterprises which they were charged with regulating, leading to an obvious conflict of interest.\textsuperscript{74}

In Khabarovsk, problems such as these were compounded by the rise of a powerful timber conglomerate, called Dallesprom, capable of both directing and challenging local government structures. Dallesprom, and its export wing, Dalles, wielded considerable influence over timber politics in the krai, both through direct pressure and because the enterprises directors won elected seats on the krai legislature. Under the Soviet system, Dallesprom controlled all the krai's timber enterprises. In the post-Soviet era Dallesprom privatized and broke up into a multitude of smaller enterprises each run by former Dallesprom managers.\textsuperscript{75} Taking advantage of their newfound autonomy, managers of the new timber enterprises used their experience and contacts generated in the Soviet era to grow wealthy and exert greater influence over timberland allocation, foreign investment and export policies.\textsuperscript{76} In response, the old Dallesprom structures soon began to reconsolidate, eventually drawing some 40 percent of the krai's timber enterprises into one Dallesprom conglomerate. The conglomerate was the largest timber producer in the region and accounted for about half of the krai's timber production.

\textsuperscript{74} Ibid., p. 7.
\textsuperscript{75} By 1995, some 300 timber "joint-stock" companies were operating in Khabarovskii krai. Josh Newell and Emma Wilson, The Russian Far East: Forests, Biodiversity Hotspots, and Industrial Developments, p. 76.
\textsuperscript{76} "Focus on the Russian Far East’s Timber Industry," Russian Far East Update, July 1994, pp. 7-10.
Decentralization in the export system served to further consolidate Dallesprom's position. Under the Soviet system, all timber exports went through a state agency called Exportles. In 1994, a new company, Rosexportles, took over most of Exportles' business, dominating the Russian timber export business. In Khabarovsk, however, Dallesprom got together with several major timber companies in Siberia and the Far East to form Dalles, a joint-stock company which became the krai's largest timber exporter. For the first half of the 1990s, Dalles played an absolutely critical role in timber exports because, besides its unparalleled access to the timber enterprises themselves, it was one of only a few organizations with the necessary permits to export, what was known as having "special exporter" status. Since most timber enterprises did not have permission to export their produce, they turned to experienced and licensed exporters, most notably, Dalles. Even after the special exporter system was abolished in 1995, Dalles' extensive experience in the export business meant that it retained its prominent position in Khabarovsk timber exports.

In sum, decentralization in the post-Soviet timber industry granted expanded powers to local government bodies, but the system of joint-jurisdiction, whereby government officials shared responsibility for the timber business with local industry structures, made for confusion and conflict. In addition, a powerful industrial conglomerate in the krai, Dallesprom/Dalles, controlled the bulk of the krai's timber industry.

78 Author's interview with Dalles manager, Khabarovsk, December 27, 1995.
Krai Administration Timber Policies and FDI

The decentralization process left the krai administration with two big issues: how to handle competing claims over timber resources, and how to deal with Dallesprom/Dalles. In both instances the administration's policies produced results which worked to discourage foreign investment.

The krai administration failed to develop effective mechanisms to deal with competing claims over timber resources. In 1994, as conflicts multiplied, the administration turned to Moscow in search of direction. In response, the State Committee on Industrial Policy directed the Khabarovsk governor to "request" that Moscow establish a krai-level commission to oversee abuses in the timber industry. Governor Ishaev dutifully complied, and the Timber Utilization Commission was established. Under the direction of Deputy Governor Viktor Tevelevich, the Commission garnered considerable power and became an important player in Khabarovsk timber politics. The Commission had the power to effectively regulate timberland allocation, but in practice, it aggravated corruption and in-fighting in the locality, and undermined the establishment of joint-ventures. Allying itself the Regional Forest Service, the Commission awarded timberland allocations behind closed doors, a system which allowed it to extract concessions from timber enterprises and JVs. Within a year, complaints from joint-ventures multiplied. Starma Holdings—a joint venture with a Boston-based conglomerate called the Pioneer Group—threatened to pull out of the krai after the Commission demanded extra payments from their project in the town of Siziman. The JV was harvesting timber, constructing a

timber-loading dock, and preparing to begin exports, when the Commission began demanding it also pay for the Forest Service's construction of a regeneration facility.\textsuperscript{81}

In addition to undermining the activities of joint-ventures, the Timberlands Utilization Commission thwarted an important new development in the krai's timber business: the extension of timberland tenders to foreign companies. International tenders were initially proposed in 1994 by the regional privatization fund, for gold mining, and in 1995, the Fund proposed that the governor organize international timber tenders.\textsuperscript{82} The governor passed the idea on to the Timberland Utilization Commission and the krai duma. A group of duma representatives—all of whom headed logging enterprises—embraced the idea and proposed establishing a new commission to deal exclusively with international tenders. The proposed Commission on International Tenders would have exactly the same members as the Timberland Utilization Commission, but its activities would be transparent and subject to Duma oversight. Tevelevich and the other members of the Timberland Utilization Commission—all members of the krai administration—fought the duma proposal in an effort to retain the non-transparent character of their dealings.\textsuperscript{83} The dispute dragged on unresolved for over two years, until eventually the Khabarovsk State Property Committee took charge of international tenders. Because of this in-fighting, it was not until 1997 that the first long-term timberland lease was offered to a foreign firm.\textsuperscript{84}

\textsuperscript{82} Author's interview at the regional privatization fund, Khabarovsk, December 28, 1995.
\textsuperscript{84} In 1997, 305.5 thousand hectares of Sukpaï's forest belonging to the Sikhote-Alin Forestry Fund were offered in open tender to foreign firms. See "Sukpaïskii forest: first long-term lease offered to foreign firms," \textit{Russian Far East Update}, July 1997, p. 4.
In addition to establishing ineffective mechanisms for conflict resolution, the krai administration at times actually worked to engender conflict. As noted above, decentralization in the timber business granted new rights to country-level administrations. The 1993 Forest Law stipulated that decisions on joint-venture establishment, and particularly on the provision of timberlands to joint-ventures, were to be taken in consultation with county officials. The Khabarovskyi krai administration, however, routinely disregarded the new procedures, leading to distrust and resentment towards joint-ventures in the very counties in which they attempted to operate, thereby rendering joint-venture activities more difficult. A prominent example was that of Sovgavanles, where the krai administration took it upon itself to make a unilateral decision about timberland allocation. In 1994, Governor Ishaev teamed up with S. Plotnikov, the director of a new timber enterprise Ekrales, to dictate the terms for establishing a new timber joint venture in Vanino County. The new JV, Sovgavanles, was approved at the krai level, and country officials were subsequently "informed" of the decision. One local report epitomizes county resentment to this process: "It is supposed that krai officials do not ignore the interests of our cities and counties, nor simply dictate conditions. Unfortunately this is not so."\(^5\) One outraged Vanino county official complained bitterly that the new joint-venture did not pay workers' salaries and expressed the county's reluctance to extend support: "...the county is directed to provide the newly appeared JV with a timber reserve. But why were we the last to find out? Why are the

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Lespromkhoz's workers kept in the dark?\textsuperscript{86} The anger and resentment which the krai administration's policy generated at the county level led to resistance from both the county administration and the Russian timber workers which delayed the establishment of the joint-venture.

The administration worked closely with the krai's timber enterprises, and while it did not take an active interest in the enterprises' foreign dealings, administrative passivity in the face of disputes between regional timber enterprises and foreign partners undermined foreign confidence in the region. The administration proved incapable of devising local solutions to such disputes. When controversy arose, krai leaders invariably looked to Moscow in search of resolution. If such resolution were not forthcoming, the administration blamed federal authorities for the dispute. A prominent example of this problem was the case of a well-publicized dispute between Dalles, and a New Zealand Company called New Trade Ltd. The dispute began in 1991, when, due to a food shortage in the krai, the regional government decided to purchase meat and butter from New Zealand. Under direction from the krai administration, Dalles signed a contract with New Trade for delivery of the food. Payment was to be made from the proceeds earned on timber exports. When the food arrived, however, Dalles' accounts were frozen because the enterprise's bank, Vneshekonombank (the Foreign Economic Bank), had collapsed. Although Dalles continued to earn revenue from timber exports, the enterprise did not pay New Trade. Dalles officials reasoned that since the accounts in question were frozen, their contract with the New Zealand company was void. The krai administration dealt with this dispute by appealing to Moscow. Krai administration officials sent

\textsuperscript{86} Interview with Tatyana Golovanova, Vanino County Administration Finance Department in a translation of a 1994 article from Priamurskie vedomosti, "Logging joint venture in Khabarovskii
petitions to Moscow—and even personal requests to Prime Minister Viktor
Chernomyrdin and to Yegor Gaidar—asking that the bank funds be released. When this
action was not forthcoming, the administration threw up its hands in defeat. New Trade
Ltd. filed suit with the Arbitration Court at the Chamber of Commerce in Stockholm in
an attempt to wrestle payment from Dalles and also attempted to file suit in Khabarovsk
and initiate bankruptcy proceedings against Dalles. These attempts were unsuccessful,
and New Trade did not receive payment.87 Incidents such as this seriously undermined
foreign investor confidence in the Khabarovsk timber business, leading to the withdrawal
of foreign investment and a subsequent decline in joint-venture activity.

Explanations for the krai administration’s policies on FDI in the timber business

Why did the Khabarovskii krai administration fail to develop policies to attract
foreign investment into the regional timber industry and accommodate those foreign
investors who were already involved in the timber business? One possible explanation
would focus on economically-derived interests. Did FDI policy outcomes in
Khabarovsk's timber business derive from the interests of Khabarovsk's timber bosses?
Perhaps timber bosses themselves were disinterested in foreign investment in general and
joint-ventures in particular? The evidence from Khabarovsk's timber industry suggests
quite the opposite. Khabarovsk's timber bosses were interested in the financial rewards to
be reaped from increasing exports, but they were also interested in attracting foreign

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investors. Indeed, there was considerable and sustained resentment about Japan's appetite for Russian timber and simultaneous unwillingness to invest in the timber business.\(^{88}\)

Another possible way to explain outcomes in terms of economically-derived interests would consider the competing interest of various players in the krai timber business. Indeed, on the face of things, the problems in Khabarovsk's timber industry appear to be a straight-forward case of struggle among regional actors for a piece of the lucrative timber business: the regional administration attempting to extract rents from joint-ventures and keep control over timberland allocation out of the hands of the regional legislature and district-level governments. Certainly competing interests among members of the krai administration, regional duma representatives, timber enterprises, and country-level governments were part of the reason why an hospitable business environment failed to develop in Khabarovsk. An interpretation of timber policy as simply the product of competing interests, however, leaves several questions unanswered. If the krai administration was simply trying to extract rents, why did krai leaders consistently turn to Moscow for guidance in adjudicating disputes—as in the cases of the Timberland Utilization Commission and New Trade? Why not attempt to resolve disputes locally to the administration's own advantage? Then there is the puzzling lack of gubernatorial involvement in the activities of the Timberland Utilization Commission, once it was established. In the dispute between Commission members and the regional duma on the question of international tenders, the governor's position was conspicuous for its near complete absence. In the end, it was the Privatization Fund, not the governor's office, that decided this matter. Why was the governor not involved?

\(^{88}\) Author's interview with Dalles manager, Khabarovsk, December 27, 1995; author's interview with Exprales acting-director, December 29, 1995.
These questions speak to a deeper problem in timber politics: the lack of leadership—proactive policy formulation—on the part of the krai administration on the question of FDI in the timber industry. The administration's policy was reactive or simply passive: the governor set up the Timberland Utilization Commission at the behest of Moscow; international timber tenders were initiated by the privatization fund; Ishaev's involvement with Expriales' JV came about at the instigation of Expriales' general director; and in the case of Dalles' dispute with New Trade, the administration kept its involvement to an absolute minimum.

A look at the administration's official policy on development of the timber industry shows that the governor in fact had little interest in FDI in the timber business. The krai administration laid out its plan for development of the timber industry in the Program for the Economic and Social Development of the Far East and Trans-Baikal. According to this document, the primary goal should not be achieving the "maximum volume of timber production," but rather an "increase in finished timber products, which would allow the export of sawn lumber and pulp and paper products." The Program recognized that Russian enterprises lacked the technology and machinery necessary to produce export-quality product and proposed to address this problem in the following manner: "The development of Russian timber processing equipment will proceed through the use of the scientific and technical know-how of enterprises from the military-industrial complex." In short, the krai administration's plan proposed using internal Russian resources to develop the timber industry, and did not envision a role for FDI in that process. In line with the Far East Association's Program, the administration envisioned funding for the timber business coming from Moscow.
In sum, krai administration lack of proactive FDI policy measures in the timber business reflects the same beliefs that drove the krai’s Far East Association and its plans for Far Eastern Development. The administration was consumed with its focus on internal Russian resources: technological know-how based on the defense industry to equip ailing timber enterprises and financial sustenance from the national government. FDI was simply not a priority. Thus, although political leaders had the tools to take advantage of FDI—because decentralization in the timber business dramatically increased local authority—and the opportunity to develop the timber industry using foreign capital—because foreign investors flocked to the krai’s timber enterprises in the wake of Soviet collapse—they simply chose not to do so. Krai leaders failed to use their new powers effectively—thereby undermining foreign investment in local timber enterprises and adversely affecting timber exports—because they were more concerned with building relations with Moscow, and more focused on the use of national resources, than on looking for direct ways to attract FDI. While Khabarovsk authorities did not openly oppose foreign investment as did those in neighboring Primore, their focus on maintaining linkages to central authority undermined the development of the regional timber industry, while the decentralization of political control in timber engendered more local confusion than local initiative.

**Conclusion**

This chapter has examined Khabarovskii krai’s approach to foreign direct investment in the 1990s. In it I ask why regional political leaders failed to develop a proactive FDI policy designed to attract foreign investors and accommodate those

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investors who did set up projects in the krai. The chapter examines a variety of explanations for regional policy outcomes including ones which focus on economic factors, Soviet institutional legacies, and strategic interaction with the national center. The chapter also examines the levels of political polarization in the krai, networks, and historicist approaches. In this conclusion I lay out the possible explanations for FDI policy outcomes and summarize the impact of ideational variables.

**Economic Factors**

When the Soviet Union collapsed, Khabarovskii krai had the highest concentration of defense enterprises of any region in the Russian Far East. The defense industry directly employed nearly a quarter of the krai’s population and accounted for 22.5 percent of the krai’s industrial production. Was the Khabarovsk governor’s lackadaisical approach to FDI a product of disinterest in foreign investment on the part of the krai’s sizable defense sector? While it is true the Khabarovsk’s defense enterprises exhibited no discernible interest in FDI, there is no evidence to connect that disinterest to FDI policy outcomes. The economic development program formulated by the krai’s Far East Association—Khabarovsk’s primary instrument for foreign economic relations—was put together by a group of regional government officials who had no connection to the military-industrial complex. While it is true that both the governor himself, and the Association’s Program, called for the federal government to subsidize regional defense enterprises, this interest in propping up the defense sector cannot explain why the governor also advocated a subsidized approach to export-oriented industries, such as the timber business. Moreover, the power of a regional defense lobby dropped significantly
over the course of the 1990s as defense production plummeted, yet the governor stuck to 
his preference for central subsidies over FDI across all sectors. It would seem, therefore, 
that the defense-oriented structure of the regional economy cannot adequately explain the 
administration's inattention to matters of foreign investment.

The timber industry was the most important export-oriented business in the krai. 
Is it possible that Khabarovsk's approach to FDI reflected the economically-derived 
interests of the krai's timber bosses? The evidence suggests otherwise. The managers of 
Khabarovsk's timber enterprises did work to set up joint-ventures with foreign 
companies. Indeed, the timber industry had more joint-ventures than any other sector in 
the krai. Those ventures foundered on lack of support from administration officials—their 
inability to set clear jurisdictional boundaries and establish effective mechanisms for 
conflict resolution. FDI policy outcomes, therefore, cannot be understood as the result of 
economically-derived interests in the timber business.

Institutions and Policies

In chapter 2, I presented two arguments about the effects of Soviet-style 
institutions on policy outcomes. One held that concentrated regional economies—a 
prevalence of large Soviet-style enterprises—promoted close relations between economic 
and political elites which in turn led to pro-FDI policies. The other held that the Soviet 
institutional legacy was likely to lead to collusive relations between economic and 
political elites—a circumstance which I hypothesized might produce policy outcomes 
unsupportive of FDI. Of the three Far Eastern regions addressed in this study, 
Khabarovsk had the most "concentrated" regional economy, yet the krai's approach to
FDI was not enthusiastic. Thus the evidence from Khabarovsk does not support the contention that concentrated regional economies yield pro-FDI policies, as Stoner-Weiss argued. What of the contending argument? Was the prevalence of Soviet-style enterprises in Khabarovsk responsible for the krai’s unenthusiastic approach to FDI? The evidence suggests that it was not. As noted above, Khabarovsk’s defense sector and the krai’s mono-industrial towns played little or no part in the formulation of the administration’s primary foreign economic policy effort—the Far East Association’s Program for economic development.

As was the case in my analysis of Primorskii krai, Joel Hellman’s partial-reform argument does go a considerable way towards explaining policy outcomes in Khabarovsk. As noted in chapter 2, Hellman argued that the "winners" of early reform measures were likely to oppose deepening reforms which could jeopardize their gains from the initial reform process. This would particularly apply to privatizing export-oriented industries which benefited from the loosening of restrictions on foreign trade. The timber business falls into this category. In Khabarovsk, there is evidence that some timber bosses opposed foreign involvement in the regional timber business because they felt that the gains from timber exports should accrue to Russian companies. One timber executive explained his position in the following manner: "Already Russian Far Eastern timber producers feel the pressure of ambitious foreign dealers who are buying up the Far Eastern taiga. It is for this reason that Far Easterners must work as quickly as possible to take a large slice of the timber market on the Japanese and other markets."90 The partial-reform argument does explain this sentiment. However, it is also clear that many timber

bosses, most notably those from the krai's largest timber enterprise, Dallesprom/Dalles, were actively engaged in establishing joint-ventures with the explicit purpose of expanding round log exports to East Asia and also developing processing capabilities for finished and semi-finished produce. In other words, many of the krai's most powerful timber bosses did not focus exclusively on retaining the benefits of the status-quo, as the partial-reform argument holds, but actively sought to deepen the reform process by working directly with foreign investors. Thus, as was the case in Primorskii krai, the industry was internally divided on the question of foreign investment.

In Primore, I argued that the outcome of such divisions was determined by the position of the regional governor on FDI. Khabarovsk's governor did not take a proactive stand on the issue—one way or another. As a result, internal discord festered—a situation which worked to undermine the efforts of regional timber bosses to work with foreign investors. The Lidoga JV discussed above provides a typical example of this phenomenon. The JV depended on raw materials from the local lespromkhoz to manufacture finished and semi-finished products. However, when the lespromkhoz realized that it could export its raw produce at higher prices than the JV was prepared to pay, it cut back on supplies to the joint-venture. This despite Dallesprom's instruction that the lespromkhoz furnish the JV with timber. Unclear jurisdictional authority—a problem fostered and exacerbated by the krai administration—made it difficult to force the lespromkhoz to comply, and the JV faltered and eventually folded. Partial-reform arguments, therefore, are useful in understanding why some timber executives as well as managers at lespromkhozy such as the one discussed here, would not support FDI. It does not, however, capture the complex dynamic of debate within the industry, explain why
some of the "winners" of partial reform did support deepening the reform process, or address the critical role of the krai administration in determining the outcome of internal industry debates.

**Networks**

Chapter 2 presented two competing visions of the impact of networks on policy outcomes—one in which networks facilitate FDI and the other in which the block it. Do these arguments apply to the case of FDI policy in Khabarovskii krai? The evidence from Khabarovskii krai's Far East Association and timber industry suggests that networks among regional economic and political elites neither contributed to, nor mitigated against, the development of a business-friendly environment conducive to FDI. Certainly the krai's business environment was not particularly user-friendly, a fact that foreign investors—actual and potential—frequently bemoaned. However, there is scant evidence to suggest that the administration's unhelpful approach to foreign investors was the product of collusive network machinations. Rather it was the product of neglect and disinterest on the part of a krai leadership whose primary focus was Moscow, not the foreigners who knocked on the krai's door.

**The Federal Center**

In chapter 2, I presented two competing visions of the central government—one in which the center interacts strategically with the regions, and the other in which the center is too weak to engage in strategic bargaining with the periphery. The story which emerges from Khabarovskii krai is one of regional effort coupled with central neglect—a
version of center-periphery relations which supports the "weak state" argument put forth by Kathryn Stoner-Weiss. The persistent and largely unsuccessful efforts of the Far East Association to bargain with central authorities in support of FDI-friendly legislation are symptomatic of a central state too weak to respond effectively to regional initiatives. To the extent the regional policy outcomes in Khabarovsk are a product of center-periphery relations, the administration's policies are more a product of central non-negotiation, than of central bargaining.

**Political Polarization**

One approach to explaining policy outcomes in Khabarovsk focuses on levels of political polarization. In chapter 2, I drew on Timothy Frye's argument about political polarization and economic growth to hypothesize that regions which experience low levels of political contestation—those in which the governor did not face serious and concerted opposition—might be most likely to develop policies which supported FDI. Of the three provinces addressed in this study, Khabarovsk's governor had the firmest grip on political power: He enjoyed by far the highest electoral mandate—88 percent of the vote in the gubernatorial election of 2000; his relations with other political figures in the krai such as the mayor of Khabarovsk city and the Presidential Representative were harmonious; and he faced no major dissent or defection in the ranks of the regional administration. Yet krai administration policies did not support FDI. It seems therefore, that political stability—an absence of polarization—did not correspond to pro-FDI policies and the development of a business-friendly environment in the case of Khabarovskii krai.
Historicist Arguments

Historicist and path dependent approaches which emphasize "lock-in" mechanisms and institutional constraints provide a tempting approach to explaining policy outcomes in Khabarovsk. The krai was, after all, the administrative center of the Soviet Far East with all the privileges of that position—including a special relationship with the national center. In the post-Soviet era, political decentralization and the election of regional governors across the Russian Far East meant that Khabarovsk lost its preeminent position in Far Eastern affairs. The primary thrust of Khabarovsk's post-Soviet policies was directed towards recovering that position by simultaneously drawing the regions of the Far East together under the umbrella of a regional association and re-forging its relations with the federal center. Thus it would seem that Khabarovsk was reenacting regional relations of the Soviet era in the post-Soviet period.

Were there particular institutional arrangements or modes of organization at work that "locked-in" this policy direction, as path-dependent arguments hold? The krai's main policy instrument—the Far Eastern Association—was indeed intended to perform the same functions as its Soviet-era predecessor. Did the organizational structure of the Soviet era association lock-in modes of operation which gave rise to the post-Soviet Association and thereby drove policy outcomes in Khabarovsk? The evidence suggests that it did not. Certainly the post-Soviet association's mission represented a continuation of Soviet institutional endeavors, but that continuity was not predicated upon institutional or organizational lock-in mechanisms. The Far East Association that registered in December of 1993 was not the institutional outcome of historical legacy. It was the brainchild of the regional governor, its legitimacy wholly dependent on his endorsement
and support. Unlike the Soviet-era organization which united the regional soviets, the new organization was headed by executive power. Thus, while historical continuity clearly played a role in the formation of the post-Soviet Association and its policy directives, that continuity was not contingent on organizational lock-in, but rather existed at the behest of regional executive power.

The Impact of Ideas

In this chapter, I have presented a number of ways in which ideas influenced FDI policy outcomes in Khabarovskii krai. I argued that the governor's belief that national interest should take precedence over regional particularism and that economic development should rightfully be predicated on national, not foreign, resources, drove policy formulation in the Far East and Trans-Baikal Association. Examining the krai's most important export-oriented industry—the timber business—I argued that the administration's inattention to FDI in that industry was the product of disinterest born of a Moscow-centric nationalist approach to economic development. That inattention allowed internal disputes within the timber industry to go unresolved, fostered conflict among political and economic actors in the regional timber industry, and left foreign investors dissatisfied and disaffected. As a result, joint-ventures in the timber industry foundered and the krai's timber processing capability continued its long slide into stagnation.

Here I return to the five part model of ideational causation introduced in chapter 2. The first step I presented was identification of the salient dimension of the crisis—economic, political, or regional. Viktor Ishaev articulated the crisis in Khabarovsk in overwhelmingly institutional terms: The problem, as the governor understood it, was
decentralization—what the governor interpreted to be the "disintegration of center-periphery ties." Ishaev believed that central control over the locality was appropriate, desirable, and beneficial to both parties. The governor was not a proponent of regional autonomy. He believed the regional governors should be appointed by Moscow, not elected by popular mandate. Contemplating the prospect of gubernatorial elections, Ishaev commented: "Alas, the central power structures, already have no power over elected administrators." In marked contrast to his counterparts in Primore and Sakhalin—both of whom made repeated entreaties to Moscow for the right to hold gubernatorial elections, Ishaev displayed little enthusiasm for electoral contest. He made no request to Moscow for gubernatorial elections. Elections in Khabarovsk took place at the time mandated by Moscow.

Ishaev argued that responsibility for the problem—the second step in my model—lay in Moscow. Again and again, he blamed the central government for the krai's economic ills. When the railways were privatized and transportation costs skyrocketed, for example, Ishaev interpreted these developments as unfair punishment meted out by an irresponsible center: "Far Easterners are not guilty of anything other than living far away. Why must they be punished with nonsensical payment for delivery of raw materials, for the transport of manufactured goods, for trains...." Similarly, he blamed Moscow for failing to regulate electricity prices for the Far East: "Residents of Bratsk and Krasnoyarsk [in Siberia] have the largest GES [power stations]. Why do they pay many

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91 Author's interview with Viktor Ishaev, Niigata, Japan, November 8, 1994.
92 "Moscow is provoking separatism in Russia: this is the opinion of Khabarovsk Governor Viktor Ishaev," Interview with Khabarovsk Governor Viktor Ishaev by Boris Reznik in Khabarovskii krai, printed in Izvestiya, November 29, 1995, pp. 1, 2. re-printed in Vladivostok, Thursday December 7, 1995, p. 8.
times less than Far Easterners for electricity? Money from the Far East also went into the
development of those power plants."  

In an interview in 2000, Ishaev angrily accused
Moscow of "pushing" the Far East "out of the Russian economic system."  

Krai economic engagement with its East Asian neighbors was, in the governor's view, a
lamentable indication of central failure and of national weakness. Ishaev expressed his
fears and frustration with this state of affairs in the national press: "Officials in Moscow
should understand that they are losing the krais and oblasts of the Far East, not as
administrative-territorial units, but economically. As the center pushes them, they are
actively moving into the Asian-Pacific market."  

Ishaev thus interpreted increasing
foreign trade and investment levels in the krai as cause for concern and despair. In 1994,
he lamented: "The krai already has about 500 joint ventures!"  

Finally by 1998, in a
desperately worded interview, conceded: "We have ceased to orient ourselves toward
remote producers of the goods we need... and towards far away consumers of our
products. Thus, an orientation toward the countries of the Asia-Pacific region has
arisen."  

As was the case in Primorskii krai, Ishaev’s interpretation of the crisis and its
genesis was closely related to his interpretation of the krai’s historical legacy. The
governor explained the post-Soviet crisis in terms of the loss of those features of the

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93 "Interview with Khabarovskii krai Governor Viktor Ishaev," Tikhoeanskaya Zvezda,
February 5, 1998, pp. 1,2.
94 Ibid.
95 "Khabarovsk governor calls for closer integration into Asia-Pacific Region," Interfax, July 21,
2000.
96 Viktor Ishaev, interviewed by Boris Reznik, "Khabarovsk krai governor on 'how to live in the
future,'" Izvestiya, re-printed in Tikhoeanskaya zvezda, October 14, 1994, p. 2.
97 Ibid.
98 Viktor Ishaev, Khabarovsk Governor, in an interview with Rossiiskaya Gazeta, Aleksei
Chichkin, "Far East Seen Turning Toward Asia," Rossiiskaya Gazeta (Biznes v Rossii
Soviet system which he deemed desirable—most notably the krai’s special status among the Far Eastern regions and its special relationship with the national capital. He chose to ignore the fact that Khabarovsk under the Soviets was the most important international business center of the Far East—in fact the only major city in which foreign businesses were permitted to set up shop. Ishaev’s decision to focus the lens of historical interpretation in Khabarovsk’s position within the national context meant that he interpreted the post-Soviet crisis in terms of the changes wrought on center-periphery relations within the national context. Therefore, despite the absence of institutional or organizational "lock-in" mechanisms to explain the continuity between Soviet and post-Soviet policies—upholding the krai’s prominent position in the national context—the governor’s interpretation of history served to provide an ideational continuity which informed the his understanding of the post-Soviet world.

Third, Ishaev provided his own interpretation of key concepts in the post-Soviet era: reform, democracy, Subject of the Federation, and patriotism. Democracy and economic reform, for the governor, were virtually synonymous with "chaos"—signifying a lack of control over legal infrastructure, economic regulation, and most importantly, irresponsibility of the center vis-à-vis the regions. The governor placed particular emphasis on his understanding of "Subject" in the new Federation. Ishaev considered his province a dutiful subject to distant and powerful central powers, whose responsibility it was to tend to krai welfare. He was thus convinced that "if only Moscow could understand" the krai’s position, the central government would come to the krai’s assistance. In attempting to address the problems of regional pensioners, Ishaev was therefore confident that his petition to Moscow to raise regional pension funds would fall
on willing ears: "Ishaev says he remains confident. He thinks they just don't see in Moscow that life in the Far East is more expensive than in the capital, the south or the central part of the country."99 Ishaev believed that regional loyalty to the national whole was the highest expression of patriotism. Thus, regional policy should be formulated with the good of the Federation in mind: In considering grain imports from abroad, for example, the governor argued that while foreign imports might be cheaper for the krai, "in the price of that grain is prosperity, and without the prosperity of the foreign producer, we would buy from poor Russian farmers and thus give them the opportunity to make a living."100 In short, the governor believed that it would be irresponsible of the krai to look outside the borders of the Federation for economic relief, even when foreign trade could alleviate dire economic hardship in the locality.

Fourth, the governor's ideas formed the basis for legitimate policy decisions. His belief in the loyalty of regional subjects to Moscow, the paternalistic responsibilities of Moscow to the regions, and his definition of patriotism, underlay regional policy's focus on Moscow as a source of funding, regulation, and conflict resolution. Moscow's failure to live up to its end of the bargain was a constant source of irritation to the governor. In 1998, after repeated petitions to Moscow for support of the krai's plan for comprehensive development of the Far Eastern region, Ishaev grew enraged: "Four years have passed since the preparation of that program [Program for the Economic and Social Development of the Far East and Trans-Baikal]. The government ministries and departments have tied it in red tape. It took only a year to draw up the program, but it has

99 Boris Reznik, "Khabarovsky krai governor on 'how to live in the future,'" Izvestiya, re-printed in Tikhookeanskaya zvezda, October 14, 1994, p. 2.
100 Cited above. Viktor Ishaev, interviewed by Boris Reznik, "Khabarovsky krai governor on 'how to live in the future,'" Izvestiya.
been in the Moscow bureaucrats' corridors for 3 years! In the spring of 1996, President Yeltsin visited Khabarovskii krai, heard our concerns and the program was awarded the status of 'presidential.'...Have the president and the government addressed these concerns? Thought about them? Resolved them? No.\(^{101}\) As the governor's frustration grew, he accused Moscow of "provoking" economic separatism in the Russian Far East by neglecting its duties to the locality.\(^{102}\) Although originally categorically opposed to Far Eastern secessionist movements, Ishaev at last turned to this alternative, not because this was an outcome which he embraced, but because he hoped that threats of secession would at last enjoin Moscow to resume its proper duties towards the locality. Announcing his support for a separate Far Eastern Republic at a press conference in 1995, Ishaev conceded that this step was simply a means of pressuring Moscow: "How else [he argued] can we prove to the government that the Far East needs special treatment by the center because of its geopolitical position?\(^{103}\) In sum, for Ishaev, petitioning Moscow for support was a legitimate and patriotic policy decision. It was because of this belief that Ishaev failed to take advantage of local economic opportunity—regarding the advances of foreign business with a mixture of distrust and disinterest and making scant use of the krai's new-found autonomy in the post-Soviet system. Instead, he turned to his masters in Moscow for direction and financial support. Only when that support was not forthcoming did he threaten secession, but even then, the goal of his policy remained unchanged: securing support from the national center.

\(^{101}\) Interview with Khabarovsk krai Governor Viktor Ishaev, Tikhoeanskaya zvezda, no. 24, February 5, 1998, pp. 1,2.

\(^{102}\) "Moscow is Provoking Separatism in Russia," (interview with Khabarovsk Governor Viktor Ishaev), Vladivostok, December 7, 1995, p. 8.

\(^{103}\) "Khabarovsk Governor Calls for 'Far Eastern Republic,'" Rossiiske Vestii, December 8, 1995, p. 1.
Fifth and finally, Ishaev took concrete steps to ensure that his policies took root in the locality. Most importantly, he enshrined his policies in the Far East Association—an organization which served as a vehicle for the governor's policies. Governor Ishaev was elected to a second term four-year in the year 2000, and at the time of writing, it is too soon to determine whether or not his policy preferences are sufficiently embedded to ensure continuity when his term expires. However, Ishaev has fared well under President Putin. The President's call for a unified legal space in the Russian Federation, willingness to remove elected regional governors such as Nazdratenko in Primore, and strong leadership style, dovetail with the Khabarovsk governor's policy outlook. Khabarovsk has been designated the center of the new Far Eastern "macro-region" established by President Putin in an effort to reign in the provinces. If Russia continues along the path Putin has taken, Ishaev's nationalist policies in the locality stand a good chance of surviving a change in regional leadership.
Sakhalinskaya oblast
Chapter 5

Internationalism: The Case of Sakhalinskaya oblast

If only those who liked Sakhalin lived there, the island would be uninhabited. –Anton Chekhov, Ostrov Sakhalin, 1895.
Nature created this island in a moment of wrath. –Vasiliy Doroshevich, 1903.

To the outside world, Sakhalin is probably best known as the site of the tragic downing of Korean Airlines flight 007 in September 1983, or else the epicenter of a territorial dispute over four islands to which Japan lays claim. In the post-Soviet era, Sakhalin won a new distinction: In 1999, Sakhalin attracted more foreign investment than any other region in Russia. Foreign money flowed into the oblast's off-shore oil and gas reserves, on what is known as the Sakhalin "shelf." Sakhalin's off-shore reserves are thought to rival the North Sea's, and are estimated at 1.5 trillion cubic meters of gas, and 700 million tons of oil (29 billion barrels), more than half the size of the reserves in Alaska's Prudoe Bay. While small compared to the Middle East, their proximity to Asian markets makes their development particularly attractive.

Over the course of the 1990s, Sakhalin's governors worked tirelessly to make foreign investment in off-shore oil and gas a reality. They negotiated directly with prospective foreign investors and actively lobbied the federal government for passage of production-sharing legislation critical to foreign involvement in the oil business. These efforts played a critical role in ensuring the future of off-shore oil development on

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Sakhalin. As one foreign business partner commented: "The key to a successful joint-venture [lies] not in Moscow but with committed and progressive regional leaders." The efforts of Sakhalin’s governors bore fruit in 1995 when production-sharing passed in the Russian Parliament and Boris Yeltsin signed it into law. In 1999, the first oil began to flow from off-shore wells.

What accounts for the proactive FDI policies of Sakhalin’s political leaders? Does the presence of off-shore hydrocarbon reserves explain policy outcomes on Sakhalin? This chapter examines a range of possible explanations, including those based on economically-derived interests. It argues that economic factors alone cannot explain why Sakhalin’s leaders chose a proactive policy designed to attract foreign investment. Indeed, it argues, Sakhalin’s governors took on powerful economically-derived interest groups in the locality and risked their office to make production-sharing and off-shore oil development a reality. The chapter begins with an historical overview which emphasizes the two most important factors potentially affecting FDI in the oblast: the territorial dispute with Japan and the history of oil development. Next, it outlines the policies of Sakhalin’s three post-Soviet governors—Valentin Fedorov, Evgenii Krasnoyarov, and Igor Farkhutdinov. Third, it examines regional policy on the divisive territorial dispute with Japan. Finally, it turns to the off-shore oil developments themselves, examining the passage of production-sharing legislation and the debate about the merits of foreign investment both in Moscow and in the region. A concluding section sums up the chapter’s

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3 Dean E. Gaddy, Drilling Editor, "Sakhalin II PSA success attests to local leaders' commitment," *Oil and Gas Journal*, March 6, 2000, p. 30.
findings and presents a five-part ideational explanation for FDI policy outcomes on Sakhalin.

Historical Background

Sakhalin's history is complex. A vast penal colony under the Tsars, pre- and post-Revolutionary Sakhalin also experienced foreign rule—at times part of Imperial Russia and later the Soviet Union, at others incorporated into the Japanese Empire. The experience of territorial occupation left the oblast with a territorial dispute which festers on into the post-Soviet period, and also laid the foundations for post-Soviet Japanese economic interest in the island's oil resources. This section provides an overview of the Tsarist legacy, the history of territorial division, and the background to foreign interest in Sakhalin's oil and gas reserves.

The Tsarist Legacy

In Tsarist times, the penal system brought a unique populace to Sakhalin. For nearly 50 years, beginning in the mid-1800s, Sakhalin was home to a different breed of individual—convicts shipped out from western Russia who served their terms in a vast penal colony. Between 1875 and 1905, Sakhalin's convict population surged from one or two thousand to over 20,000 people. Life on Sakhalin was exceptionally challenging. The Russian writer, Anton Chekhov, illustrated this well when he visited Sakhalin in 1895, by observing, "I have seen Ceylon, which is paradise, and Sakhalin, which is hell." In a similar vein, John Stephan, the foremost western historian of the Russian Far East,

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described life under Sakhalin's notorious penal rule in his unparalleled history of the
island:

On Sakhalin, the guards were more criminal than the convicts and the free settlers
suffered more than the imprisoned. On Sakhalin, free women sold their children
to preserve a mockery of a family, while convict women, rationed like precious
commodities, were known to murder their designated spouses in hope of a better
match. On Sakhalin, men and women went to the woods not in search of grapes
nor to gratify their lust, but for deadly toxic wolfsbane which would bring a quick
end to their tormented lives. On Sakhalin, peasants talked wistfully of that same
Siberia that Muscovites dreaded.\(^6\)

The Territorial Dispute

Japanese-Russian rivalry over Sakhalin dates back to the early years of discovery
and cartography when both Japanese and Russian explorers visited the island; even
determination of Sakhalin's island status became a matter of some dispute, with Soviet
sources crediting Russian surveyors, and Japanese as well as pre-Soviet Russian sources
unanimously crediting Japan. Cartographic exploits aside, the matter of territorial
ownership remained murky and fraught with strife; in 1855, Russia and Japan signed the
Treaty of Shimoda, separating the "Northern Territories"—four islands adjacent to
Hokkaido which went to Japan, from the rest of the Kurile chain—which went to Russia,
but leaving the question of ownership of Sakhalin unresolved.\(^7\) In 1875, the Treaty of St.
Petersburg granted Russia possession of Sakhalin island proper, but ceded the entire
Kurile chain to Japan. At the beginning of the 20\(^{th}\) century, as Japan's imperial power
waxed, Sakhalin became a less secure location to house Imperial Russia's convicts, and
Tsarist penal rule on the island drew to a close. The Russo-Japanese War (February 1904-
September 1905) shattered the peace on Sakhalin and re-introduced Japan's territorial

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\(^6\) Ibid., p. 65.
claim. The Japanese invasion of Sakhalin in July of 1905 was particularly significant because it represented the only instance of the war in which Russian territory was invaded, occupied, and annexed by the enemy.\(^8\) The Treaty of Portsmouth which ended that war on September 5, 1905, partitioned the island along the 50\(^{th}\) parallel, granting Japan control over the southern portion, which the Japanese re-named Karafuto. Japan retained control over southern Sakhalin for 40 years, until its defeat in World War II, and even invaded and held the northern portion of the island for a period of five years between 1920 and 1925.

In the summer of 1945, with Japan reeling from two atomic blasts, the Soviet army swept into southern Sakhalin and the Kurile islands, seizing Karafuto and the entire Kurile chain, including the Northern Territories, and incorporating them into Sakhalin oblast. On the Kurile Islands, Soviet operations continued even after the Japanese surrender, and the four currently disputed islands were occupied on September 20, eighteen days after Japan signed the act of capitulation. At Yalta, Stalin reached an agreement with the United States and Britain by which the Soviet Union laid claim to the Kurile chain, in payment for its involvement in the war against Japan. Neither the Potsdam Declaration, accepted by Japan as the terms of capitulation, nor the San Francisco Peace Treaty, nor the joint Soviet-Japanese Declaration of 1956, succeeded in clarifying the dispute over the four islands: While Japan accepted the loss of the Kurile Islands to the Soviet Union, the treaties failed to stipulate what exactly was meant by the term "Kurile Islands." The Soviet Union included the Northern territories in its definition

\(^7\) The four islands are: Iturup (Etorofu in Japanese), Kunishir (Kunashiri), Shikotan, and the Habomai group, off the coast of Hokkaido.
of the Kurile chain, while Japan understood them to be an entirely separate entity.

Essentially, Japan reverted to the definition operative under the St. Petersburg Treaty discussed above, while the Soviets argued that Japanese aggression in 1905 and the subsequent signing of the Portsmouth treaty invalidated previous agreements. Moreover, Stalin failed to acquire internationally recognized territorial rights as the Soviet delegates walked out of the peace conference in San Francisco after a disagreement on the islands, refusing to sign the treaty. Although the Soviet Presidium issued two edicts, in 1946 and 1947, merging the Kuriles (including the disputed islands) into Sakhalin oblast, the unilateral nature of these edicts precluded their validity under international law.

Some distinction has, however, been made between the two smaller islands of Shikotan and Habomai, and the larger northern islands of Iturup and Kunashir. At San Francisco, the Japanese Plenipotentiary Representative, Shigeru Yoshida, characterized the two smaller islands as part of Hokkaido, while conceding that the case of the two northern islands could be open for discussion. The final text of the 1956 declaration reflected this distinction by stating that the Soviet Union would transfer Shikotan and Habomai to Japan after a Japanese-Soviet peace treaty was signed, but by the end of the first post-Soviet decade, no such treaty was concluded. Although Japanese politicians attempted to raise the issue of the islands in subsequent years, not until 1988 did the Soviets agree that there was even any issue to discuss. In April 1991 Gorbachev made his historic trip to Tokyo. While he failed to meet Japanese expectations of a territorial concession, the Soviets effected a major policy shift in recognizing the existence of a territorial dispute and making direct reference to the four islands.

8 See A.N. Ryzhkov, "Iz istorii otkrytiya, issledovaniya, i osvoeniya Sakhalina i Kurilskikh ostrovov," in K.I. Knyazev, ed., Sakhalinskaya oblast, Yuzhno-Sakhalinsk, 1960, pp. 87-90,
Japanese Economic Influences

In addition to territorial dispute, the long years of Japanese occupation, or partial occupation, exercised a profound economic influence over the territory which constitutes post-Soviet Sakhalin oblast. The Japanese presence brought economic benefits to Sakhalin—in particular, significant infrastructure development in the south of the island—and Japan’s rule was considered relatively benign. The Japanese also introduced an element of market economics to the area at a time when the rest of Russia labored under the communist economic system. Finally, the Japanese presence brought with it a degree of ethnic diversity which persisted into the post-Soviet period. In terms of specific industry interests, Japan cultivated a long-term interest in Sakhalin’s oil business. Post-Soviet projects for cooperative oil development with Japan constitute, in their essential elements, a continuation of plans made nearly a century before Soviet collapse.

When the Japanese seized southern Sakhalin in 1905, infrastructure development was one of their primary goals. Japanese planners built roads, set up schools and clinics, and developed a communications infrastructure. Japan put special emphasis on the railway system so that in the 1990s, about 80 percent of Sakhalin’s railway mileage lay below the 50th parallel. In a pattern similar to the colonization of Hokkaido, Tokyo sent in survey teams to determine appropriate sites for agriculture, fishing, and forestry. Settlers from Japan’s main island received parcels of land and were quickly and
cited in Stephan, p. 78.

9 The Soviet and pre-Soviet occupation of Sakhalin did not involve the slaughter and enslavement of the native populace, as it did in China and Korea; in fact, Japanese sources claim that after 1905, Japan released all political prisoners held on Sakhalin, although Russian sources dispute this. See I.A. Senchenko, Ocherki istorii Sakhalina: vtoraya polovina XIX v., nachalo XX v., Yuzhno-Sakhalinsk, 1957, pp. 67-71, cited in Stephan, p. 81.

efficiently integrated into the community. As a result of Japanese efforts, total annual valued production on southern Sakhalin increased 40 fold between 1907 and 1941.\(^\text{12}\)

Japanese colonial rule also introduced southern Sakhalin to market-oriented economics by allowing a role for private business and exposing those businesses to foreign markets. As John Stephan explains: "In Karafuto, private corporations exploited vast parcels of public lands, with only a supervisory role played by public authorities... Karafuto's extractive and manufacturing industries oscillated in response to world market trends..."\(^\text{13}\) As a result, Sakhalin—at least the southern portion—stands alone among the Russian Far Eastern provinces in its direct experience with market economics during the Soviet period.

Japanese rule brought an ethnic diversity to Sakhalin which is still in evidence in post-Soviet Russia. Under Japanese rule, Chinese, Poles, Russians, and Japanese lived together on Sakhalin, with Koreans by far the largest minority group. During the 1930s, Japan brought Koreans to Sakhalin to work in the coal mines, pulp factories, and fisheries. By 1941, some 300,000 Japanese lived alongside 150,000 Koreans. Japan transferred about 100,000 Koreans to the main Japanese islands during the course of the Pacific War, but when Sakhalin returned to Soviet power in the summer of 1945, about 43,000 Koreans still remained on Sakhalin. The division of the Korean peninsula and the subsequent outbreak of the Korean War precluded repatriation for most Sakhalin Koreans, and today their descendants continue to live under Russian rule.\(^\text{14}\)

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\(^{11}\) Stephan, p. 87.
\(^{12}\) Ibid., p. 117.
\(^{13}\) Ibid., p. 130.
\(^{14}\) Ibid., pp. 161-162.
Sakhalin's oil fields were of special interest to Japan. Oil was first discovered on Sakhalin in 1880, when a Russian merchant named Ivanov heard stories of a "black lake of death" in north-east Sakhalin where birds perished in an inky mire..."\textsuperscript{15} In 1904, Ivanov's son-in-law, Grigorii Zотов, struck oil. International interest was quick to follow, and German, Chinese, and English investment flowed to northern Sakhalin. Japanese interest in Sakhalin's oil grew further in the years leading up to the Russian Revolution, and in April of 1919, with the Soviet Union enmeshed in the chaos of civil war, Tokyo issued a statement declaring Sakhalin oil to be "absolutely necessary," to the resolution of Japan's fuel problems.\textsuperscript{16} Thirst for oil constituted the primary motivating force behind Japan's subsequent move into northern Sakhalin, and in the summer of 1920, the Japanese army occupied northern Sakhalin, declaring the entire island an "Autonomous Sakhalin State." From 1920 to 1925, the Japanese extracted approximately 100,000 tons of oil annually from northern Sakhalin's on-shore wells. During this period, Japan successfully retained control over Sakhalin oil in the face of both Soviet and foreign pressures, most notably an aggressive effort on the part of an American company, the Sinclair Oil Company, to wrest control of the oil fields from Japan.\textsuperscript{17}

By 1925, in a brilliant diplomatic coup, the Soviet Union forced the Japanese out of northern Sakhalin. However, according to the terms of the Convention which established diplomatic relations between Japan and the Soviet Union, (signed in Beijing on January 20, 1925), the Japanese retained the right to develop oil and coal reserves and

\textsuperscript{15} Ibid., p. 93.
\textsuperscript{17} In January 1923, the Soviet Union confirmed Sinclair's oil rights on northern Sakhalin, but when Sinclair geologists attempted to land on the island they were turned back by Japanese troops. Stephan, p. 102.
retained control over concessions in northern Sakhalin for a period of forty-five years.\textsuperscript{18} In line with this agreement, Japan established two oil companies which were to prospect for eleven years and exploit northern Sakhalin oil reserves for forty-five years.\textsuperscript{19} By the mid-1930s, in the wake of the Anti-Commintern Pact which Japan signed on November 25, 1936, Soviet tolerance for the Japanese presence on northern Sakhalin began to show evidence of strain. Under Soviet pressure, Tokyo and Moscow signed a Neutrality Pact on April 13, 1941, in which Japanese Foreign Minister Matsuoka Yosuke agreed to liquidate Japanese concessions by the end of the year.\textsuperscript{20} When Germany invaded the Soviet Union later that year, however, Tokyo seized on Soviet vulnerability to push for an extension of drilling rights through 1943. A year later, with the Asian war going badly for Japan, and Soviet troops advancing into the Ukraine, the Japanese abandoned all oil and coal concessions on northern Sakhalin.\textsuperscript{21}

With the definitive end of Japanese rule on Sakhalin, the Soviet Union set about developing the island's oil and gas reserves on its own, but in the early 1970s, the Soviets became interested in high-potential off-shore oil development, a project beyond their technical capabilities, and began to cast about for foreign assistance. To that end, Moscow invited the Japanese back to Sakhalin, and on January 28, 1975, signed an agreement with the Sakhalin Oil and Gas Development Company

\textsuperscript{18} Japanese companies won the right to drill in 50 percent of northern Sakhalin's designated oil areas and paid between 5 and 15 percent royalties. Japan also retained the right to send survey missions to search for new oil fields, and could share any deposits they located equally with the Soviet Union. The details of these concessions were agreed on December 14, 1925, and formed the legal basis of the Japanese presence on northern Sakhalin from 1925 to 1944. Stephan, p. 107. \textsuperscript{19} Stephan, p. 132. \textsuperscript{20} A. K. Ilin, "K likvidatsii laponskikh kontsesii na severnom Sakhalin i prolongatsii na piatlet rybolovnoi konventsii," (Liquidation of the Japanese Concessions on northern Sakhalin and the 5-Year Proloegation of the Fishing Convention), \\textit{Bolshevik}, no. 9, 1944, pp. 69-73, cited in Stephan, p. 138. \textsuperscript{21} Stephan, p. 139.
(Sodeco), a consortium of 17 Japanese corporate shareholders together with the United States' Gulf Oil.\textsuperscript{22} The agreement provided several hundred million dollars in credit through Japan's Import-Export Bank for exploration equipment such as drilling rigs, drill casing, and computers. In return, Japan won the rights to 50 percent of all oil and gas produced off-shore for a period of ten years. Japan and the Soviet Union began exploratory drilling in the late 1970s, but the relationship soured as Soviet debt to Sodeco soared, accusations of bribery flew, and the Japanese uncovered mostly natural gas, rather than oil. By the middle of the 1980s, Sodeco pulled out of its agreement, and while Soviet development efforts continued, they bore little fruit.\textsuperscript{23} Thus matters stood when the Soviet Union collapsed in 1991.

\textbf{Geography, Infrastructure and Economic Structure}

A long slender island just off the eastern coast of the Russian Federation, modern-day Sakhalin stretches a desolate 950 kilometers from the 45\textsuperscript{th} latitude north to the 54\textsuperscript{th}. To the north lies the Sea of Okhotsk, to the east, the Pacific Ocean, and to the west and south, the Sea of Japan. At its narrowest point, the straits which separate Sakhalin from the mainland are a mere seven kilometers wide, and the island lies just 45 kilometers north of Japan's prefecture Hokkaido. The oblast of Sakhalin includes the Kurile island chain, a 1,200 kilometer chain of 59 volcanic islands (including 39 which are active)

\textsuperscript{22} Japan's National Oil Company held more than 40 percent of Sodeco's equity. Matthew Sagers, "Prospects for Oil and Gas Development in Russia's Sakhalin Oblast," \textit{Post-Soviet Geography}, vol. 36, no. 5, 1995, p. 278.

stretching from the coast of Hokkaido north to the Kamchatka peninsula. The island is prone to seismic activity, particularly in the north where two-thirds of the population of Neftegorsk, an oil town, perished in an earthquake in the summer of 1995. At over 7,000 kilometers and 8 time zones from Moscow—a direct flight between Moscow and the oblast capital Yuzhno-Sakhalinsk takes 11 hours—Sakhalin is one of the most remote provinces of the Russian Federation. Covering an area of 87,000 square kilometers, Sakhalin is slightly smaller than its Japanese cousin, Hokkaido. The island's climate varies from south to north: In the center and north the average January temperature is minus 12F, while in the south winter temperatures average 21F. Sakhalin's population is sparse and has been dropping since the dissolution of the Soviet Union. At the end of the 1990s, oblast population stood at approximately 650,000, down from the pre-1991 figure of 720,000. Over 80 percent of the population is urban, concentrated in the south of the island with 160,000 people living in the capital of Yuzhno-Sakhalinsk. Ethnic Russians and Ukrainians make up 88 percent of the population and Koreans account for 5 percent.

Infrastructure on Sakhalin is underdeveloped compared with Primor and Khabarovsk, particularly in the north of the island. One largely unpaved road reaches from Yuzhno-Sakhalinsk in the south, to Okha, in the north. A rail system connects the capital city to two southern ports: Korsakov (population 44,500 in 1995) which is the oblast's largest fishing center and is open to international shipping, and Kholmsk (population 50,000 in 1995), home to a fishing fleet and the terminus of the ferry from Vanino in Khabarovskii krai. In 1995 a ferry service began operation between Korsakov

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and Hokkaido prefecture in Japan. The island has an international airport in Yuzhno-
Sakhalinsk with regular service to Hokkaido and charter service to Seoul in Korea.

Sakhalin's economy is primarily dependent on the fishing industry. When the
Soviet Union collapsed, Sakhalin accounted for 25 percent of the Far East's fishing
fleet.26 Fish continued to play a central role in the island's economy throughout the 1990s,
employing 22 percent of the industrial workforce (1995), and representing 30 percent of
regional output (1997).27 As in the case of Primorskii krai, fish exports were critical to
the regional economy, consistently accounting for some three-quarters of total exports
(officially reported), almost exclusively going to Japan. The timber business also played
an important role in Sakhalin's economy: Some 60 percent of the island is forested. In
addition to harvesting round wood, Sakhalin had a developed pulp and paper
manufacturing business under the Soviet regime. Over the course of the 1990s the
manufacturing business dwindled so that production of pulp and paper on Sakhalin
virtually ceased by the end of the decade. Sakhalin also has a modest coal industry which
produced about one million tons of coal annually and employed 14 percent of the
industrial work force in 1995. On-shore oil and gas was a major industry under the Soviet
system, with extraction focused around the northern town of Okha (population 37,000 in
1995), but with reserves dwindling, the local oil business fell on hard times. The island
has limited oil processing capability, and most oil was shipped via pipeline to refineries
in Khabarovsky krai. Undeveloped off-shore oil and gas reserves have been Sakhalin's
most lucrative prospective natural resource.

M.E. Sharpe, 1994, p. 70.
The structure of Sakhalin's economy seems particularly likely to generate economic interests with pro-FDI inclinations. Sakhalin has no defense industry—one sector likely to have little interest in FDI. Foreign investors' greatest interest in Sakhalin lay naturally in the large off-shore oil and gas deposits. Indeed, as Russia lacked the technology to develop these deposits, off-shore oil and gas development would not have been feasible in the 1990s without the participation of foreign oil companies. Sakhalin governors developed an actively pro-FDI policy specifically geared to attracting foreign investment to the off-shore oil projects. Was regional FDI policy a product of economically-derived interests? In other words, is the simple fact that off-shore oil fields exist and that foreign capital was necessary for their development enough to explain FDI policy outcomes on Sakhalin? This chapter will consider the role of economically-derived interests in the formulation of pro-FDI policies in oil and gas in the section below on oil and gas.

The Governors: embracing foreign investment

Valentin Fedorov

The first post-Soviet decade got off to an unusual start on Sakhalin, even by the standards of the time. In 1991, Sakhalin was led by an unusual man, Valentin Fedorov. An outsider to Sakhalin, Fedorov was born and raised in the Far Eastern region of Yakutia but studied economics in Moscow at the orthodox Marxist Plekhanov Institute of the National Economy, and later worked at the Institute of World Economies and
International Relations of the USSR Academy of Sciences, also in Moscow. In the late 1980s, frustrated by the slow pace of perestroika, Fedorov dreamed of establishing a free-market experiment far from the heavy hand of Moscow bureaucrats. He chose Sakhalin. In the spring of 1990, when Sakhalin held regional elections, Fedorov seized the opportunity, moved to Sakhalin to campaign, won 85 percent of the vote and a seat on the local soviet, and was subsequently appointed chairman of the Soviet Executive Committee (ispolkom) of the oblast. In August 1991, Fedorov openly supported Yeltsin during the attempted coup, and in return, on October 8, the President appointed him head of the Sakhalin Oblast administration.

In economic matters, Fedorov argued that local initiative, not central regulation, would unlock provincial potential. Fedorov's go-it-alone philosophy translated into a concrete policy proposal to establish the entire island as a free economic zone where he could pursue economic reform free of the heavy hand of Moscow bureaucrats. Such a scheme, Fedorov believed, would allow Sakhalin to become largely self-sufficient and would demonstrate to the nation the benefits of a free market system. Promising to "buy from Moscow Sakhalin's freedom," he fought to wrestle control over the island's natural resources from Moscow and place them under direct provincial jurisdiction. It was largely this aspect of Fedorov's platform—namely the credible prospect of autonomous

33 Fedorov's unilateral attempt to declare the entire island a free-economic zone did not win a receptive hearing in Moscow, and although the notion survived his tenure, it never produced any concrete results. Subsequent governors dropped the idea.
economic development—that won Fedorov his seat on the local legislature in the 1990
elections.

Fedorov also evinced an early and enthusiastic commitment to market reform. As
noted above, Fedorov's choice of Sakhalin as a suitable province in which to run for
governor was predicated on the oblast's great distance from Moscow, a physical
dislocation which the new governor believed would be conducive to free-market
experimentation divorced of central control. Upon arrival in the oblast, Fedorov
immediately set about implementing his plan: He supported the growth of small
businesses, slashed bureaucratic and legal obstacles to individual entrepreneurs, and cut
through layers of government red tape to facilitate entrepreneurial ventures. He worked
with enterprise managers, encouraging them to sell any output which exceeded mandated
plan on the island's nascent markets, founded a "Sakhalin Fund" to provide financial
support for local farmers and small businesses as they struggled to get off the ground, and
provided space in government offices for an "infant-business incubator," where young
businesses could share equipment and experiences and consult with American and
Japanese volunteers. Soon, corner flower stands, produce markets, and small private
restaurants made their appearance on the island.\textsuperscript{34} Within five short months of his taking
office, fifty new private farmers went into business, and by early 1992, Sakhalin boasted
800 small private farms and 196 private retailers.\textsuperscript{35} In this way, Fedorov brought to
Sakhalin an awareness of the principles of market economics and provided concrete
evidence of the benefits of market-oriented reform.

\textsuperscript{34} Walker, "An Island of Capitalism?" pp. 29-31.
\textsuperscript{35} L. Novikova, "Governor of Sakhalin," \textit{Argumenty i Fakty}, no. 44, 1991, cited in Brown,
"Sakhalin's Valentin Fedorov Makes Nationalist Allies," p. 34.
Fedorov was enthusiastic about foreign economic affairs. He believed that foreign investors would contribute to Sakhalin's drive towards self-sufficiency, and foreign investment played an integral role in the governor's proposals for free economic zone status on the island. Geographic distance from Moscow together with free economic status, the governor reasoned, would attract foreign investment because investors would feel insulated from the vagrancies of the post-Soviet economy and comparatively free of central government meddling.  

Fedorov placed particular emphasis on the oblast's oil business, arguing that foreign investment in oil and gas would provide the key to turning the island economy around. It was Fedorov who first introduced production-sharing proposals on Sakhalin, lobbying Moscow for federal legislation to support production-sharing, battling local oil enterprises, and actively engaging in decisions on foreign partners in Sakhalin's oil deals.

In April 1993, Fedorov lost his position as a result of a confluence of factors. For one thing, his market reforms did not deliver the anticipated economic benefits, leading to discontent in the locality. Local leaders began to accuse the governor of incompetent management leading to a drop in industrial output, and unreasonable price increases.

For another, in 1992, Fedorov began to criticize Gaidar's "shock therapy" approach to economic transition. Rather than rapid whole-sale reform, Fedorov argued, Sakhalin should work to simultaneously expand the market sector, while gradually reducing the planned sector of the economy. Most problematically, the governor adopted a highly

nationalist approach to the territorial dispute with Japan. He repeatedly voiced opposition to the Yeltsin administration's talks with Japan on the disputed islands, and increasingly allied himself with nationalist and communist leaders. Moreover, when his initial economic experimentation proved less than successful, Fedorov backed off from economic reform efforts: He called, for example, for a program whereby no more than 10 percent of the oblast's state-owned enterprises would be privatized per year.\(^{39}\) By April 1993, Fedorov's vacillating policies and growing nationalist rhetoric lost him support both in Moscow and the regional soviet—which demanded his resignation—and Boris Yeltsin removed him from office. He worked briefly as Deputy Minister of Economics in Moscow, ran unsuccessfully for a seat on the State Duma, and in 1997 was elected Prime Minister of the Republic of Sakha (Yakutiya).\(^{40}\)

**Evgenii Krasnoyarov**

On April 8, 1993, Yeltsin appointed Evgenii Alekseevich Krasnoyarov to replace Fedorov as Sakhalin governor.\(^{41}\) Like Fedorov, Krasnoyarov endorsed an autonomous go-it-alone approach to economic development. To that end, he worked to strengthen the power of the regional executive. While Krasnoyarov endorsed local solutions to Sakhalin's problems, he also recognized that maintaining good relations with the national capital could assist his efforts to build local solutions. Krasnoyarov believed that international interaction would bring economic prosperity to the island, but unlike

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Fedorov who failed to foster amicable relations with neighboring Japan, Krasnoyarov specifically set out to build good relations with the island's wealthiest neighbor.\textsuperscript{42} Krasnoyarov espoused an autonomous approach to regional development and to that end, he undertook substantial administrative reform intended to address the oblast's declining industrial output by strengthening the local executive branch. He set up a new "Economic Council," composed of enterprise directors, members of his administration, and small business representatives, to devise solutions to local economic problems.\textsuperscript{43} He recommended the establishment of a Sakhalin Bank for Reconstruction and Development to support infrastructure development on the island.\textsuperscript{44} He re-organized the oblast administration to include departments on fishing, industry, timber, fuel, and energy.\textsuperscript{45} As a result of these changes, the power of the oblast's executive branch increased dramatically over the course of Krasnoyarov's tenure.

Krasnoyarov supported Fedorov's earlier proposals for production-sharing legislation in the national legislature. Unlike Fedorov, however, Krasnoyarov recognized that a good relationship with Moscow was also important to ensuring Sakhalin's future growth, and he cultivated strong ties to the national capital. Krasnoyarov took several concrete steps to prove his loyalty to Moscow and improve the oblast's relationship with the capital which had suffered as a result of Fedorov's nationalist proclivities. In the fall of 1993, when tanks bombarded the White House in Moscow, Krasnoyarov faced down the oblast soviet and declared his support for Russian President Boris Yeltsin.\textsuperscript{46} Shortly

\textsuperscript{42} Author's interview with Evgenii Krasnoyarov, Niigata, Japan, November 9, 1994.  
\textsuperscript{44} "Sakhalin development bank," \textit{Vostok Rossii}, no. 31, August 6, 1993, p. 13.  
\textsuperscript{46} "Regional council sessions denounce presidential decree," \textit{TASS} September 25, 1993.
thereafter, when the regional legislature refused to ratify an important Presidential
Decree, "On stage-by-stage constitutional reform in the Russian Federation," which
supported a new Russian constitution, Krasnoyarovsky transferred all legislative powers to
the regional executive and unilaterally proffered oblast support to the Russian President.\(^{47}\)
As his tenure progressed, the governor's relations with Moscow continued to improve. In
December 1993, he won a seat on the Federation Council and became Deputy Chairman
in charge of relations with Asia-Pacific for the Committee on International Affairs, and a
member of the Committee on Federal Structures.\(^{48}\) By 1995, the governor was traveling
to China and Japan with Russian Foreign Ministry delegations, and had joined forces
with Alexander Yakovlev's newly-founded Social Democratic Party, which he saw as the
champion of small and medium-sized business of the kind he hoped to foster on Sakhalin.
He used his affiliation with this national Party to support an initiative to establish a "fund
for regional support of democracy," which he hoped to head himself in order to "build
Russia, the Far East, Sakhalin and the Kurile Islands."\(^{49}\) In this way, Krasnoyarovsky
developed new and substantive ties to national institutions.

Krasnoyarovsky also embraced Fedorov's ideas on the importance of foreign
investment, but where Fedorov failed to develop amicable ties with the oblast's closest
and wealthiest neighbor—Japan, Krasnoyarovsky established an immediate connection.
Krasnoyarovsky was himself well-versed in the intricacies of economic relations with Japan:
Prior to gubernatorial appointment, he had served as General Director to one of the

island's longest-lived joint-ventures—a Russian-Japanese undertaking called Pilenga Godo which used Japanese technology to harvest and farm seafood. Upon Krasnoyarov's appointment, the governor of Hokkaido, Takahiro Yokomichi, was so pleased that he personally telephoned his Russian counterpart to congratulate him on the appointment.50 Within two months, Krasnoyarov met with governor Yokomichi to discuss setting up air service between Hokkaido and Sakhalin, an effort which bore fruit in 1995 with the establishment of regular flights between Yuzhno-Sakhalinsk and Hokkaido's Hakodate airport. He further worked to improve relations with Japan by actively lobbying both Moscow and Tokyo for a Japanese consulate on Sakhalin.51 Krasnoyarov also attempted to mitigate the ill effects of territorial dispute with Japan by helping to establish and facilitate a system of visa-free visits for Japanese nationals to the four disputed islands.52 The governor's efforts meant that in the space of two years, Sakhalin's relations with Japan improved dramatically.

Despite the governor's good relations with Moscow and strides in the area of foreign economic relations, in the spring of 1995, Krasnoyarov fell foul of his own constituents. Disagreement centered on finances. Allegations against the governor accused him of misusing federal funds intended for earthquake victims in the southern Kurile islands in 1994.53 Then there was the issue of the balancing the oblast budget: The governor pushed through a balanced budget, and was supported by a portion of the regional legislature; but four deputies voted against balancing the budget, including the

51 Author's interview with Evgenii Krasnoyarov, November 9, 1995, Niigata.
52 "Hokkaido governor leaves for Russia," Kyodo June 1, 1993; Japan Times, June 2, 1993.
deputy chair of the Duma, Lyubov Shubina. The balanced budget meant a radical drop in support for the districts, and those districts in the north of the oblast were particularly hard-hit and antagonistic to the governor.\textsuperscript{54} In March of 1995, representatives from the northern districts banded together in an organization called Soglasie (Agreement), which accused the governor of discriminating against the north, advocated civil disobedience, and called on the public to join a campaign to oust Krasnoyarov.\textsuperscript{55} By April, this effort, which became known as the "Spring Offensive," gained the support of regional duma speaker, Valiulla Maksutov, who sent a telegram recommending Krasnoyarov's removal to President Boris Yeltsin, Prime Minister Vikor Chernomyrdin and Chief of the Presidential Staff Sergei Filatov.\textsuperscript{56} Days later, Krasnoyarov submitted his resignation to President Yeltsin.

In sum, Krasnoyarov retained essential components of Fedorov's policies, but expanded and modified upon them by explicitly focusing on relations with Japan, and by improving the oblast's relationship with the national center. In the process, he also strengthened the power of the regional executive, further enabling him to push through gubernatorial policies over the objections of local opponents. When Krasnoyarov was removed in April 1995, he moved to Moscow and accepted an influential position at the State Committee on Fisheries.\textsuperscript{57}

\textsuperscript{54} Author's interview with Nail Yarulin, Mayor of Okha, August 12, 1995.
\textsuperscript{56} "Sakhalin movement wants to sack governor," \textit{TASS}, April 10, 1995.
\textsuperscript{57} "Sakhalin's Krasnoyarov resigns," \textit{Interfax}, April 12, 1995; \textit{FBIS Sov}, 95/71, April 13, 1995, p. 29.
Igor Farkhutdinov

President Yeltsin appointed Sakhalin's third post-Soviet governor, Igor Pavlovich Farkhutdinov on April 24, 1995. Farkhutdinov shared the autonomous developmental approach of his predecessors and like them, he saw foreign economic participation as the key to Sakhalin's future. Farkhutdinov's own tough personal history on the island—he had lived in the northern reaches under spartan conditions—bolstered the appeal of his approach to regional development. In a vein similar to Fedorov, who saw Sakhalin's geographic position as an opportunity to explore new and creative approaches to economic change, Farkhutdinov argued that Sakhalin's position, far from Moscow and adjacent to East Asia offered special opportunities: Arguing that "a close neighbor is better than a distant relative," Farkhutdinov held that "the characteristics of Sakhalin oblast's geographic position compel you to engage in and build international relations on a regional level...." At the same time, Farkhutdinov, like Krasnoyarov, understood the importance of building a good relationship with Moscow, and he expanded on Krasnoyarov's efforts to smooth relations with Moscow. These efforts bore fruit: It was under Farkhutdinov that production-sharing at last passed in the national legislature, and Sakhalin's foreign sponsored off-shore oil ventures began operation.

Like Fedorov, Farkhutdinov espoused an autonomous go-it-alone approach to Sakhalin development, and his own personal history contributed to the force of that approach, as well to his popularity in two successive electoral contests. Throughout his tenure, Farkhutdinov repeatedly referred to his early experiences on Sakhalin, experiences which echoed the harsh times which Sakhalin endured under the Tsars.

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58 Interview with Sakhalin Governor Igor Farkhutdinov, by Valerii Davydov, Rossiiskaya Gazeta, July 22, 2000, p. 4.
Farkhutdinov arrived on Sakhalin at the tender age of 22 when the USSR Ministry of Energy assigned him to work at a power station in the remote village of Tymovskoe. In a 2000 newspaper interview, he dramatically illustrated his experience in Tymovskoe:

Conditions were spartan. When I arrived I was initially in a hotel, with conveniences on the street. But since I was not very important, the station manager put me in a mobile mechanized column's hostel. There were more than 100 people living there who had been released from prison to do forced labor in the plants. They were good men, it was just that they were a little noisy. Then the hostel completely collapsed. They began to re-house everyone. I had to live in one of those old railway cars that stand on the tracks next to the power station. I was in one of the compartments. It would be minus 45 in the winter in those parts. The car was heated with steam, a system that was far from technically perfect. Every minute you would get the hydraulic knocking—bang! bang!—like someone wielding a hammer. If you wanted to get to sleep, you had to shut the heat off. It would go quiet, but 15 minutes later the temperature was back down below zero, because the car was made of metal. I lived there for probably a year.  

Farkhutdinov effectively parlayed his early experiences on Sakhalin into political capital, building on his common cause with Sakhalin's tough frontier populace, and the island's history, to garner support for strong and effective executive power. Farkhutdinov began his political career on Sakhalin in 1985, when he was appointed mayor of the town of Nevelsk. According to local reports, he won the respect of the townspeople, making strides in the areas of "economy and finance, energy and construction, transportation and telecommunications, trade, agriculture, health and education." By 1991, his enthusiasm and energy led to an appointment as mayor of Sakhalin's capital, Yuzhno-Sakhalinsk. As city mayor Farkhutdinov ruled with a strong hand, eliminating political rivals and consolidating all key administrative functions in his own hands: planning and

60 Svetlana Rodionova, "Governor of 59 Islands," (interview with Sakhalin oblast governor Igor Farkhutdinov), Rossiiskaya Gazeta, October 18, 2000, pp. 1-3.
61 Ibid.
development, finance, privatization, natural resource development, international
economic ties, and internal affairs.\textsuperscript{63} He retained this position until President Yeltsin
appointed him governor of the oblast in April of 1995. When he became governor, local
newspapers approvingly reported that the new governor promised to be a "strong and
controlling commander in chief,"\textsuperscript{64} and praised his work as city mayor where "he made a
lot of improvements and managed to contain the fuel and power generation crisis."\textsuperscript{65} Less
than a month after his appointment, Farkhutdinov proved his supporters right when he
provided effective and rapid relief to survivors of a disastrous earthquake which shook
the northern oil town of Neftegorsk and left two-thirds of its inhabitants dead.

Farkhutdinov's focus on regional autonomy and strong executive leadership did
not preclude good relations with the capital. Like Krasnoyarov, Farkhutdinov understood
the value of amicable ties with Moscow. He allied himself with pro-Kremlin national
Parties, particularly when Sakhalin won the right to hold gubernatorial elections. The first
gubernatorial elections (following three separate appeals to Moscow) took place on
October 20, 1996, when Farkhutdinov allied himself with Prime Minister Viktor
Chernomyrdin's party, Our Home Is Russia. During that campaign, Chernomyrdin
personally campaigned on Farkhutdinov's behalf, promising national support for special
development programs on Sakhalin should Farkhutdinov's bid prove successful.\textsuperscript{66}
Farkhutdinov won the election with 39 percent of the vote in a field of 10 candidates.\textsuperscript{67} In

\textsuperscript{63} Upon his appointment, Farkhutdinov fired first deputy governor Nikolai Dolgikh. In 1996,
Dolgikh, now head of the Sakhalin Financial-Production Group, mounted an unsuccessful
challenge to Farkhutdinov in the first gubernatorial elections.


\textsuperscript{66} "Regional Profile: Sakhalin Oblast," \textit{OMRI Russian Regional Report}, Vol. 2, no. 3, January 22,
1997.

\textsuperscript{67} \textit{RFE/RL Newsline}, No. 17, Volume 2, no. 1, January 9, 1997.
Sakhalin's second gubernatorial elections, held on October 22, 2000, Farkhutdinov again affiliated himself with a pro-Kremlin party, Unity, and won handsomely with 56.5 percent of the vote.  

Unlike his predecessors—both of whom were replaced at the request of the regional legislature—Farkhutdinov maintained good relations with the Sakhalin duma. The first post-Soviet legislature on Sakhalin was elected on March 27, 1994. Out of a total of 27 seats, only 12 were filled, and an average of 17 percent of the electorate cast its vote "against all." The legislature began work despite the large number of unfilled seats, but it was deeply divided with half the deputies, including the speaker Valiulla Maksutov, from enterprises and commercial structures, and the other half, led by vice-chair Lyubov Shubina, supported (either officially or unofficially) by the Communist Party. The duma had difficulty voting on legislation because deputies would simply refuse to attend legislative sessions. A new duma, with a full complement of 27 deputies was elected on October 20, 1996, and only three of the deputies from the first legislature (among them Shubina who had been instrumental in Krasnoyarov’s removal,) won re-election. The new legislature was openly supportive of Farkhutdinov—who ran successfully for governor on the same day the duma elections took place. Farkhutdinov supported the candidacy of the duma's speaker, Boris Tretyak. Tretyak held Sakhalin's sole seat on the State Duma from 1993 to 1995. In December 1995 he was unseated by Communist Party candidate Ivan Zhdakaev, who won with 23.4 percent of the vote to Tretyak's 20.9 percent. Farkhutdinov's relations with the oblast's Presidential

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69 Author's interview with duma speaker Valiulla Maksutov, Yuzhno-Sakhalinsk, November 28, 1995.
Representative Viktor Kamornik, appointed in October 1993, were likewise harmonious. Relations with the center were also comparatively conflict-free. Shortly before the June 1996 presidential election Yeltsin campaigned on Sakhalin with Farkhutdinov and also signed a bilateral power-sharing agreement at that time.

In sum, Farkhutdinov's dual-prong policy, at once courting Moscow while simultaneously proactively encouraging foreign investors—particularly those from Japan and South Korea—proved highly successful, both in helping to secure electoral mandate and in furthering progress on the oblast's international oil projects, a dual effort which had proven untenable for Sakhalin's previous governors. In this way, he both won financial support from Moscow—some 17 million rubles within six months of his appointment\(^7\)—and also increased the oblast's attraction for foreign investors.

Farkhutdinov's policies shared the central elements of his predecessors, but he also enjoyed a level of political saviness and support which allowed him to more effectively pursue his goals, particularly in the oil business, Sakhalin's key industry.

**Explanations: were pro-FDI policies on Sakhalin the product of economic structure?**

Three post-Soviet governors on Sakhalin embraced proactive policies designed to attract FDI to the oblast. Why? The most obvious, and tempting, explanation for this policy outcome lies in the structure of the regional economy—most importantly the off-shore oil and gas reserves which required foreign participation for their development. It seems clear that all three governors believed that exploitation of off-shore hydrocarbon

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\(^7\) Author's interview with duma member Lyubov Shubina, Yuzhno-Sakhalinsk, November 30, 1995.

resources with the participation of foreign companies held the key to economic
development on Sakhalin. Did gubernatorial policy, however, reflect the economically-
derived interests of Sakhalin's inhabitants? Was a pro-FDI regional policy the inevitable
outcome of the region's economic structure—as the policy continuity across three
administrations might suggest?

If the governors' pro-FDI policies were a product of economically derived
interests, we would expect to find some evidence—a group of individuals, a particular
industry, an organization of enterprises—which supported FDI in off-shore oil
development, and we would expect the political power of that group to increase (or at
least remain stable) over the course of the decade. When Valentin Fedorov arrived on
Sakhalin in the spring of 1990, there was no such group. In fact, Sakhalin's most
important industry—the fishing business—was less than enthusiastic about off-shore
exploration because it threatened to compromise fertile fishing waters. Fedorov himself
had virtually no connection to any real or potential interest groups on Sakhalin. He was
an outsider. He had spent only a few months on Sakhalin when he won a seat on the
regional soviet. Fedorov was explicit about his goals on Sakhalin: The remote region
offered an ideal "laboratory" in which to conduct his experiment in free-market,
internationally engaged, development.72 He came to Sakhalin to implement that idea.
Fedorov's pro-FDI policies, in other words, were the product of his ideals—not the result
of indigenous economically-derived interests. In a very literal sense, Fedorov personified
the injection of fresh ideas into the region.

72 See Walker, "An Island of Capitalism?" and Brown, "Sakhalin's Valentin Fedorov Makes
Nationalist Allies."
What of Evgenii Krasnoyarov? Was Krasnoyarov's support for FDI the result of economically-derived interests? The evidence suggests a disconnect between Krasnoyarov's support for FDI in off-shore oil development, and regional economically-derived interests. Krasnoyarov was selected for his know-how and business acumen developed in the course of his involvement with a Japanese-Russian fishing joint-venture. As noted about, the oblast's fishing industry was not enthusiastic about oil development, and the industry's antipathy for the off-shore projects grew over the course of the decade. Election results from December 1993 give some indication of the depth of the divide on Sakhalin on the question of FDI. The oblast voted 40 percent for Vladimir Zhirinovsky's ultra-nationalist Liberal Democratic Party of Russia (LDPR). The LDPR's blatantly xenophobic platform was antithetical to pro-FDI policies. At the same time, Sakhalin elected Boris Tretyak as its representative to the State Duma. Although Tretyak ran as an independent, his policy preferences were broadly pro-reform, pro-market, and pro-FDI. He won with 23.3 percent of the vote. Opposition to FDI and production-sharing appears to have grown under Krasnoyarov's governorship. By December 1995—some 8 months after Krasnoyarov resigned—Sakhalin voted Tretyak out and replaced him with a vocal member of the Communist Party who opposed production-sharing.

Dissent and opposition to FDI and production-sharing reached new heights under governor Igor Farkhutdinov. A fuller discussion of the opposition appears in the section below on oil and gas. In brief, Farkhutdinov faced growing opposition from the regional oil company and a powerful opponent in the gubernatorial race who represented the interests of indigenous oil producers. Farkhutdinov was the only governor in the three Far

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73 Author's interview with State Duma Representative Boris Tretyak, Yuzhno-Sakhalinsk, November 28, 1995.
Eastern regions who failed to win an absolute majority in his first gubernatorial race and had the weakest mandate in the second. In sum, even as Sakhalin's governors persisted in supporting FDI in the off-shore oil business, opposition to production-sharing and FDI grew and expanded on Sakhalin over the course of the 1990s. It seems doubtful, therefore, that gubernatorial policy was the product of indigenous economically-derived interests. Quite the contrary: The governors persisted in their policies despite growing local suspicion of FDI and increasingly vocal resistance to production-sharing.

The Disputed Islands

The long-running territorial dispute over the four islands, known in Japan as the Northern Territories, and in Russia as the Southern Kuriles, is perhaps the best-known aspect of Russian-Japanese relations. Because these islands de-facto constitute an integral part of Sakhalin oblast, it would appear reasonable to assume that passions about the territorial dispute would run highest on Sakhalin, that Sakhalin's leaders would vehemently defend the territorial integrity of their oblast, and that they would therefore be unenthusiastic about cooperating with Japanese business. In other words, it would seem reasonable to conclude that the territorial dispute between Japan and Russia would constitute a serious impediment to economic cooperation between Sakhalin and Japan and that as a result of the dispute, pro-FDI policies—particularly in relation to Japan—would be unlikely to emerge on Sakhalin.

This section shows that this is not the case. In view of the officially critical position which the territorial dispute occupied in Russian-Japanese relations, the biggest story about the islands for Sakhalin, was its stunning non-importance. This section argues
that while Sakhalin's governors did routinely make official pronouncements about Russia's rightful claim to those islands, in actuality, they focused their energies on unofficial diplomatic efforts designed to defuse or sidestep confrontation on territorial issues. The section begins with a brief overview of official negotiations between Japan and Russia on the islands issue during the 1990s. It then shows how, despite official gubernatorial statements on the importance of territorial integrity, Sakhalin's leaders were primarily concerned with devising ways to circumvent the issue, and were fundamentally more interested in economic relations with Japan than in defending Russia's territorial integrity.

At the national level, during the 1990s, Russia and Japan made virtually no progress on the territorial dispute, and as the century drew to a close, the two countries had yet to sign a peace treaty. In October 1993, Boris Yeltsin made an official visit to Tokyo. In meetings with Prime Minister Morihito Hosakawa, he recognized the validity of the 1956 joint declaration that promised to return two of the islands to Japan. The Tokyo Declaration that emerged after the 1993 summit agreed to seek a solution to the territorial dispute "on the basis of historical and legal facts," though Russia then backed off sharply on a promise of talks due to nationalist pressure at home. Subsequently, the new Japanese Prime Minister, Ryutaro Hashimoto, decided to put the territorial dispute aside, and instead stressed the need for Japan to strengthen economic relations with Russia. Russia's First Deputy Prime Minister, Oleg Soskovets, visited Japan in November 1994, when he reaffirmed the primacy of the Tokyo Declaration and Russia's interest in concluding a peace treaty with Japan. In April 1996 Hashimoto and Yeltsin met again at the Moscow Nuclear Safety Summit, where they agreed to establish a Peace Treaty
Working Group. The next encounter of import came in November 1997 at an informal "no neck-tie" meeting between foreign ministers held in Krasnoyarsk. Here, the foreign ministers pledged to conclude a peace treaty by the year 2000. Yeltsin and Hashimoto next met in Japan in April 1998, where they re-affirmed their intention to meet the year 2000 deadline. In November, Japan's new Prime Minister Obuchi made an official visit to Russia. This was the first official visit by a Japanese Prime Minister to Russia in 25 years. While diplomatically significant, this visit too, failed to resolve the territorial issue.\(^4\) No further substantive progress on the islands has been made under Russia's new president Vladimir Putin.

Throughout the 1990s, the territorial dispute was central to Russia's relations with Japan, and on Sakhalin, the post-Soviet governors took care, in their official pronouncements, to support the Federation's right to ownership of the islands. Ultimately, however, the governors' adherence to market approaches to economic development was simply incompatible with serious involvement in the territorial issue, because vehement engagement in the island dispute was primarily the province of nationalist political parties, which opposed economic reform and market-directed growth. Of the three governors, Fedorov was the only one who took a serious interest in the islands issue, and the alliance which this spawned between the governor's office and nationalist political leaders cost the governor his job.\(^5\) During his brief tenure, Krasnoyarov too voiced official support for Russia's claim to the islands, echoing Moscow's indignation when, in

\(^4\) Facts in this paragraph were provided by the Japanese Foreign Ministry's home page: http://www.mofa.go.jp/region/europe/russia/territory/index.html#III

\(^5\) Fedorov issued a statement on the islands, refusing to take part in talks with Japan and condemning Russian negotiations with Japan because, he contended, they would call Russia's sovereignty over the islands into question. "Contacts between Hokkaido and Sakhalin governors resumed," TASS, May 13, 1993.
January 1994, Japan demanded a reduction in Russian military presence on the islands.\textsuperscript{76} Farkhutdinov voiced his position succinctly: "We have a definite position: Russia has no extra islands or extra land."\textsuperscript{77} In short, on the basis of their official statements, Sakhalin's governors all appeared to be strong supporters of Russia's claim to the four islands.

This section argues that official pronouncements aside, the territorial dispute played little or no role in Sakhalin governors' political agenda. This is not to say that the governors favored turning the islands over to Japan. Rather, the governors' agenda focused on autonomous regional development and foreign economic interaction, and they devoted little energy to discussion of the territorial issue. Farkhutdinov outlined his approach in an interview with \textit{Rossiiskaya Gazeta}: "The territorial problem between Russia and Japan started in our oblast. You cannot work out policy between the center and the region without taking this into account. At the same time, regional governments realize that without multifaceted development of cooperation between the provinces of the Russian Far East and the territories and countries of Asia-Pacific, you cannot open territories to foreign investments."\textsuperscript{78}

Besides eschewing a focus on territorial dispute and directing voter concerns to economic issues, Sakhalin's governors took a number of concrete steps designed to mitigate the ill effects of territorial disagreement by increasing contacts between Sakhalin and Japan, particularly with the northern Japanese prefecture of Hokkaido. The first way in which they did this was by expanding the physical infrastructure necessary to facilitate contact. In this way they oversaw the establishment of regular flights between Yuzhno-

\textsuperscript{76} "Russia to tighten access to disputed islands," \textit{Japan Times}, January 29, 1994, p.3.
\textsuperscript{77} Interview with Sakhalin Governor Igor Farkhutdinov, by Valerii Davydov, \textit{Rossiiskaya Gazeta}, July 22, 2000, p. 4.
\textsuperscript{78} Interview with Sakhalin Governor Farkhutdinov in \textit{Rossiskaya Gazeta}, July 22, 2000, p.4.
Sakhalinsk and Hokkaido's Hakodate airport as well as a regular ferry service between the Sakhalin port of Korsakov and Wakkanae on Hokkaido.\textsuperscript{79} In 1994, Krasnoyarov presided over the establishment of a Japanese Cultural Center designed to educate Sakhalin residents about Japanese culture and customs. Under Farkhutdinov, these activities expanded to include student and government personnel exchanges, as well as business promotion forums. While far from formal diplomatic negotiations, these efforts at "soft diplomacy," together with the increased opportunities for travel between the two countries, went a long way towards warming relations between the oblast and Japan.

On a more concrete note, Sakhalin's governors engaged in a series of informal diplomatic meetings with their counterparts on Hokkaido, designed to effectively bypass the territorial issue and establish formal Japanese Consular offices on the island. This was an ambitious undertaking in view of the fact that, until the end of 1996, Japan did not even recognize Russia's control over southern Sakhalin, the former Karafuto.\textsuperscript{80} The process got underway in 1994, when Krasnoyarov helped to establish a Hokkaido Prefecture Representative Office in Yuzhno-Sakhalinsk. The office provided the focal point for informal meetings between Hokkaido and Sakhalin officials, as well as an informal setting for Foreign Ministry officials on both sides to meet.\textsuperscript{81} In this way, Sakhalin Governors set up a Working Committee composed of Sakhalin and Hokkaido officials to brainstorm ways to improve ties between the two provinces, and to jointly lobby Moscow and Tokyo for full Japanese consular services on Sakhalin. By the end of 1997, these efforts bore fruit when Japan agreed to expand the Hokkaido Office into a

\textsuperscript{79} Author's interview with Nobuo Arai, assistant to Hokkaido Governor, Sapporo, January 13, 1995.
\textsuperscript{80} "Tokyo to Accept Russian Control of Southern Sakhalin," Kyodo, December 1, 1996.

A third way in which Sakhalin governors worked to mitigate the ill effects of territorial dispute was by actively facilitating travel to Sakhalin for Japanese nationals wishing to visit birth-sites, family grave sites, or the disputed islands themselves. These measures were of great symbolic importance in Japan, and in 1999, Japan's Deputy Foreign Minister, Minoru Tamba, visited Sakhalin in person to travel to his birth-site in the Sakhalin town of Penzenskoe. Sakhalin's governors also actively supported a system of non-visa travel for Japanese citizens wishing to visit the disputed islands. In this way, 3380 Japanese nationals visited the islands and 3113 Russian residents of the islands visited Japan during the period between 1992 and 1999. Japan's Ministry of Foreign Affairs reported that these visits "resulted in an increase of friendship and understanding between the peoples of both countries."

Sakhalin's governors thus engaged in both official and unofficial endeavors to smooth relations with Japan and mitigate the detrimental effects of the territorial dispute. The goal of these endeavors was to build a foundation for eventual formal peace between the two countries. Farkhutdinov explained his strategy in a 2000 interview, arguing: "We have agreements between Sakhalin oblast and Hokkaido Prefecture in almost all spheres, which are called a 'mini peace treaty.'" He argued that a similar treaty should be signed at the national level, and that it was not necessary to make such a treaty contingent on

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81 Author's interview with former aide to Hokkaido governor Yokomichi, Sapporo, January 13, 1995.
85 http://www.mofa.go.jp/region/europe/russia/territory/index.html#III
resolution of the territorial dispute. By the year 2000, governor Farkhutdinov began to step into the official realm with a concrete proposal that Russia sign a peace treaty with Japan without addressing the territorial issue.

**Explanations: why Sakhalin's governors side-stepped the territorial issue**

Why did Sakhalin's governors chose to side-step the territorial issue? Was here some set of economically-derived interests which supported a policy of effectively ignoring territorial dispute in favor of a focus on Japanese FDI? The section above on gubernatorial policy across three administrations argued that there was no economically-derived indigenous group of interests that favored FDI and production-sharing. Was there some group on Sakhalin that favored effectively dismissing the territorial issue?

The evidence suggests quite the contrary. When Valentin Fedorov moved to Sakhalin, regional passions on the territorial dispute ran high, fueled by the governor's own embrace of nationalist politics in the latter part of his tenure. In fact, Fedorov's tenure embodies the dual forces tugging at Sakhalin's politics: the drive for Japanese oil-oriented FDI on the one hand, and the problem of territorial dispute with Japan on the other. Fedorov's inability to resolve that dichotomy led eventually to his own undoing. Sakhalin's unusually high support for the ultra-nationalist LDPR in the 1993 elections suggests that support for territorial integrity on Sakhalin did not abet under Krasnoyarov's leadership. In December 1993, nearly 40 percent of Sakhalin's electorate caste their vote for LDPR, far above the Russia median of 23 percent, and more than any other province

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in the Russian Far East. Under Farkhutdinov, Sakhalin elected Communist Party member Ivan Zhdakaev to represent the oblast in the State Duma, replacing Boris Tretyak—an avid supporter of production-sharing and FDI. Zhdakaev supported neither production-sharing nor FDI in Sakhalin’s oil and gas industry, and territorial integrity formed an integral part of his platform. 88 Besides the oblast’s selection of political representatives, evidence suggests that the region’s largest industry—fishing—was categorically opposed to the cession of territory to Japan. The waters around the disputed islands are fertile fishing grounds, and confrontation between Russian and Japanese fishing vessels was a common feature of the post-Soviet landscape. In interviews, Sakhalin’s fishing bosses repeatedly voiced their opposition to Japanese control of the islands and their territorial waters. 89 In sum, there was considerable support on Sakhalin for a nationalist policy on the territorial issue, as well as opposition to FDI and production-sharing in the oil business, yet Sakhalin’s governors—particularly Krasnoyarov and Farkhutdinov—sidestepped the territorial dispute and consistently supported FDI in the island’s oil industry. It seems therefore, the gubernatorial policy on FDI and on the disputed islands was not the product of indigenous economically-derived interests.

Oil and Gas

The story of FDI on Sakhalin is the story of oil investment. This section on oil and gas begins with an overview of Sakhalin’s major off-shore oil and gas projects as they stood in the 1990s. Second, it explains the primary tenets of production-sharing

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88 Author’s interview with Ivan Zhdakaev, Moscow, March 16, 1996.
89 Author’s interview with enterprise director at Sakhmoreprodukt, Kholmsk, August 8, 1995; author’s interview with the head of the Marine Resources Department, Sakhalinpromryba,
legislation and outlines the history of its passage into law. Third, it shows how gubernatorial ideas and leadership on Sakhalin played a critical role in the formulation and passage of production-sharing legislation at the national level. Fourth, it shows how Sakhalin's governors translated their ideas into action to overcome sizable opposition to production-sharing at the oblast level.

Overview of Sakhalin's Oil and Gas Projects in the 1990s

In the wake of Soviet collapse, the Russian government opened off-shore exploration and extraction on Sakhalin to international tender. Over the course of the first post-Soviet decade, two major projects named Sakhalin-1 and Sakhalin-2 made significant headway, and by the end of the decade, Sakhalin-2 began to produce and export oil. Other oil projects, Sakhalin-3 through Sakhalin-6, were in the early stages of formulation.

Sakhalin-1

The first project, called Sakhalin-1, revived the 1975 agreement between the Soviet Union and Japan's Sodeco, discussed in the historical section above. The Soviet-era agreement had foundered when the Japanese side withdrew from the project after the Soviet Union failed to pay Sodeco for exploratory drilling and feasibility studies—a debt which totaled $276.6 million, and continued to accrue interest throughout the remainder of the Soviet period.¹ In the early 1990s, however, with a new government in Moscow, Sodeco became interested in reviving its claim to the two off-shore fields—Chayvo and

Odoptu—which it had planned to explore under the 1975 agreement. On November 24, 1993, Sodeco brought Exxon on board and together they signed an initial protocol with the Russian government re-starting Sakhalin-1, and also adding a new field, Arkutun-Dagi, to the project. The three fields included in Sakhalin-1 are estimated to contain 291 mmt of oil and 421 bcm of natural gas, and Arkutun-Dagi, first discovered in 1989, is the largest known field on the Sakhalin shelf.² In exchange for the addition of Arkutun-Dagi, Sodeco agreed to drop its claim to overdue Soviet payments. By September 1994, following the completion of a feasibility study, the Russian government formally approved the project. On May 11, 1995, Exxon and Sodeco signed a joint operating agreement with the Russian government covering development of the three Sakhalin-1 fields, and in June of that same year, signed a more formal agreement during the Gore-Chernomyrdin meetings. The total project cost was projected at $15 billion, and project length set at 33 years. Production was to follow an initial five-year "evaluation" period which would focus on further geological and technical study. The project anticipated a peak annual output of 10 mmt of oil and 15 bcm of gas, to begin approximately four years after the onset of production.

Sakhalin-1 did not produce any oil or gas in the first post Soviet decade, due primarily to technical and financial obstacles—although Sodeco officials were also frustrated with the slow pace of Russian legislative development.¹ First, as the Japanese had discovered in the 1970s, seismic surveys conducted by Exxon found large reserves of gas rather than oil. While gas reserves are potentially commercially viable, processing to liquid form—liquid natural gas or LNG—would require the construction of an LNG plant

² It has an estimated 113 mmt of oil, 5 mmt of condensate, and 68 bcm of gas.
on Sakhalin, or potentially, a pipeline to consumers in Northeast Asia, particularly Japan. The cost of such an undertaking would be high, design difficult, and initiation of such a project would require long-term agreements with consumers to secure funding. In. Compounding these issues, Exxon proved unsuccessful in reaching an agreement with the Russian environmental agency, Goskomekologiya, on treatment of drilling mud and cuttings, and as a result, canceled exploratory drilling in the summer of 1999.

In addition, Sakhalin-1 ran into financial trouble with its Russian partners. Sakhalin-1 includes Russian partners, Rosneft and SMNG. Rosneft holds a 17 percent stake in the project, SMNG, through its subsidiary, Sakhalinmorneftegaz-Shell holds a 23 percent stake, with Exxon and Sodeco holding 30 percent each. The project operator is Exxon Neftegaz Ltd., an Exxon subsidiary. In 1998, Mobil came on board when Exxon bought out Mobil Corp in a merger which created ExxonMobil. The inclusion of Russian partners meant that Russian companies were responsible for providing a portion of project investment funds. According to the terms of their agreement, Rosneft was to provide $8.5 million per year during the initial "evaluation period," and SMNG, $11.5 million per year. But in 1998, Rosneft proved unable to make any contribution at all to

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3 Author's interview with the director of Sodeco's Yuzhno-Sakhalinsk office, Toshihiro Sugiura, Yuzho-Sakhalinsk, August 3, 1995.
5 Ibid. In May 2000, however, new Russian President Vladimir Putin closed down the State Committee for the Environment, folding it into the agency in charge of resource exploitation, the Natural Resources Ministry. This change effectively removed environmental constraints from the agenda, leaving the oil companies free to disregard environmental concerns. See Anna Badkhen, "State Environment Body Goes Way of Dodo," St. Petersburg Times, May 23, 2000.
Sakhalin-1. Problems such as these delayed project progress so that at the end of the 1990s, Sakhalin-1 remained mired in the appraisal stage.

Despite the project's slow progress throughout the first post-Soviet decade, it nonetheless did generate revenue for both federal and local levels of the Russian Federation. Indeed, by 1997, it had already produced 52 million rubles in tax revenue and a 20 million dollar bonus from the consortium. By 2001, ExxonMobil announced plans for a $12 billion investment in Sakhalin-1, the largest direct foreign investment package in the Russian Federation.  

Sakhalin-2

The second project, Sakhalin-2, fared considerably better than Sakhalin-1. By the end of the 1990s, Sakhalin-2 had begun production, and the project was bringing tangible resources to the oblast. On June 5, 1999 Sakhalin-2 pumped its first oil, and in September, the first tanker of oil shipped to Korea. Sakhalin-2 was the first production-sharing project to be implemented in the Russian Federation, and also the first instance of international financing for an off-shore hydrocarbon project in Russia: In 1998 it won $348 million in non-resource financing from the U.S. Overseas Private Investment Corporation (OPIC), the European Bank for Reconstruction and Development (EBRD), and the Import-Export Bank of Japan.  

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Sakhalin-2 got off the ground in May 1991, when the Russian government invited international bidding for a feasibility study of two off-shore oil fields at Lunsky and Pultun-Astokhoski. Six consortia competed in the bidding process, with the winning bid going to a group which consisted of Marathon Oil, McDermott International, and Mitsui. The three created a holding company which they called Sakhalin Energy Development Company. By the end of 1992, Mitsubishi and Shell joined the Sakhalin-2 project, and McDermott withdrew; Marathon held the lion's share of the project with a 37.5 percent stake, Mitsui held 25 percent, Mitsubishi 12.5 percent, and Royal Dutch/Shell 25 percent.\textsuperscript{12} The four, often referred to as MMMS, legally incorporated themselves into a single operating company called Sakhalin Energy Investment Company.\textsuperscript{13} Significantly, this project has no Russian partner.

MMMS completed feasibility studies, at a reported cost of $75 million, by January 1993, and submitted its findings for review to the Russian government.\textsuperscript{14} The consortium signed a final agreement with the Russian government in June 1994, during the Gore-Chernomyrdin meetings. The agreement set a project length of 25 years with total investment projected at $10 billion. It envisioned peak liquid production at 9 mmt per year within four years of project implementation, and peak gas production at 15.5 billion cubic meters (bcm) per year.\textsuperscript{15} It began production in 1999.

\textsuperscript{13} Sagers, "Prospects for Oil and Gas Development in Russia's Sakhalin Oblast," p. 283.
\textsuperscript{14} Ibid., p. 282.
\textsuperscript{15} Ibid., p. 283.
Production-Sharing Legislation

The passage of production-sharing legislation—the process by which foreign companies remit a portion of their produce to the state in place of certain tax obligations\textsuperscript{16}—unlocked the door to foreign investment in Sakhalin's oil and gas projects. For the new Federation, production-sharing provided an obvious solution to problems faced by the indigenous oil industry. Production-sharing dominates oil extraction across the developing world, where countries lack the financial and technological means to effectively exploit resources. In many instances, post-Soviet enterprises too lacked the financial means to effectively extract hydrocarbon deposits: Under the Soviet system, state-owned enterprises extracted oil for domestic use and for export. In the post-Soviet era, Sakhalin's major oil enterprise—Sakhalinmorneftegaz—facing privatization and financial meltdown, was forced to severely curtail production and in some instances, stop it altogether. Compounding these problems, traditional hydrocarbon sources were beginning to dry up, and the indigenous enterprise lacked the means to drill new wells. By 1991, Sakhalin's land-based oil fields, which supplied oil during the Soviet era, were practically depleted. The oblast pinned its hopes on prospective off-shore extraction—a

\textsuperscript{16} Remittance of produce could be either in the form of oil itself, or else its dollar equivalent. According to Sakhalin government estimates, in the absence of production-sharing agreement, foreign oil companies' tax burden would render any project untenable. Taxes which foreign oil companies would have to pay were: royalties (6-16 percent), geology and fund payments (10 percent), Value Added Tax or VAT (20 percent), excises (about 14 percent), on production or sales; profit tax (38 percent); payments to pension fund (28 percent), state employment fund (2 percent), social insurance (5.4 percent), medical insurance (3.6 percent), education fund (1 percent), militia fund (2 percent), and transportation fund (1 percent), plus excess wage tax (38 percent) on wages bill. On imports, companies would be responsible for paying customs duties, excise, VAT, and customs clearance. In addition there would be property tax (2 percent of assets), land use payments, and payments for loss of fish due to oil development. This information provided to Judith Thornton by Sakhalin government officials in 1999 and cited in Thornton, "Sakhalin Energy: Problems and Prospects," p. 175.
complex process in which Russia companies lacked experience. The passage of production-sharing legislation, by allowing foreign participation in oil extraction, could address both the financial and the technological obstacles facing Sakhalin's post-Soviet oil industry.

In 1991, when the Soviet Union collapsed, the Russian Federation had no production-sharing legislation. Implementation of production-sharing agreements required the passage of federal legislation, and the story of that passage was torturous. Proposals for production-sharing legislation appeared as early as 1991, but they would have to wait until 1995 before the law was passed. By law, a legislative proposal must pass three readings in the lower house, or State Duma, then be approved by the upper house, or Federation Council, and finally receive Presidential approval. The State Duma finally passed the third reading of the law on June 14, 1995, but when it came before the Federation Council on October 3, the members of the upper house refused to ratify it. The Federation Council sent the law back to the Duma, which again passed it on December 6. It subsequently passed in the upper house on December 19, and was at last signed into law by the Russian President on December 30, 1995.

The law exempted investors, their contractors and subcontractors from taxes, fees, and excises except for the tax on profits, royalty payments, bonuses, exploration payments, land use payments, and insurance coverage for Russian employees. It stipulated that no more than 30 percent of Russia's oil reserves could be developed under

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17 On Sakhalin, Russian oil companies' lack of experience in off-shore drilling was further compounded by severe climactic conditions in the Sea of Okhotsk, where the off-shore oil reserves are located. Here, the sea is covered in ice for up to nine months a year, with ice thickness reaching up to two meters. In addition, the area is seismically active. Svetlana Kuzmichenko, *American Consulate Report*, Vladivostok. February 17-20, 1997.
production-sharing agreements (PSAs), and each PSA required individual approval from the State Duma, central government, and the regional legislature. Each PSA would also include specific local content requirements and individualized breakdowns for dividing profits between the Federation and foreign companies and between center and locality.

According to the terms of Sakhalin's PSAs, signed for Sakhalin-1 and Sakhalin-2, Russia would receive between 40 and 60 percent of the revenue, depending on the stage of the project, and the oblast was to receive 60 percent of Russian project revenue, with Moscow receiving 40 percent. Passage of this legislation provided a tremendous boost to Sakhalin's oil ventures, and when Sakhalin-2 came on line in 1999, it was the first PSA-governed oil venture in the Russian Federation to begin production.

*Sakhalin's Struggle for Production-Sharing Legislation in Moscow*

Intervention on the part of Sakhalin's governors played an important role in the successful passage of PSA legislation at the federal level. Naturally, an array of forces was instrumental to PSA passage—including the distribution of members' Party-affiliation in the upper and lower houses, the interests of major Russian oil companies, other legislation before the State Duma, timing of elections, and so on—but, I argue, at the critical junctures, proactive action on the part of Sakhalin's executive provided the necessary impetus to carry PSA legislation through to conclusion. This section first examines the basis of national-level opposition to production-sharing, and then shows

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20 Isabel Gorst, "High-level backing for PSAs, Petroleum Economist, October 2000.
how Sakhalin governors effectively countered PSA opponents in both the upper and lower houses of the Russian Parliament.

Production-sharing faced opposition in the Russian Parliament, on several counts. The primary objection was on nationalist grounds: Opponents argued that Russia should develop its natural resources alone and that production-sharing would give foreigners the "opportunity to pilfer Russia." Most proponents of this view were members of the Communist Party: Of forty-six Communist Party members in the Federation Council, only three supported the legislation, thirty voted against it, and the rest abstained from the vote. Opponents accused supporters of production-sharing of "selling the motherland," and argued that Russia should hold off on off-shore oil drilling until the emergence of indigenous technical capabilities. In particular, they objected to any sales of Russia oil abroad which would bring profits to foreign oil companies, and argued that any profits from the sale of Russian oil should rightly accrue to the Federation alone. Other objections to production-sharing focused on the exemption of foreign oil companies from a series of Russian taxes, holding that foreign companies should be subject to the same tax obligations as Russian enterprises. Some members of the Federation Council, which at the time was largely composed of Russian governors, refused to support the legislation because they could not see an obvious benefit for their own regions. Others argued that the law could not pass until other supporting legislation was passed, because as presented

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23 In his study of production-sharing legislation in Russia, Gary Wilson argued that representatives in the State Duma and Federation Council from oil producing regions were more supportive of production-sharing legislation than those representatives from non-oil producing regions. Wilson based his findings on an analysis of debate transcripts from the Russian parliament. Gary N. Wilson, "Crude" Federalism: Oil Politics and the Evolution of
to the Federation Council, production-sharing legislation contradicted pre-existing legislation.24 The greatest hurdle which PSA legislation faced, however, was not organized opposition to its passage, but disinterest and lack of understanding among members of Parliament. Many did not even bother to show up at sessions in which PSA legislation was voted, or else, if they did show up, did not participate in the voting. Often, even when they were provided with material explaining the legislation, they did not read it, and, if they did vote, they based their decisions on conversations with colleagues rather than consideration of the printed resources provided them. Such was the case of many members who voted against the legislation.25

That production-sharing legislation passed in Parliament at all is a testament to the tenacity and dedication of Sakhalin's leaders. It was Sakhalin's governor, Valentin Fedorov, who first introduced production-sharing proposals in Moscow and who consistently fought for passage of the legislation. Fedorov introduced legislative proposals in 1991, and actively supported development of Sakhalin-1 and Sakhalin-2 under production-sharing agreements. During his brief tenure, governor Krasnoyarov worked to keep the proposals alive, and Farkhudinov's leadership at last succeeded in bringing production-sharing legislation to fruition. Farkhudinov's efforts, particularly in the last months of 1995, when production-sharing was hotly debated in the Federation Council, were critical to passage of the law. When the Federation Council refused to

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ratify production-sharing in October 1995, the governor kicked into high gear. He gathered a team of supporters from the oblast administration and flew to Moscow to meet with members of both houses. He met with members of the upper house, provided them with copies of the law, distributed documents supporting his position, and explained the intricacies of production-sharing to the legislators. In less than three weeks, the Sakhalin team gathered supporting signatures from ninety-four members of the upper house, an effort which forced the Federation Council to reconsider its veto. As a result, the upper house again voted on production-sharing; it again failed to approve production-sharing, but this time by only 19 votes. In the original upper house vote held on October 3, only 41 members supported the law. By the time of the October 24 session, 281 members voted to remove the upper house veto on production-sharing. Undeterred by the setback in the Federation Council, the governor's team turned to lobbying the State Duma, where production-sharing again passed, and finally succeeded in securing passage in the upper house on December 19. President Yeltsin signed production-sharing into law on December 30. Even after the law was enacted, Farkhutdinov continued to tireless lobby for passage of important supporting legislation. He effectively lobbied for passage of the Enabling Law and Normative Acts in both houses of Parliament,\textsuperscript{26} as well as for amendments to a variety of related laws particularly those pertaining to land rights, customs duties, and federal-regional tax authority.\textsuperscript{27}

\textsuperscript{26} Dean E. Gaddy, "Sakhalin II PSA success attests to local leaders' commitment," \textit{Oil and Gas Journal}, March 6, 2000, p. 30.

\textsuperscript{27} "Oil and Gas: The Russian Parliament and Sakhalin-II," \textit{Russian Far East Update}, April 1995, p. 5.
The Local Debate: Governors and Alternatives on Sakhalin

The fight over production-sharing was waged not only in Moscow, but also on Sakhalin. All three of Sakhalin's governors took on the fight, but the third, Igor Farkhutdinov, had the greatest impact, and this section focuses on him. As in the capital, local opponents argued that production-sharing arrangements would give foreigners undue access to Russian wealth, and held that Russian enterprises, not foreign oil companies, should develop off-shore hydrocarbon deposits. Local opponents forged a powerful coalition on Sakhalin, attempting to block passage of production-sharing legislation and mounting a credible challenge to the governor in electoral contest.

Disagreement about the desirability of production-sharing arose in the early post-Soviet years on Sakhalin, and revolved around the local oil enterprise, Sakhalinmorneftegaz (SMNG). SMNG directors, like enterprise directors in Primor'e and Khabarovsk, feared losing control of their enterprise to foreign interests. SMNG's General Director, Anatolii Chernyi was interested in off-shore development, but his enterprise lacked the requisite technology and know-how to exploit off-shore resources. Chernyi recognized this, and favored establishing a joint-venture between SMNG and a foreign partner to begin work on the Sakhalin shelf. At the time, joint-ventures were the preferred form of cooperation in Russia, due in part to the new Federation's inexperience in dealing with foreign investors, but also because joint-venture arrangements promised Russian enterprises, but not the state, a direct financial stake in development projects, while ceding minimal control over enterprise operations to foreign partners. Chernyi had worked with MMMS member McDermitt in 1990, when McDermitt teamed up with the
Soviet Ministry of Oil and Gas to produce plans for a joint-venture to develop the Lunsky and Pultun-Astokhoski fields, which later became Sakhalin-2.

When Fedorov introduced proposals for production-sharing in 1991, Chernyi became enraged. He blamed Fedorov for the move towards production-sharing, accused the governor of attempting to reap the financial benefits of oil exploitation for himself and of enlisting Federal Government support in his endeavor, at the expense of Sakhalin's indigenous oil enterprises.\textsuperscript{28} The governor, and his foreign allies, Chernyi contended, had neither Sakhalin's nor the Federation's best interests at heart. He argued that development plans for Sakhalin-2 over-estimated profitability and that "financial arrangements"—namely production-sharing—were unlikely to bring prosperity to Sakhalin.\textsuperscript{29} When he realized that a joint-venture was out of the question, and further, that the Sakhalin-2 PSA would not even include a Russian partner, Chernyi's position hardened. In a 1995 interview with a local paper, entitled "Oil is not milk—it will not spoil after fifty years," he argued that Sakhalin's off-shore deposits should rightly be developed by Russian enterprises alone—with no foreign involvement—and that Russia should wait until the indigenous industry had acquired the technical know-how to do the job itself.

To counter opposition from Sakhalinmorneftegaz, Farkhutdinov took on the enterprise director directly. In 1995, Anatolii Chernyi resigned the company's directorship under pressure from the governor. The new director, Sergei Bogdanchikov, supported production-sharing, and Farkhutdinov saw to it that SMNG got the lion's share of subcontracting jobs. SMNG's new leadership stood by the governor and foreign investors in the fight to get production-sharing passed in the Federation Council. In an

\textsuperscript{28} Author's interview with Anatolii Chernyi, Sakhalin, August 17, 1995.
official SMNG press release, the enterprise's new leaders pointed out that SMNG was a partner in the Sakhalin-1 project, and that the enterprise played an important subcontracting role in Sakhalin-2. They deplored federal opposition to production-sharing, accusing Moscow legislators of depriving their oblast of critical funds, jeopardizing company health benefits, undercutting pension funding, and throwing enterprise employees out of work.\(^{30}\)

Despite the change in leadership at SMNG, Chernyi's position continued to hold considerable sway on Sakhalin, as evidenced in two separate electoral contests. First, in the 1995 elections to the State Duma, Sakhalin voters turned their backs on incumbent Boris Tretyak, an avid and active supporter of production-sharing who had labored hard to shepherd production-sharing legislation through the lower house in 1995. Instead, they elected Communist Party member Ivan Zhdakaev, a man whose support for production-sharing was less than enthusiastic: Zhdakaev expressed serious misgivings about the benefits production-sharing projects would bring to the islanders themselves, and accused members of the oblast executive of engaging in personal enrichment schemes from off-shore oil projects.\(^{31}\) Second, in 1996, Chernyi himself mounted a vigorous gubernatorial election campaign designed to unseat incumbent Igor Farkhutdinov and undo production-sharing. Although Chernyi lost to Farkhutdinov, he did garner 27 percent of the vote—coming in a strong second in a field of ten candidates—a sizable percentage in view of

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\(^{29}\) Interview with Anatolii Chernyi, "Neft'—ne moloko, i cherez pyat'desyat let ne prokisnet," (Oil is not milk—it will not spoil after fifty years), V. Kul'bakov, **Sovetskii Sakhalin**, p. 2.


\(^{31}\) Russell Working, "Sakhalin is a 'giant gas pump on the Pacific Rim.' So why is it taking so long to get out the petroleum?" *Vladivostok News*, No. 176, September 18, 1998.
the fact that Farkhutdinov won with 39 percent. Third, even after the passage of production-sharing legislation and Farkhutdinov's electoral victory on Sakhalin, the debate about the merits of production-sharing continued to rage within SMNG itself: In 1998, a group of SMNG directors teamed up with members of the regional duma to lobby the governor, and Moscow, for direct Russian enterprise participation in the Sakhalin-2 project—which had no Russian partner.

**Explanations: why the governor supported production-sharing**

Why did Sakhalin's governors support the passage of production-sharing legislation? An explanation based on economically-derived interests appears obvious: This was simple economic calculus—the governors hoped to reap the financial benefits of multi-million dollar oil projects on the Sakhalin shelf. Several aspects of the production-sharing story, however, suggest that a simple derivation of economically motivated interest may be insufficient to explain FDI policy outcomes on Sakhalin. First, there is the absence of an interest group—some kind of social, economic, or industry-based group on Sakhalin which supported the passage of the legislation. There was no such group. Next is the vexing question of the organized opposition, which centered on the oblast's own oil business, and also drew strength from the largest regional industry—fishing. If economically-derived interests drive policy outcomes, and the strongest and most organized economic interests on the island opposed production-sharing, then why did policy outcomes favor production-sharing? Why, in other words, would an elected official knowingly risk his office by facing down an indigenous organization of economic

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interests which opposed production-sharing legislation? These questions suggest that drawing a straight causal line between economic interest and FDI policy outcomes in the case of production-sharing may be too simple an approach.

The pro-FDI policy on production-sharing on Sakhalin was not a foregone conclusion. In fact, serious debate about the merits of production-sharing was a perennial feature of oblast politics throughout the 1990s, even after the passage of the legislation and the incorporation of the indigenous oil company into many aspects of the off-shore oil projects. Even after Farkhutdinov's electoral victory in 1996, opponents of production-sharing continued to organize against him. As a result, Farkhutdinov's electoral mandate, as well as his ability to control key positions in the oblast, was substantially weaker than that of his counterparts in Primorski and Khabarovskii krais. While Nazdratenko and Ishaev routinely garnered 70 to 90 percent of the regional vote, Farkhutdinov's mandate hovered between 40 and 60 percent. Farkhutdinov was the only governor in the three regions who failed to win an absolute majority in electoral contest—a fact which nearly cost him the race in 1996. The oblast's representative to the State Duma between 1995 and 1999 openly opposed the governor's pro-FDI policies. In Yuzhno-Sakhalinsk, the first mayoral elections similarly produced a victory for an opponent of production-sharing—Fedor Sidorenko—who replaced a Farkhutdinov appointee and beat out the governor's choice for the elected post. A long-time opponent of production-sharing, Sidorenko had been a member of the oblast duma and a vocal supporter of Anatolii

34 In 1996, the regional election law required candidates to win an absolute majority or go to a run-off. When Farkhutdinov won only 39 percent of the vote, the election commission declared him the winner, and the regional legislature met in a hurried session to amend the law to require only a simple majority. Information provided by Nobuo Arai in Sapporo to Jeffrey Hahn. Cited in Jeffrey Hahn, "The development of political institutions in three regions of the Russian Far East,"
Chernyi. A poll conducted on Sakhalin in 1998 found widespread skepticism about the merits of production-sharing amongst Sakhalin's populace, despite Farkhutdinov's electoral victory. The poll, conducted by the Vladivostok News found that: "most of the general population of Sakhalin...believe that their lives are not going to improve as a result of the impending oil projects....Many people...believe that the income generated by these projects will not be used by their government in a responsible way." Interviews with Sakhalin's fishing bosses found similar skepticism and opposition to the off-shore projects; Sakhalin's fishing bosses worried that oil development would adversely affect the environment and might wipe out fish populations. In this way, opposition to FDI and to production-sharing continued to fester throughout Farkhutdinov's tenure.

That Sakhalin's governors were interested in the economic gains to be reaped from off-shore oil development is not in dispute. That their pro-FDI policy was the result of economically-derived interest group pressure is. Rather, the governors persisted in their support of production-sharing projects in the face of organized opposition from indigenous economic interests. Why did they chose to do this? In multiple interviews and speeches, the governors laid out the rational for their policy. They believed that the most serious crisis facing the region and the Federation was economic in nature, that it was due to a dearth of capital infusion and that the acquisition of foreign capital served a patriotic purpose. The following section will argue that the governors' support for production sharing was a result of a particular set of ideas: ideas about the genesis of economic crisis

35 Interview with Fedor Sidorenko in Sovetskii Sakhalin, August 10, 1995, pp. 1,2.
in the region and in the Federation as a whole, ideas about market reform and the role of the region in the federal structure, and ideas about patriotism and democracy. The conclusion discusses a variety of possible explanations for FDI-related policies on Sakhalin and then outlines the ways in which gubernatorial ideas influenced policy outcomes.

Conclusion

This chapter has examined Sakhalin's FDI policies in the 1990s. In it I ask why Sakhalin's governors developed proactive policies designed to attract foreign investors to the oblast. By 1999, Sakhalin was the top FDI performer in Russia. Investment focused on off-shore oil and gas deposits on the Sakhalin "shelf." In this chapter, I ask whether Sakhalin's pro-FDI policies were the product of indigenous economically-derived interests in the oil business. I argue that they were not. Instead, I argue that FDI policy outcomes on Sakhalin can best be understood in terms of gubernatorial ideas. This conclusion lays out the chapter's findings and relates the empirical evidence to a number of possible explanations for policy outcomes. It then presents a five part ideational explanation for pro-FDI policies on Sakhalin

Economic Factors

One approach to explaining the pro-FDI policies of Sakhalin's governor's draws a causal line between economic factors and policy outcomes. By this argument, the presence of large off-shore oil and gas reserves that require foreign investment for

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development generates economic interests which lead to pro-FDI regional policies. A number of studies of Russian regions suggest that this is indeed the case, most notably Gary Wilson's study of the passage of production-sharing legislation in the State Duma and Federation Council. Wilson argues that representatives from oil producing regions such as Sakhalin were uniformly supportive of the PSA laws. Wilson's study is based on an analysis of debates in the Russian Parliament and on case studies of two oil producing regions: the Republic of Tartarstan and the Khanty-Maniisk autonomous okrug in Tiumen oblast. Representatives from both of these regions supported production-sharing.

The evidence presented in this chapter's analysis of Sakhalin suggests that the relationship between economic factors and policy outcomes in the case of production sharing legislation is a complex one. Sakhalin's governors supported production sharing, but they did so in the face of sustained resistance from powerful organized interests, at the risk of loosing political office in electoral contest, and at the price of significant political legitimacy—a markedly lower level of support among voters than that enjoyed by their counterparts in Primore and Khabarovsk. There was no interest group on Sakhalin that supported production sharing. The indigenous oil company was deeply divided. The fishing industry was largely opposed. The region's sole representative to the State Duma from 1995 to 1999 was a member of the Communist Party and was hostile to foreign investment and to production-sharing. The first elected mayor or the region's capital, Yuzhno-Sakhalinsk was an open opponent of production-sharing. As was the case in Primorskii krai, policy outcomes on Sakhalin were highly contingent on the policy position of the regional governor, and that position was not determined by economically-derived interest groups. On Sakhalin, as in Primorskii krai, a powerful
regional enterprise was sorely divided on the question of FDI and production sharing in particular. The outcome of the internal enterprise debate was determined by the governor. When Farkhutdinov moved to oppose those directors hostile to the PSA—by removing the enterprise director—Sakhalinmorneftegaz came out in favor of production-sharing legislation. So cantankerous was the debate, however, that internal enterprise resistance to the PSAs continued to fester even after production-sharing was signed into law.

Another facet of the governors' pro-FDI policies—quiescence on the territorial dispute with Japan—is also difficult to explain in terms of economic factors and economically-derived interests. Had there been some discernible interest group on Sakhalin that actively supported production sharing, that group might also have been responsible for the governors' muted response to the territorial controversy. There was, however, no such group. Moreover, there is evidence to suggest that a sizable portion of Sakhalin's populace favored a strong nationalist response to the problem: Sakhalin's unusually high vote for the ultra-nationalist LDPR in December 1993, the election of Communist Party member Ivan Zhdakaev to the State Duma in 1995, the fishing industry's antipathy to territorial bargaining. Here again, the policy that Sakhalin governors elected to pursue appears to run counter to regional interests rather than to align with them.

Another approach to explaining policy outcomes which uses economic factors as explanatory variables focuses attention on the interaction between political cleavages and energy resources. According to this argument, put forth by Pauline Jones Luong and Erika Weinthal and introduced in chapter 2, political leaders are likely to bring foreign investment into the energy sector when they wish to expand rents. Rents derived from
foreign investment allow political leaders to reward supporters and defeat opponents. Leaders faced with high levels of opposition and low alternative rents use foreign investment to defeat opponents; alternatively, leaders with low alternative rents who do not face strong opponents also seek foreign investment in order to generate the rents necessary to maintain the status quo. Sakhalin's leaders—most notably Igor Farkhutdinov who was the only governor to face electoral competition—did face strong opposition. However, that opposition did not take form prior to the introduction of foreign investment; that is, the were no pre-existing political cleavages, as per Luong and Weinthal's analysis. Instead, political cleavages were predicated on hostility to foreign investment and to production-sharing in particular. In other words, Sakhalin political leaders' policy on foreign investment actually fostered the development of political cleavages on the island. Moreover, the evidence does not suggest that Sakhalin's leaders needed the rents from production-sharing projects to retain political office. Quite the contrary: It was the governors' support for production-sharing that pitted the governor against a popular political adversary in electoral contest. It seems therefore, that FDI policy outcomes on Sakhalin can not be explained in terms of political cleavages and the search for rents.

**Institutions and Policies**

Another approach to understanding regional policy outcomes focuses on the impact of institutional legacy. Can the legacy of Soviet era institutions explain FDI policy outcomes on Sakhalin? One argument about institutional legacy, put forth by Kathryn Stoner-Weiss, holds that "concentrated" regional economies in which mono-industrial
towns dominate are likely to produce investment friendly policies. Of the three cases addressed in this dissertation, Sakhalin had the least "concentrated" economic structure, and most investor-friendly policies. It would seem, therefore, that Stoner-Weiss' argument about the impact of Soviet institutional legacy does not explain outcomes either on Sakhalin or in the other Far Eastern cases.

Other arguments about institutional legacy note the detrimental effects of Soviet era economic structures and suggest that regional economies that are dominated by large Soviet-style enterprises are unlikely to be investor-friendly. Compared with Primore and Khabarovsk, Sakhalin's economy had few large enterprises. Most notably, Sakhalin had no defense industry—in contrast to the relatively militarized economies of the mainland provinces. In the preceding chapters, I hypothesized that a prevalence of military-industrial enterprises would mitigate against the development of pro-FDI policies. Did the dearth of defense plants on Sakhalin mean that the regional economy was more likely to support FDI? Put another way, did the non-military structure of the regional economy contribute to Sakhalin's pro-FDI stance? The evidence suggests not. In fact, opposition to FDI and production-sharing came from two export-oriented segments of the economy: the fishing industry and the indigenous oil company. Moreover, the chapters on Primore and Khabarovsk showed that the prominent place of the defense industry in regional economies was unrelated to FDI policy outcomes. It seems, therefore, that the Soviet institutional legacy in the three Far Eastern provinces had little bearing on FDI policy outcomes.

Another approach—Joel Hellman's argument about the impact of partial reform on policy outcomes—does speak to policy outcomes on Sakhalin. As noted in chapter 2,
Hellman argued that the beneficiaries of partial reform were likely to support the status quo and would therefore oppose deepening reforms. As was the case in Primore and Khabarovsk, this dynamic was clearly in evidence on Sakhalin. When Sakhalinmorneftegaz underwent privatization in 1994, management gained control over nearly 60 percent of company stock.\textsuperscript{38} Most of the remaining stock was left in government hands and subsequently offered in the loans-for-shares program in 1995, a process which SMNG boss Anatolii Chernyi vigorously opposed.\textsuperscript{39} Once SMNG managers gained control over company assets, their opposition to production-sharing gathered momentum. Thus an internal debate took shape within SMNG about the merits of production-sharing versus exploitation of oil resources through joint-venture agreements or by national companies alone. As in the mainland provinces, the outcome of that debate was determined when the governor stepped in. Allying himself with the foreign oil companies, Farkhutdinov moved in to removed SMNG's director and replace him with an oil boss who was sympathetic to production-sharing. Hellman's argument identifies "winners" from partial reform as opponents to a deeper reform process. SMNG's position on production-sharing can in part be understood in terms of opposition by manager-owners to deepening reform, i.e. production-sharing. Partial reform cannot, however, explain either the rise of internal enterprise debate on production-sharing, or the fact that SMNG eventually came out in support of the PSAs. Combining the partial reform argument with an understanding of the pivotal role of the regional executive, however, offers a more complete explanation for policy outcomes on Sakhalin. Moreover, the opposition of early reform "winners" in SMNG, was not simply an effort

\textsuperscript{38} Author's interview with director, Vladinvest, Okha, August 12, 1995.

\textsuperscript{39} Author's interview with Anatolii Chernyi, Yuzhno-Sakhalinsk, August 17, 1995.
to preserve the benefits of partial reform for manager-owners. That opposition was driven by nationalist concerns as well.

Networks

The literature presented in chapter 2 suggested that the density networks—notably those among political and economic elites, is likely to impact policy outcomes. Some studies argued that dense networks were likely to produce policies favorable to FDI, but most argued that sustained interaction between political leaders and enterprise managers tended to be collusive and produce policy outcomes that do not support FDI. In the cases of Primorskii and Khabarovskyi krais, I argued that the density of regional business-government networks could not account for FDI policy outcomes. On Sakhalin, business and government leaders were notably less cooperative than in either of the mainland provinces. As noted in the analysis above, powerful enterprise managers actively opposed the governor and challenged him in electoral contest. What networks did emerge on Sakhalin were the product of alliances initiated and forged by the governor himself—namely the replacement of Sakhalinmorneftegaz' recalcitrant leader with an oil boss who supported the governor's position on production-sharing. In general, however, Farkhutdinov was far less successful than either of his mainland counterparts at establishing viable networks in support of his policies, and his electoral mandate was correspondingly weaker than that of both Nazdratenko and Ishaev. What networks did emerge, however, were the product of gubernatorial policy, and can not serve as explanations for policy outcomes. Networks on Sakhalin were important to the success of pro-FDI policies on Sakhalin, but it was not the strength or weakness of networks per se
that accounts for policy outcomes, but the way in which the governor used them to shape business-government relations and most importantly, the ends to which he put them.

**The Federal Center**

Were policy outcomes on Sakhalin the product of regional bargains struck with a strategic central government? Certainly the Russian Parliament was instrumental in the passage of production-sharing legislation. Indeed, of necessity, Sakhalin's support for PSA arrangements in off-shore oil development required considerable interaction with the federal center—because it required the passage of federal-level legislation. In Sakhalin's case therefore, more than in either the cases of Khabarovsk or Primore, strategic interaction between the regional administration and the Russian government played an important role in regional policy. Some studies of federalism in Russia, such as Daniel Treisman's study of fiscal federalism, have argued that the federal center interacts strategically with the regions. Others, such as Kathryn Stoner-Weiss' work, portray a federal center too weak and disorganized to engage in strategic regional bargaining, and argue that regional, not central, initiative characterizes center-periphery relations in the post-Soviet period.

The evidence from Sakhalin supports important elements of both arguments. The initial push for production-sharing legislation was a regional initiative, as Stoner-Weiss' analysis suggests. Moscow did, however, react to that initiative in a strategic manner, as Treisman suggests—thus the lengthy bargaining process leading up to passage of the production-sharing legislation. In chapter 2, I suggested that whether or not the center responded strategically to regional initiative might depend on issue area. I suggested that
secessionist demands of the type Treisman investigated were likely to draw Moscow into strategic bargains with the regions; conversely regional initiatives of the type Stoner-Weiss examined, such as the introduction of land-leasing arrangements, might be less likely to draw central attention. The evidence from the three Far Eastern regions supports this argument. Only Sakhalin initiated policies which actively drew the federal center into active negotiation about legislation that had a national impact. The evidence from Sakhalin, does, however, suggest that regional policies—Sakhalin governors’ decision to support PSAs and the decision to side-step the territorial issue—were, as Stoner-Weiss argued, the product of regional initiative.

Political Polarization

In chapter 2, I drew on Timothy Frye's argument about the adverse effects of political polarization on economic growth to hypothesize that regions in which the governor faced strong opposition would be unlikely to develop pro-FDI policies. The evidence from Sakhalin does not support this hypothesis. Of the three cases examined in this dissertation, governor Farkhutdinov faced the greatest regional opposition, both in electoral contest and from regional elites such as enterprise directors and the elected mayor of Yuzhno-Sakhalinsk. Yet under Farkhutdinov's guidance, Sakhalin developed the most investor-friendly policies in the Far East. On Sakhalin, therefore, a high levels of political polarization co-existed with investor-friendly policies and a business environment most conducive to FDI.
Historicist Arguments

Were Sakhalin's pro-FDI policies the product of particular historical experiences or institutional constraints that "lock-in" power configurations, as historicist and path-dependent approaches posit? In the section on institutions and policies above, I argued that the Soviet institutional legacy could not account for policy outcomes on Sakhalin. But what of historical experience? Sakhalin's off-shore oil projects—and in particular Sakhalin-1—were in fact the continuation of Soviet-era projects. Thus Sakhalin governors' interest in off-shore oil projects appears to be the logical extension, or revival, of processes which begun under Soviet leadership. Certainly foreign interest in Sakhalin's oil, notably Japanese interest in Sakhalin-1, constituted the continuation of Soviet-era endeavors. But what of the governors' decision to support the production-sharing approach to off-shore oil development? Here the evidence for historical continuity is less convincing. This chapter has shown that there were a variety of possible approaches to development on the Sakhalin shelf, including joint-venture arrangements and a proposal that off-shore oil be developed by Russian companies alone. Historical experience did not dictate one approach over another. The decision to adopt production-sharing was that of the Sakhalin governors themselves, and not the product of "locked-in" historical exigency.

The Impact of Ideas

In this chapter, I have suggested a number is ways in which ideas influenced FDI policy outcomes on Sakhalin. I have argued that Valentin Fedorov's support for market reforms led him to believe that foreign investment held the key to development on the
island, and I have shown that subsequent governors picked up on these ideas to support the passage of production-sharing legislation in the State Duma and Federation Council. I have argued that economically-derived interests on Sakhalin were disconnected from actual policy outcomes, and that, in contrast to leaders in Primorskii and Khabarovskii krais, Sakhalin governors chose to ally themselves with those members of the economic elite who supported FDI.

Here I return to the five part model of ideational causation which I introduced in chapter 2. First, identification of the crisis on Sakhalin focused almost entirely on economic matters. In contrast to Primore, where the governor focused on the political dimensions of crisis—namely democratization—and Khabarovsk, where the governor identified the dissolution of center-periphery relations as the salient issue, economic hardship was the primary concern of Sakhalin's leaders. Thus economic backwardness and the promise of autonomous development of Sakhalin's economy formed the basis of Fedorov's 1990 campaign in the krai soviet. Farkhutdinov, similarly, honed in on the economic dimension of the crisis, focusing on the oblast's inherent natural wealth which he contrasted to the decrepit state of the regional economy.

The genesis of economic crisis—the second step in my model—was, according to Sakhalin's governors, the legacy of the Soviet economic structure. This analysis of the cause of crisis stands in striking contrast to that of Khabarovsk and Primore leaders—who argued that the crises in their regions were due to the dissolution of Soviet-era structures. On Sakhalin, Fedorov's 1990 campaign emphasized Sakhalin's semi-colonial status under the Soviet regime and the island's consequent inability to enjoy the benefits of its natural wealth. Similarly, Farkhutdinov held that the oblast's economic troubles
were the product of Soviet economics which had "squandered the island's potential." As was the case in both Primore and Khabarovsk, the governors' interpretation of historical regional experience played an important role in determining their understanding of the post-Soviet crisis. As outlined above, Sakhalin's historical legacy was complex and contradictory: both the beneficiary of foreign economic interaction and the victim of foreign territorial incursion. The governors chose to emphasize the latter—playing up the historical benefits of foreign investment, and side-stepping the messy territorial conflict. Thus Sakhalin's post-Soviet policies on oil investment bear a close resemblance to Soviet era efforts to attract investment into the oil sector—despite the absence of tangible "lock-in" mechanisms. Continuity was provided by the ideationally-inspired historical interpretation of Sakhalin's leaders.

Third, Sakhalin's governors provided interpretations of key concepts in the post-Soviet era: reform, democracy, Subject of the Federation, and patriotism. From the beginning, Sakhalin's leaders identified reform and democracy with progress. This stands in stark contrast to Primore's governor Nazdratenko, who saw democracy as the root of regional crisis and equated economic reform with the theft of national resources. On Sakhalin, Valentin Fedorov portrayed economic reform as a grand "experiment" which he embraced with enthusiasm. Farkhutdinov similarly identified reform with regional enrichment, an interpretation which he drove home in his quest to garner support for production-sharing legislation. Farkhutdinov interpreted the establishment of democratic institutions on the island as emblematic of progress, and Sakhalin stands alone among the three provinces addressed here in its lack of corruption and manipulation in the electoral process. Farkhutdinov believed that the role of the Federation Subject was to serve the

40 Author's interview with Igor Farkhutdinov, August 9, 1995.
national whole—as did Khabarovsk’s governor—but the Sakhalin leader’s interpretation of that service could not have been more different from that of his mainland counterpart. The development of autonomous regional approaches to economic development, the governor argued, was the patriotic duty of every Federation Subject. In this way, Sakhalin’s leaders defined the quest for foreign investment as a patriotic undertaking which would best serve the interests of the federal whole—an interpretation which closely mirrors the Chinese approach to FDI. Fedorov intended his “experiment on the Pacific” to serve as an example for the entire nation to emulate. In a similar vein, Farkhutdinov believed that the development of off-shore oil resources by foreign companies best served the national interest. Defending his support for production-sharing, he explained: “...we see it as most perspective not only for Sakhalin, but for the whole nation.”

Fourth, ideas shaped legitimate policies on Sakhalin. Farkhutdinov’s focus on the economic dimension of the crisis and his interpretation of patriotism in terms of FDI led him to argue that favoring foreign oil companies over indigenous ones was a correct and legitimate policy decision. The governor argued that the most efficient companies should develop Sakhalin’s oil. Thus, in 1998, when Rosneft failed to come up with the requisite funding for Sakhalin-1, and considered scaling down its involvement in the project, Farkhutdinov supported that proposal. Explaining his position, he argued: “Even if they [Rosneft] quit the project, that will not be a tragedy. The Sakhalin-2 project, under way without Russian participation is more dynamic than Sakhalin-1 and brings us benefits.”

41 Interview with Sakhalin Governor, Igor Farkhutdinov, by Lyuba Pronina, Moscow Times, August 3, 2000.
Farkhutdinov's decision to side-step the territorial dispute with Japan was similarly a product of the governor's understanding of salient aspects of the crisis facing his region and the patriotic nature of foreign economic interactions. To this way of thinking, focusing on territorial divisiveness to the detriment of foreign investment opportunities would actually be an unpatriotic act. Farkhutdinov thus did his utmost to distance himself from the territorial dispute which he portrayed in terms of center-periphery relations rather than international relations: "You cannot work out policy between the center and the region without taking this [the territorial dispute] into account. At the same time, regional governments realize that without multifaceted development of cooperation between the provinces of the Russian Far East and the territories and countries of Asia-Pacific, you cannot open territories to foreign investments."43 Farkhutdinov's decision to knowingly take on organized regional interests in his quest for PSA legislation can better be understood in terms of systematic adherence to his belief system, than in terms of simple economic interests. That the governor sought economic benefits for the oblast is not in dispute. That his policies were the product of indigenous economically-derived interests is; as noted above, the most powerful organized interests in the krai consistently opposed gubernatorial policy. The governor's willingness to stick to his policies in the face of that opposition can best be understood in the context of the beliefs outlined here.

Fifth, and finally, Sakhalin's governors took steps to ensure the durability of their policies. Levels of institutional embeddedness where more pronounced on Sakhalin than in either of the other two regions addressed in this study. Largely this was a function of two aspects of Sakhalin's FDI policy: the fact that it focused on federal legislative

43 Cited above. Interview with Sakhalin Governor Farkhutdinov in Rossiskaya Gazeta, July 22, 2000, p.4.
change, and the fact that it required the creation of a regional constituency in support of that legislation. First, the primary focus of Sakhalin's FDI policy was legislative formulation and passage at the federal level. Fedorov began the process when he first proposed production-sharing legislation in 1991. Once that ball was in play, the quest for legislation took on a life of its own. By introducing production-sharing and the notion that its passage into law could mean prosperity for Sakhalin, Fedorov created a constituency—small at first, but tenacious—with a vested interest in its success. Fedorov tied the office of governor on Sakhalin to the PSAs. His actions in defense of production-sharing created a legacy which future governors could not ignore. It created an alliance between the governor's office and foreign oil investors who came to Sakhalin during his tenure and stayed for the duration of the decade. Thus the feisty independently-minded entrepreneurial approach of Sakhalin's first post-Soviet governor laid the ideational seeds of oblast policy for the remainder of the 1990s. When Farkhutdinov became governor, he took further steps to embed gubernatorial dedication to production-sharing into regional institutions. He set up a department within the regional administration specifically dedicated to the Sakhalin shelf. He restructured the leadership of the regional oil company, Sakhalinmorneftegaz. He insisted on a generous local content clause to the PSAs and helped regional enterprises set up subcontracts. For these reasons, Sakhalin's favorable FDI policies are likely to survive an eventual change of leadership in the regional administration.

Second, Sakhalin governors created a local constituency in favor of production-sharing. These were Farkhutdinov's voters. In 1996, they did not account for even half of Sakhalin's populace, but they were numerous enough to ensure a simple—but not an
absolute—majority. Farkhutdinov worked hard to rouse popular support for his policy. He emphasized the economic rewards which would accrue to Sakhalin and then made good on his promises. He pointed out that Sakhalin-2's foreign partners paid out some $160 million to the Russian enterprises which had first discovered the fields at Piltun-Astokhoye and Lunskoye, and that they would continue to pay out bonuses to the Russian government (to be divided between Moscow and Sakhalin) at each stage of the project's development. In 1998 alone, Farkhutdinov calculated, foreign oil companies contributed $12.5 million to the oblast budget. This was a trend that Farkhutdinov argued, would continue. He pointed out that foreign company investment estimates predicted spending some $36 billion over the life of Sakhalin-1, 2, and 3. In addition, he pointed out that the oil companies had agreed to pay $100 million directly to the Sakhalin government over a period of five years. Farkhutdinov made plans for new social programs which oil development would finance. He promised to build schools and hospitals. He promised to revamp Sakhalin's inefficient coal-powered electrical plants by converting them to gas. He pointed out that the anticipated $100 was specifically earmarked for improvement of Sakhalin's railroads, highways, and agriculture. In particular, he emphasized job creation: In 1998, Farkhutdinov reported, foreign oil ventures created 2,000 new jobs, and, the governor predicated, some 10,000 new

46 Russell Working, "Sakhalin is a 'giant gas pump on the Pacific Rim,' So why is it taking so long to get out the petroleum?" Vladivostok News, no. 176, September 18, 1998.
49 Brown, "Black Gold: Investors, residents dream of oil riches."
positions would open up once the oil ventures took off. He emphasized the benefits to Sakhalin's companies from subcontracting opportunities: Foreign oil companies had agreed to give some 70 percent of contracts to Russian or joint-venture Russian companies. In 1997, for instance, Sakhalin-1 paid out $120 million to subcontractors, and 80 percent of those contracts went to Sakhalin-based companies and joint-ventures. In the latter part of the 1990s, the Sakhalin-1 Consortium signed contracts with 40 Russian companies. In this way, Farkhutdinov brought home in a credible manner the tangible benefits which the people of Sakhalin could expect to enjoy. In 2000, Farkhutdinov's electoral base increased from 40 to 56.6 percent. In Sakhalin's next gubernatorial election, support for production-sharing and foreign companies' development of the Sakhalin shelf is likely to be even higher.

51 Brown, "Black Gold: Investors, residents dream of oil riches."
Part III: Conclusion
Chapter 6
Conclusion

Strength does not come from physical capacity. It comes from indomitable will. Mohandas K. Gandhi

Since the Soviet experiment ended in 1991, Russia has been hemorrhaging money. By conservative estimates, capital flight in the 1990s equaled 150 billion dollars. In the same period, Russia attracted a paltry 17 billion in foreign direct investment. The figures speak for themselves. Without an influx of capital investment, Russia will grow increasingly restive, mired in poverty, rife with discord, sullen in its disillusion with the new era, a society bifurcated between those few unspeakably wealthy and the impoverished masses. The architects of reform believed that in delivering Russia from the shackles of communist economic exigencies they would free its people to engage in the business of making money and that in this way, Russia would prosper. Russians still await that bright future. It is in the provinces that the suffering is truly visible. Here, far from the bright lights of Moscow, women nurse their children in dank rooms bereft of light and oft times of heat in the dead of winter. Male life expectancy in Russia has fallen to 57 years of age as crime rates skyrocket, disease takes its toll, and disaffected youth turns to drugs. Investment cannot cure all of Russia’s ills. But in an increasingly interconnected world, foreign direct investment holds the key to prosperity, and without it, Russia will not prosper.

To integrate itself into the global economy, Russia needs investment into its export-oriented industries. In the provinces, where regional markets are small, investment for export offers a way out of regional poverty and holds the key to redressing the severe developmental imbalance between Moscow and the regions. Among the remote
provinces of the Russian Far East, export-oriented investment can promote economic integration with neighboring East Asia. Indeed, the three provinces to which this study pertains rank among the top twelve regional destinations for FDI—outside the urban centers of Moscow and St. Petersburg—and the bulk of that investment flows into the export business. Foreign investors are drawn by the Far East’s rich natural resources—fish, timber, oil—and also the region’s geographic location—perched on the edge of the Pacific Rim with proximate access to Asian markets for its exports. But economic factors alone cannot explain the success or failure of foreign projects in the Far East, or in the Russian regions in general. A comprehensive study of foreign investment in the Russian regions conducted by the World Bank found no significant relationship between wealth of economic factors and levels of foreign investment. Rather, the World Bank, along with multiple Russian studies, found that FDI policy in the provinces—the creation of a business-friendly environment at the regional level—consistently exerted the most profound impact on FDI volumes. We have, however, little understanding of how regional leaders formulated FDI policy in the 1990s. This dissertation seeks to fill that gap.

The dissertation builds on a number of studies which note that Russian regional executives in the 1990s exerted a power over political outcomes independent of structural variables. In this vein, Jeffrey Hahn’s work on political institutions in Yaroslavl' and in the Russian Far East found that executive power in the regions eclipsed all other political institutions so that particularism and a reliance on personal authority drove policy outcomes.\(^1\) Following Guillermo O'Donnell's work,\(^2\) Hahn dubbs this process "delegative

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\(^1\) Jeffrey W. Hahn, "The development of political institutions in three regions of the Russian Far East," in Cameron Ross ed., *Regional Politics in Russia*, Manchester and New York: Manchester

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democracy" and warns that it bodes ill for democratic consolidation in Russia. Peter Kirkow's work on market reform in Altaiskii and Primorskii krais similarly found that regional governors exerted a decisive influence over economic policy outcomes which bore no relation to the structure of regional economies. Yoshiko Herrera's study of the secessionist movement in Sverdlovsk oblast, although it did not focus specifically on gubernatorial power, also argued that policy outcomes were disconnected from objective economic circumstances. Among those studies which identify the regional governors themselves—rather than external economic or institutional structures—as the critical element to understanding regional policy outcomes, few ask why the policy decisions of the governors vary across regions. Jane Prokop's study of industrial policy and marketization in Sverdlovsk, Irkutsk, and Primor'e is a notable exception to this tendency, and offers an explanation for regional policy variation based on the ideas espoused by different governors. The explanation offered in this dissertation—while different from Prokop's in several of its essential elements—is similarly ideational in nature.

That these studies identify the locus of regional policy variation in gubernatorial power should come as no surprise in light of Boris Yeltsin's simultaneous efforts to increase both regional autonomy and executive power. After exhorting the provinces to take as much power as they could swallow, Yeltsin went on to dissolve the regional soviets in the wake of his confrontation with the Russian Parliament in October 1993. By

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gathering the reins of power in the hands of the executive, Yeltsin hoped to push through economic reforms which the recalcitrant Parliament, and presumably the regional soviets, opposed. It is an ironic fact that in his effort to further democratic development and market reform, the President opened the door for regional governors to consolidate unprecedented power in their own hands thereby undermining democracy in the regions—in Hahn's words, giving rise to delegative democracy—and granting regional governors the power to stymie economic reform efforts should they so choose. In the realm of FDI policy, this dissertation has argued that governors used their powers to formulate and implement diverse policies on FDI—designed to either attract or repel foreign investors, at the discretion of the regional executive. A primary task of this dissertation has been to identify the ways in which regional governors' policy impacted FDI and to determine how and why the governors selected FDI policy goals.

The dissertation derives its primary explanatory power from ideational considerations, but it also identifies important aspects of institutional change in Russia which enhanced the power of ideas to influence policy outcomes during the transitional period of the 1990s. First, as noted above, the unprecedented power which Yeltsin's political reforms granted regional governors allowed for the rise of personal "fiefdoms" in which the governor—divorced of institutional constraint—dominated the policy-making business. Second, Moscow's policy on FDI lacked clarity, consistency, and direction—a circumstance which invited regional innovation and inter-regional variation. Third, even as the national rules on FDI remained unformulated, the transfer of state property into private hands proceeded at a rapid rate; this sequencing of reform—privatization prior to FDI—meant that manager-owners developed vested interests in
their enterprises which subsequent foreign investment was likely to threaten. The dissertation builds on this "partial-reform" argument.

This concluding chapter is divided into four parts. In the first, I tie together the dissertation's findings on materialist approaches drawing comparatively on the three empirical cases. In the second, I elaborate on the dissertation's ideational model of causation drawing together the evidence from the three cases. In the third, I explore the theoretical implications of my findings, focusing in particular on the relationship between ideas and interests. The final section suggests ways in which the dissertation's findings can contribute to future research.

**Materialist Theories: Comparative Findings**

The dissertation has been concerned with exploring a range of materialist arguments—arguments which draw their explanatory power from the constellation of forces external to the individual. These include the distribution of economic factors, institutional configurations and policies, business-government networks, political polarization, center-periphery relations in the federal context, and historicist considerations. In this section, I revisit each of these theoretical approaches in light of the evidence gathered from the three Far Eastern cases.

**Economic Structure**

One of the primary findings of this dissertation is that an analysis based on economic factors does not provide a satisfactory explanation for FDI policy outcomes in the Russian regions. Theoretical approaches which explain policy outcomes in terms of
economic factors generally posit that regions with globally competitive factors are likely
to develop policy regimes favorable to FDI. Steven Solnick's study of transnational and
subnational pressures in the Russian Federation epitomizes this approach.\(^5\) The evidence
from the Far Eastern regions, however, provides no support for this argument. Rather, as
Peter Kirkow found in the cases of Altai and Primorye, Jane Prokop found in the cases of
Sverdlovsk, Irkutsk, and Primorye, and Yoshiko Herrera found in the cases of Sverdlovsk
and Samara, the three-way regional comparison among Primorye, Khabarovsk, and
Sakhalin offered in this dissertation identifies a disconnect between economic factor
considerations and policy outcomes.

One way in which the dissertation explored the impact of economic structure on
FDI policy outcomes was by considering the role of defense production in regional
economies. According to this hypothesis, regions whose economies are more closely
intertwined with the defense complex are less likely to develop policies hospitable to FDI
because the defense business in Russia was closed to foreign participation and
traditionally hostile to foreign interaction. Of the three regions which this dissertation
examines, two—Primorye and Khabarovsk—had sizable defense sectors at the time the
Soviet Union collapsed. Table 1 lays out the comparative importance of defense in the
economies of these two regions. It indicates that the defense sector played a considerably
greater role the economy of Khabarovskii krai than in that of Primorskii krai. If the
hypothesis that a prevalence of defense industries in regional economies leads to
inhospitable FDI policies were true, we would expect Khabarovsk's business environment
to be notably less hospitable to foreign investors than that of Primorye. This was decidedly

\(^5\) Steven Solnick, "Russia between States and Markets: Transnational and Subnational Pressures
in the Transition," in Aseem Prakash and Jeffrey A. Hart, Responding to Globalization,
not the case. Primorski krai's FDI policy was openly hostile to foreign investors, while Khabarovsk's was benignly neglectful.

**Table 1: Percentage of Defense Industries in Khabarovsk and Primore, 1991**

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Khabarovsk</th>
<th>Primore</th>
</tr>
</thead>
<tbody>
<tr>
<td>Value of production</td>
<td>22.5</td>
<td>13.6</td>
</tr>
<tr>
<td>Number of personnel directly involved in production</td>
<td>24.0</td>
<td>20.0</td>
</tr>
<tr>
<td>Value of fixed capital</td>
<td>17.0</td>
<td>10.3</td>
</tr>
</tbody>
</table>


Sakhalin has no defense industry, but there is no evidence to suggest that the absence of a defense sector on Sakhalin accounts for the oblast's proactive policy towards FDI. The most obvious—and tempting—explanation for Sakhalin's pro-FDI policy outcomes is, however, one which focuses on economic factor analysis: Sakhalin has oil. In chapter 5 on Sakhalin, I laid out a number of arguments which showed a disconnect between policy outcomes and the presence of oil on Sakhalin, focusing most notably on the active resistance of the indigenous oil enterprise as well as that of the local fishing business. Here I place Sakhalin's policies in comparative perspective.

In the national context, Sakhalin's proactive FDI policy is anomalous, even among oil-producing regions. Russian oil majors have generally been hostile to foreign participation in the energy business, seeking to keep the profits from oil development and sale in Russian hands. Russian oil company Yukos, for example, has actively lobbied against legislation to protect foreign investments in the oil business, even when foreign companies proposed exploration of fields as yet untouched by Russian companies. Simon Routledge, 2000.
Kukes, President of the Tyumen Oil Company, Russia's fourth largest producer, explains that resistance in terms of national pride: "There is often resistance to getting big foreign oil companies into Russia because...it would show the weakness of Russian oil companies...The...common view among Russian oil executives [about foreign investment] is: we can do without." Foreign oil executives similarly attribute the resistance of their Russian counterparts to nationalist considerations. One foreign oil executive explained Russian oil bosses' aversion to FDI in these terms: "Their feeling is, 'What right do you have to come in here to take that oil from our country and profit from it?'" On Sakhalin, managers at the local oil company, Sakhalinmorneftegaz (SMNG), similarly sought to retain control over oil production for themselves and opposed production-sharing agreements (PSAs) on the Sakhalin shelf—despite their own inability to develop off-shore resources alone. The position of SMNG's leadership on FDI echoes a general trend among Russian oil bosses who broadly opposed FDI, production-sharing, and the admission of foreign companies into previously untapped oil fields—such as the icebound regions in Russia's northwest arctic regions, and the Verkhnechonsk, Talakan, and Yurubchen reservoirs in eastern Siberia. Most Russian oil bosses, like those who led SMNG, believed that, in time, Russian oil companies would develop the capability to develop those fields without the participation of foreign companies. They preferred to wait.

Sakhalin's governors, most notably Igor Farkhutdinov, did not. Farkhutdinov opposed the local oil bosses, and his pro-FDI policies won out. The governor's actions stand in stark contrast to the general course of Russian policy on FDI in oil. The Russian

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government has largely gone along with the indigenous oil industry and overwhelmingly supported the retention of control over oil assets in Russian hands by transferring control of the industry to insiders and close supporters. As Pauline Jones Luong and Erika Weinthal explain in their article on oil and gas development in the Soviet successor states: "Although foreign involvement would have undoubtedly increased the selling price of Russia's oil and gas industry and improved its productive capacity through the introduction of new technologies, state leaders opted to forgo a greater financial pay-off for political gain—that is, sustaining domestic support." Resistance to production-sharing in the State Duma was overwhelmingly expressed in nationalist terms and supported the position of the Russian oil sector. Although production-sharing did pass in 1995, a host of supporting legislation has yet to pass, leaving foreign oil companies reluctant to engage the Russian oil industry. As a result, few PSAs have actually gone into operation. Sakhalin is the exception: The oblast is home to two of only three operative PSAs in Russia. Outside Sakhalin, the governors of other oil-producing regions have been reluctant to sign PSAs, citing nationalist concerns. A foreign venture with Texaco in the harsh tundra of the Timan Pechora Basin, for example, fell through when the regional governor refused to sign on. Sakhalin's policy on FDI in the oil business stands in striking contrast to Russian federal policy in general and also to the policies of the other Russian oil-producing regions, few of which have shown an inclination to negotiate PSAs with foreign oil companies.

So severe is nationalist opposition to FDI in Russian oil—from the oil companies themselves, from federal government, and from regional administrations—that, according

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7 Pauline Jones Luong and Erika Weinthal, "Prelude to the Resource Curse: Explaining Oil and Gas Development Strategies in the Soviet Successor States and Beyond," *Comparative Political*
to industry experts, "by keeping foreigners out of new fields...Russia runs the risk of delaying their development so long that production from mature fields might fall rapidly before new sources can replace them." The effects of Russian policy can easily be discerned from comparative FDI figures: Foreign oil companies have invested $13 billion into Kazakhstan since 1993, $8 billion into Azerbazarh since 1994, but only $5 billion into Russia since the Soviet Union collapsed in 1991. The bulk of that investment in Russia has gone to Sakhalin.

Sakhalin's pro-FDI stance is also anomalous in the context of regional responses to outside projects—those which involve the injection of foreign capital but not the acquisition of enterprise shares—in the Far East. Farkhutdinov's proactive engagement with foreign investors in off-shore oil projects stands in startling contrast to Evgenii Nazdtratenko's response to the Tumen River Area Development Program (TRADP) proposal to invest billions of dollars into Primorskii krai's dilapidated port infrastructure. The TRADP projected an investment of $30 billion for the entire project, a sum readily comparable to Sakhalin's off-shore oil investments. Like the Sakhalin projects, the TRADP constituted an effort by outside investors to inject capital into infrastructure development without gaining direct control over Russian enterprise stock or assets.

Indeed, the TRADP was less threatening to regional economic actors in Primor'e than the off-shore oil projects were to economic actors on Sakhalin. On Sakhalin, the regional oil enterprise felt directly threatened by the off-shore projects which enterprise bosses felt rightly fell within their own jurisdiction to develop once indigenous capabilities were sufficiently developed—even if that were to take 50 years, as SMNG's general director

intoned. Sakhalin's fishing enterprises were also unenthusiastic about the PSAs, and fishing was the island's largest industry. In Primorskii krai, conversely, the TRADP posed no threat to indigenous industry which had no plans to develop the southern Primor ports itself; no Primore enterprise director voiced opposition to the project. Thus it would seem, Sakhalin's governor had greater incentives to oppose the PSAs—as his counterparts in other oil-producing regions chose to do—than Primore's governor had to oppose the TRADP. On Sakhalin, after all, organized economic interest groups actively worked to foil production-sharing, while in Primore, no such opposition to the TRADP existed. In sum, the divergent responses of the Sakhalin and Primore governors to outside foreign projects cannot be understood in the context of economic factors and interests.

Institutions and Policies

Gauging the impact of institutional configurations on policy outcomes in transitional Russia is a difficult task because the institutions of the Federation were new, fluid, and structurally identical at the regional level. By late 1995, each region had an elected governor, an elected legislature, a Presidential Representative, a regional Property Fund and Committee etc. A primary finding of this dissertation is that the way in which these regional institutions operated de facto, was a function of gubernatorial policy. In other words, policy outcomes were not a function of institutional configurations, rather, institutional operations were the outcome of regional policies promulgated by the governor. This finding is in line with that of Prokop's study which argued that

"institutions...tend to be more a result than a cause of policymaking." As noted above, therefore, institutional arrangements did matter in that the new federal structure granted unusual autonomy to regional governors, as Hahn and others have noted, and it was that autonomy—not institutional variation—which allowed for divergent policy outcomes across regions.

It may largely be for this reason that regional studies in Russia which point to institutional variables to explain divergent policy outcomes do not apply to the cases examined in this dissertation. In each of the empirical chapters, I examine, for example, Stoner-Weiss' contention that concentrated regional economies promote elite consensus leading to "good governance" and an environment hospitable to FDI. In none of the three cases does this argument hold up. Comparing across provinces, I find that Sakhalin—with a diversified regional economy, little heavy industry, and no defense sector—has the least concentrated regional economy, yet provided by far the most FDI-friendly environment. Khabarovskii krai, conversely, had the most concentrated regional economy with the largest percentage of its workforce engaged in defense production, yet exhibited a lackadaisical approach to foreign investment which failed to produce a business-friendly environment. Other studies which focus on institutional variables, such as Stephen Hanson's work on Leninist institutions, argue, contrary to Stoner-Weiss, that a preponderance of Soviet-style economic institutions mitigates against the development of liberal capitalism; from this, I hypothesized that regional economies dominated by Soviet-style enterprises would be less likely to develop investor-friendly policy regimes. Here again, however, a comparison across regions does not provide evidence to support the argument. Khabarovsk inherited an economic institutional structure dominated by

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9 Prokop, Abstract.
Leninist institutions—indeed Khabarovsk was the industrial manufacturing center of the Soviet Far East—yet its approach to foreign investors was significantly more hospitable than that of neighboring Primore, which inherited fewer Leninist institutions yet developed a policy regime openly hostile to FDI. I find, therefore, that institutional structure—as the legacy of Soviet times—does not correspond to the development of FDI-friendly policies.

By far the most useful and applicable approach in the institutionalist tradition, I find, is the "partial reform" argument put forth by Joel Hellman. 10 According to Hellman's argument, those who "win" from the initial reform process are likely to oppose a deepening of reforms which could jeopardize their gains from the partial reform equilibrium. Hellman cites in particular manager-owners of privatizing enterprises and regional government officials who have gained a stake in regional enterprises. These individuals are likely to resist changes to enterprises structure—and especially the acquisition of company stock by outside investors who advocate internal company restructuring—because those changes could undermine insider control of the enterprise.

My findings in this dissertation build and elaborate on Hellman's argument. A comparison between Sakhalin and Primore is instructive in this regard. In both cases, I find that enterprises managers were broadly receptive to "outside" investors, if those investors were Russian. Primore's Far East Shipping Company (FESCO), for example, lobbied hard to include Muscovites on their board of directors; on Sakhalin, the Russian oil company Rosneft, acquired a controlling share of SMNG in the mid-1990s without encountering opposition from SMNG managers. I find, however, that the acquisition of

company assets—be they shares or resources to which the indigenous enterprise laid claim—by foreigners, was a highly divisive issue, which enterprises managers hotly debated amongst themselves. Aversion to foreign acquisition of company assets, moreover, was not simply a function of managers' fears that foreign control would lead to enterprise restructuring or otherwise endanger enterprises accounts; indeed, in its effort to evict foreigners from the company, FESCO officials agreed to pay an exorbitant sum to the regional government—a payment which forced the company to begin selling off its assets to meet debt obligations. Finally, I find that in both Sakhalin and Primore, internal enterprise debates on the desirability of foreign investment were resolved only upon gubernatorial intervention. In Primorskii krai, governor Nazdratenko sided with those factions which opposed foreign investors, and the foreigners were evicted. On Sakhalin, governor Farkhutdinov allied himself with foreign companies and those managers at SMNG who supported foreign investment in offshore oil, and forced the resignation of SMNG director Anatolii Chernyi, who opposed the production-sharing agreements. Thus, while some manager-owners did react to partial reform in the way that Hellman envisions, not all of them did. Most importantly, the position of the regional governor was decisive in determining the ultimate position of enterprise managers, and that position did not always involve the preservation of gains from partial reform.

Networks

As in the case of institutional arguments, in this dissertation I find that business-government networks in the post-Soviet regions were the product of particular policy decisions, so that the presence or absence of network connections in and of itself cannot
account for policy outcomes. This finding runs counter to Stoner-Weiss' contention that
dense networks among political and economic leaders engender good governance and
generate a business-friendly environment. Business-government relations in both
Primorskii and Khabarovskii krais were significantly denser than on Sakhalin, yet
Sakhalin had the most business-friendly environment of the three. My findings also do
not support the popular argument that close business-government relations tend to be
collusive, lead to corruption, and bring forth an atmosphere unconducive to economic
reform or FDI. As noted in chapter 2, a number of studies of Russian reform make this
claim, and the argument is not surprising in view of the Russian reformers' stated goal to
"de-politicize" the economy. Yet I find that on Sakhalin, it was direct government
interference in the affairs and very structure of regional enterprises—that is the proactive
construction of business government alliances through the dismissal of uncooperative
enterprise managers—that led to the development of pro-FDI policies and a business-
friendly environment on the island. In other words, the fact that Sakhalin was business-
friendly cannot be attributed to the comparative weakness of business-government
relations in the oblast. Rather, the active construction of network relations between the
governor's office and the regional oil company played a critical role in ensuring pro-FDI
policy outcomes—that is, support for production-sharing legislation and the enactment of
PSAs on the Sakhalin shelf. In sum, networks in the Far Eastern regions did play a role in
determining policy outcomes, but they were the tools of gubernatorial power, not
independent variables in their own right.
Political Polarization

It stands to reason that foreign investors prefer stable polities, and that polarized polities, because they lack the stability to uphold consistent legal frameworks, are likely to prove unattractive to foreign investment. In this dissertation, I draw on Timothy Frye’s argument that political polarization leads to lower economic growth rates\(^{11}\) to hypothesize that polarization at the regional level gives rise to an instability anathema to successful foreign investment projects. Examining polarization in terms of challenges to gubernatorial office, I find that the evidence from the three Far Eastern cases does not support this contention. Indeed, Khabarovsk, by the far the least polarized region among the three, had a business environment significantly less receptive to FDI than Sakhalin—where the governor faced a serious electoral challenge and failed to secure an absolute majority. Both Nazdratenko in Primorye, and Farkhutdinov on Sakhalin faced obstinate and unrelenting opposition to their policies throughout their tenures. Yet FDI policy outcomes in these two regions were diametrically opposed: Primorye developed an isolationist policy hostile to foreign investors, while Sakhalin actively courted foreign investment and developed a business-friendly environment. Comparing Primorye with Sakhalin, I find that polarization in the locality is the result, not the cause, of regional policy. In Primorskiy krai, the governor’s heavy-handed approach to FDI—among other policies—proved the source of his perennial conflicts with the Vladivostok mayor, several of the Presidential Representatives, and the opposition forces which formed around these political figures. On Sakhalin, the process is even more obvious. Here, the governor’s proactive endorsement of production-sharing legislation and off-shore PSAs

gave rise to strong opposition figures who repeatedly challenged the regional executive. Thus, Sakhalin's governor had the weakest regional mandate among the three regions. In short, the absence or presence of political polarization in the locality cannot, in and of itself, account for policy outcomes in the cases examined in this dissertation.

Center-Periphery Relations

Studies of Russian federalism are divided on the question of state power. Some, such as studies by Daniel Treisman and Steven Solnick depict a central state engaged in a strategic bargaining game with the regions. In Treisman's analysis, the central state reacts to regional secessionist demands by increasing fiscal transfers to restive regions thereby placating them.\(^\text{12}\) According to Solnick's analysis, the central state not only reacts to regional demands, but also formulates strategies explicitly designed to undermine regional autonomy—such as the bilateral treaty system.\(^\text{13}\) On the other side of the federalism debate, Kathryn Stoner-Weiss has argued that the central state is too weak to respond effectively or strategically to regional demands and that intergovernmental relations in Russia are a function of regional innovation rather than central strategy.\(^\text{14}\)

The evidence from the three cases presented in this dissertation broadly supports Stoner-Weiss' vision of intergovernmental relations. In each of the three cases, FDI policy was a regionally-initiated affair—as Stoner-Weiss argues—rather than the product of strategic manipulation by central power. The evidence from this dissertation also


supports Stoner-Weiss' response to Solnick on the question of bilateral treaties. Solnick argued that bilateral treaties constituted a strategic mechanism used by Moscow to undermine regional autonomy. Stoner-Weiss countered that the manner in which the treaties arose—at the behest of the regions rather than as a strategic ploy from the center—shows that the regions, not the center, are the ultimate arbiters of intergovernmental relations in Russia. Among the three Far Eastern cases, Khabarovsk and Sakhalin signed bilateral treaties with Moscow, while Primorski krai—by far the most politically volatile of the three—did not. In the cases of both Khabarovsk and Sakhalin, bilateral treaties were the product of regional, not central initiative. Khabarovsk was the first region of the Far East to sign a bilateral treaty with Moscow, and governor Ishaev explicitly sought to use that treaty to regularize and systematize center-periphery relations. This was not, in other words, an attempt by Moscow to deflate restive regional autonomy, as Solnick contended. Rather, it was an effort initiated by regional officials to ensure smooth and stable relations with the central government.

In chapter 2, I suggested that whether or not the center engages in strategic interaction with the regions may depend on issue-area. Treisman's work deals with secessionism—a highly divisive issue-area likely to evoke a reaction from Moscow. Stoner-Weiss' work focuses on a range of issues such as the leasing of land, regional-level legislation, and the appropriation of central funding for regionally mandated purposes. It may be that such issues do not provoke the strategic behavior on the part of central authorities that secessionist threats do. A large-n study across multiple issue-areas would be necessary to test this hypothesis, but the evidence from the three Far Eastern

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14 Kathryn Stoner-Weiss, "The Russian Central State in Crisis: Center and Periphery in the Post-Soviet Era," in Zoltan Barany and Robert Moser eds., Russian Politics: Challenges to
regions, while not conclusive, does suggest that Moscow responds strategically to some types of demands, even as it ignores others.

A comparison between Khabarovsky and Sakhalin is instructive in this regard. Throughout the 1990s, both provinces actively attempted to bargain with Moscow for legislative change. Khabarovsky secured Presidential approval for its Far East and Trans-Baikal Development Program, but was frustrated when Moscow failed to follow through on its end of the bargain; with virtually no central financing, the Program was a reality on paper only. Sakhalin also lobbied hard—for the passage of production-sharing legislation—but this legislation brought tangible results to the region in the form of functioning production-sharing agreements, to which Moscow signed on. It seems therefore, that in the case of Sakhalin, where Moscow saw real benefits from PSAs with no requirement of financial commitment from the central government, central powers became actively involved in the process of passing and implementing legislation.

Khabarovsky' development plan, conversely, required central financing and did not envision short-term returns—and did not attract serious attention from central authorities. The comparison between Khabarovsky and Sakhalin suggests that the central government does interact strategically on issues which it deems of import, while neglecting others. In both cases, however, the initiative came—as Stoner-Weiss argued—from the regional level.

**Historicist and Path Dependent Approaches**

In this dissertation, I have argued that historicist and path dependent explanations have limited capacity to explain policy variation across the three Far Eastern provinces.

Path dependent approaches are contingent on the existence of "lock-in" mechanisms which serve to perpetuate particular modes of organization and behavior and thereby dictate policy outcomes. Perhaps the most obvious feature of post-Soviet Russia was the virtual obliteration of the political institutions of the Soviet era, and for this reason, it is difficult, if not impossible, to identify lock-in mechanisms which would facilitate the continuation of Soviet era practices into the post-Soviet era. Elements of Soviet economic institutions—a preponderance of large state-owned enterprises, the defense sector—did survive into the post-Soviet era, but, as outlined above, the regional structure of economic institutions was disconnected from policy outcomes in all three cases.

Nonetheless, the fact that regional-level FDI policy in the Far Eastern provinces bore a striking resemblance to elements of the Soviet era regional experience is inescapable: Vladivostok was a closed military port under the Soviets and developed an isolationist foreign economic policy which was hostile to FDI; Khabarovsk was the administrative center of the Soviet Far East and developed post-Soviet policies designed to unite the Far East under Khabarovsk leadership; Japan had been actively interested in Sakhalin’s off-shore oil deposits since the mid-1970s and Sakhalin developed a policy designed to facilitate Japanese and other foreign investment in off-shore oil. In the empirical chapters, I argued that path dependent arguments cannot explain these historical continuities: Soviet military might closed Vladivostok to the outside world but in post-Soviet Vladivostok, the military was a fading force and had no hand in devising regional policy; Khabarovsk's Far East and Trans-Baikal Association, while designed to unite the Far Eastern regions under a single umbrella, was not an institutional hold-over from Soviet times, but an instrument of gubernatorial power; on Sakhalin, Japan and
other foreign countries evinced an interest in off-shore oil both before and after Soviet collapse, but there was no indigenous lock-in mechanism on Sakhalin which dictated a production-sharing approach. In sum, while historical continuity does appear to play some role in the formulation of post-Soviet regional policies, the path dependent approach does not capture the mechanisms of that dynamic.

**Ideational Causation**

In this dissertation, I argue that the explanation for variation in regional FDI policy outcomes lies in divergent sets of ideas held by the regional governors. To understand why regional governors formulated policy as they did, I argue, it is to the ideas which informed individual leaders—rather than to objective external circumstance—that we must look. We must understand reality as they saw it. We must consider the beliefs that motivated them. We must understand how they thought.

**Critical Juncture**

Like other ideational approaches, this dissertation emphasizes the "critical juncture" at which Russia found itself in 1991. The collapse of Soviet political institutions, the end of Communist Party monopoly on power, the radical restructuring of economic relations—these were monumental events that opened up new and unprecedented opportunities for change in Russia. The 1990s in post-Soviet Russia was a time to construct new institutions for a new nation. It is at such moments in history—when the old has been brought low and the new is just emerging—that ideas play a particularly critical role in determining the contours of new policies and institutions.
This dissertation emphasizes an additional important aspect of the transformative crisis which Russia faced in the 1990s: an ideational crisis. It would be difficult to understate the gravity of the ideational crisis which Russia—and its newly empowered regional leaders—faced in the wake of Soviet collapse. Men and women who had dedicated their lives to the socialist cause, who believed the Soviet Union to be a world power, and who were raised in the belief that the West represented decadence and class oppression, found their dreams were shattered. In the remote regions of the Far East, far from the cosmopolitan centers of Moscow and St. Petersburg, the shock was arguably greater. In the wake of Soviet collapse came uncertainty—an uncertainty which post-Soviet reforms have failed to address.

The dissertation is in agreement with Steven Solnick's discussion of weak state identity in Russia, in which he argued that Russia faces the challenge of "reconceiving" the Russian state in the post-Soviet era.\textsuperscript{15} The challenge of reconception is exacerbated by what Michael McFaul calls the "neoliberal philosophy" which informed Russia's economic reformers. In his study of privatization in Russia, McFaul argued that the neoliberal philosophy behind Russian reform precluded the creation of viable market-supporting institutions—such as an effective court system, an accounting system in line with world standards, institutions governing the payment of dividends, and a social security system. McFaul argued that this state of affairs—which he attributes to the

ideational underpinning of reform—threatens to ultimately undermine the progress of economic reform.\textsuperscript{16}

In this dissertation, I find that institutional weakness was not the only consequence of neoliberal philosophy. Russian reformers failed to effectively "sell" their ideas. Economic reform in Russia was predicated on a set of beliefs about human behavior—what Andrei Schleifer called "economic man"—which held that, given the chance, Russians would respond "rationally" to the incentives set up by new institutional structures—such as those supporting privatization.\textsuperscript{17} For this reason, Russian reformers did not seek to legitimate their reforms in ideational terms—as did those in Eastern Europe who tied reforms to ideas of nationalism and "rejoining the West," or even those in China who infused the economic reform process with nationalist symbolism. In Russia, with the legitimacy of past institutions and the principals on which they were founded in tatters, the reformers failed to provide a new ideational grounding—to infuse the institutions of the new Federation with meaning. This dissertation places the divergent ideas of regional leaders in the context of weak post-Soviet state identity and the ideational vacuum emanating from Moscow. Weak institutions governing matters related to FDI, an unusual concentration of power in gubernatorial office, and the uncertain legitimacy of those institutions which were established, combined to allow room for ideas and governors to drive FDI policy outcomes in the provinces. The dissertation developed a five part model of ideational causation, which I now revisit in light of the comparative evidence from all three Far Eastern cases.


Part 1: Crisis? What Crisis? Ideas identify the salient crisis

Russia in the 1990s was in crisis along a number of dimensions. Politically, the system which enshrined the primacy of the Communist Party was replaced by a democratic party system in which multiple parties as well as independent candidates competed in popular elections at the central and regional levels. Institutionally, the introduction of a federal system re-defined center-periphery relations from a system of "prefects" to one in which the regions became "Subjects of the Federation."

Economically, state property was transferred into private hands as radical "shock therapy" transformed a socialist planning system into a market economy. A comparison of the three Far Eastern regions shows that regional governors—while naturally concerned with all aspects of the reform process—chose to focus on one or the other of these three aspects. Defining what exactly the problem is constitutes the first conceptual step towards devising a solution. The different choices which leaders in the three provinces made provide the first step to identifying the ideational cause of the disparate policies they elected to pursue.

Primorskii krai's first governor, Vladimir Kuznetsov, saw the problem in economic terms. He believed that Soviet collapse was the result of economic mismanagement, that the socialist economic system was fundamentally unsustainable, and market principals would bring prosperity to the krai, and to Russia as a whole. But Kuznetsov was not an adept politician. Like the radical reformers in Moscow, he assumed that his efforts at market reform and foreign economic engagement would simply be accepted in the locality—in other words that, given the opportunity, Primore's inhabitants would rationally seek profit from economic reform. Kuznetsov made no real
effort to sell reform or his ideas about the value of FDI to the locality. He soon lost his post to Evgenii Nazdratenko, a man who knew how to sell an idea, and who dominated Primor' politics for the remainder of the decade.

Nazdratenko defined the crisis in overwhelmingly political terms. The problem with Russia and the krai, the governor argued, was a lack of "unified government" and his proposed solution—the institution of a "unified government of Slavic people." Unlike his predecessor, Nazdratenko was a master politician. He drew power to himself, manipulating his friends and casting out his enemies. Dissension in the ranks was not tolerated. If democracy means freedom of speech, freedom of thought, and free and fair elections, then there was no democracy in Primor' during Nazdratenko's tenure. The governor effectively implemented his vision of unified government. A small but vocal opposition doggedly attempted to unseat the governor, but under the crushing weight of Nazdratenko's political machine, it was ineffectual. Thus, Nazdratenko was singularly successful at addressing the crisis—as he defined it.

In Khabarovsk, governor Viktor Ishaev's evaluation of the crisis was decidedly different. The problem, Ishaev contended, was the decentralization of center-periphery relations enshrined in the new federative arrangements between Moscow and the Subjects of the Federation—in short, what the governor termed the "disintegration of center-periphery ties." The governor was not a proponent of regional autonomy. He believed that direct central control over the locality was appropriate, desirable, and beneficial to both parties. Throughout his tenure, Ishaev sought ways to recapture the prefectural relationship with Moscow which the krai maintained under the Soviet system.

19 Author's interview with Viktor Ishaev, Niigata, Japan, November 8, 1994.
On Sakhalin, governor Igor Farkhutdinov—and his two predecessors, Valentin Fedorov and Evgenii Krasnoyarov—zeroed in on the economic dimension of the post-Soviet crisis. The problem, they contended, was economic underdevelopment due to the weakness of free-market institutions. In 1990, economic backwardness and the promise of autonomous development based on free-market principals formed the basis of Fedorov's campaign in the krai soviet. Farkhutdinov, similarly, honed in on the economic dimension of the crisis, drawing attention to the oblast's natural wealth which he contrasted to the decrepit state of the regional economy.

In sum, the leaders of the three Far Eastern regions conceptualized the crisis in radically different terms. While all the leaders were concerned with the multiple facets of the crisis facing post-Soviet Russia, they chose to prioritize one aspect of the crisis above the others. Thus they explicitly chose to focus on different aspects of crisis: political change in Primore, institutional restructuring of center-periphery relations in Khabarovsk, and economic underdevelopment on Sakhalin. These differing conceptualizations of crisis formed the ideational foundation for future policy directives.

Part 2: Kto vinovat? Ideas explain the causes of economic crisis

With the nature of the crisis determined, the search for a guilty party was on. In the provinces, regional governors turned to a Soviet era question: kto vinovat? Who is responsible? Here the dissertation builds on Judith Goldstein and Robert Koehane's concept of "causal beliefs" and Mark Blyth's parallel argument about the importance of explanations for crises. Blyth argued that the ways in which critical actors diagnose economic crises drive the policies which they then develop to address them.
A comparison among the three Far Eastern regions reveals widely divergent beliefs about the causes of crisis. In Primorskii krai, governor Nazdratenko blamed foreigners—non-Slavic peoples in particular—and those Russian reformers who had fallen under their influence. According to the Primore governor, foreign influence was responsible for the deplorable lack of political unity among the "Slavic race," a disbanding of the Soviet-era Union which, in the governor's opinion, constituted the most serious aspect of Russia's crisis. In Khabarovskii krai, governor Ishaev had a very different notion of where responsibility for the crisis lay: The blame lay with Moscow—not simply the reformers and their Western allies, as Nazdratenko contended—but with the central government as a whole. In particular, Ishaev took exception to what he perceived as Moscow's abrogation of its responsibilities to the region. Thus Ishaev did not blame political reform and democratization *per se*, but he did believe that the federal government was remiss in its failure to direct regional policy and its refusal to continue subsidies to the regions. The Sakhalin governors' analysis of the crisis could not have been more different from that of their counterparts on the mainland. Where both Nazdratenko and Ishaev defined the problem as the loss of some aspect of the Soviet regime—political unity for Nazdratenko, paternalistic oversight from Moscow for Ishaev—Sakhalin's governors saw the legacy of the Soviet system as the source of the problem. It was the vestiges of irrational Soviet planning, they contended, that were responsible for the economic crisis on Sakhalin. In sum, an examination of the causal beliefs which underlay regional leaders' interpretation of the post-Soviet crisis reveals wide variation in the belief systems which regional governors espoused.
As noted in the section on historicist explanations above, it is impossible to ignore the fact that post-Soviet policy outcomes in the three Far Eastern regions bear a striking resemblance to their Soviet pasts—this despite the weakness or complete absence of tangible institutional or organizational "lock-in" mechanisms. In this dissertation, I find that that continuity was a product of ideationally-inspired historical interpretation: In other words, the ways in which post-Soviet regional leaders defined and diagnosed the crisis were closely linked to their interpretation of the Soviet past. Each of the three regions had a complex and contradictory historical legacy in which some aspects of the historical legacy consisted of positive and beneficial interactions with foreign powers, while others consisted of war, hostility, and foreign aggression. How the governors chose to interpret that history—which aspects they chose to emphasize—was directly related to their understanding of the post-Soviet crisis.

The case of Primorskii krai is perhaps the most complex because two different governors chose to emphasize very different aspects of regional history. Vladimir Kuznetsov explicitly harkened back to Vladivostok's vibrant pre-Revolutionary years when the city was a cosmopolitan international trading center; in line with this historical emphasis, he diagnosed the krai's post-Soviet crisis as the product of a Soviet system which stifled that pre-Revolutionary grandeur. Evgenii Nazdratenko, conversely emphasized the power of Siberia's leaders under the Tsars—particularly Nikolai Muraviev, Eastern Siberia's governor-general under Tsar Nicholas I\textsuperscript{20}—and glorified Vladivostok's military might under the Soviets; he diagnosed the krai's post-Soviet problems as the product of weak leadership due to lack of unity.

\textsuperscript{20} Boris Laputin, "Ispytanie Vlast'yu," ("Trial of Power") \textit{Boevaya Vakhta}, December 2, 1995, p. 3.
In Khabarovsk, Viktor Ishaev emphasized the krai's privileged position in the context of the Soviet Far East and the special relationship it enjoyed with Moscow under the Soviet regime. Khabarovsk was also the most international city in the Soviet Far East—the only major city open to foreign business—yet Ishaev chose to ignore this aspect of the krai's historical experience. He diagnosed the krai's post-Soviet crisis in terms of its loss of status in the new era.

Sakhalin's historical legacy was similarly contradictory—at once the beneficiary of foreign economic interaction and the victim of territorial incursion. The post-Soviet governors—beginning with Valentin Fedorov, overwhelmingly emphasized the historical benefits which foreign capital brought to the island. In the post-Soviet era, they emphasized the economic aspects of the crisis and argued that the irrational Soviet system had proven an obstacle to both economic growth and effective interaction with foreign capital. Thus the Far Eastern governors' interpretation of the regional historical experience provided an ideationally-inspired continuity in the absence of effective "lock-in" mechanisms.

Part 3: Westernizers and Slavophiles? Ideas (Re-)Define Key Concepts

Nineteenth century intellectual life in Russia was dominated by a debate between "Westernizers," who believed that Russia should embrace "modern" European modes of political and social organization, and "Slavophiles," who held Mother Russia sacrosanct and believed that a unique culture dictated a social organization specific to Russia alone. In the ideational vacuum left by the crumbling Soviet empire, regional leaders in Russia returned to many of the old precepts in an effort to make sense of the institutions and
policies of the new Russia. In the new Federation, the meaning of concepts such as "reform," "democracy" and "Subject of the Federation" were as fluid and amorphous as the institutions which were designed to support them. Most contentious, perhaps, was the meaning of "patriotism" in the new era. In the absence of clear leadership on the meaning of these terms—for several years Russia did not even have a national anthem—regional leaders devised their own interpretations of the new concepts. A comparative analysis of these interpretations across the three Far Eastern regions shows wide variation.

Economic reform, for Sakhalin's leaders, signaled Russia's entrance into the ranks of the "civilized" world. In language akin to that of the 19th century Westernizers, Sakhalin's governors consistently portrayed economic reform as a progressive movement which would raise Russia from the poverty inflicted by years of Communist rule to its rightful place in the club of modern Western nations. The interpretations of economic reform offered by the governors of Primore and Khabarovsk were strikingly different. In Khabarovsk, governor Ishaev, while taking care not to directly criticize the Russian President, generally equated reform with "chaos," a circumstance which he blamed on Moscow's inability to meet its obligations to the regions. In Primore, Nazdratenko went much further in his condemnation of reform. Economic reform, Nazdratenko contended, was a diabolical plot, crafted by hostile foreign powers and traitorous Russian collaborators with the express purpose of weakening the Russian people and the Russian state.

Interpretations of "democracy" similarly varied wildly among the three regions. Neither Khabarovsk nor Primore were particularly enthusiastic about democratic developments—such as elections. In Khabarovsk, Ishaev displayed little enthusiasm for
regional elections, voicing his opinion that regional governors were best appointed by Moscow, not elected by popular mandate. Primor'e Nazdratenko, conversely, actively sought electoral mandate, but in fact manipulated the electoral system to serve his own goal of power consolidation—eliminating viable competitors prior to election day, forcing voting in regional enterprises, and issuing dictates to local administrators to turn out a vote in his favor. Only on Sakhalin did the meaning and practice of "democracy" approach one which would be recognizable to Western democracies. Sakhalin's regional press was free of gubernatorial interference—in striking contrast to Primorskii krai where the governor controlled virtually every mass media outlet. Elections on Sakhalin were the freest and fairest among the three regions: Viable competitors ran against the governor who mounted a real campaign based on actual issues. As a result, the governor's electoral mandate was significantly less than that of his counterparts whose inflated mandates—Ishaev won 88 percent of the vote in his second gubernatorial run—bespeak a lack of free debate or serious consideration of political alternatives.

"Subject of the Federation" was also a concept open to broad and varying regional interpretation. To Nazdratenko's thinking, Primorskii krai was an entity unto itself, divorced from the Russian heartland and cast out from the national fold. Decentralization of center-periphery relations constituted, for the governor, the virtual severance of ties between Moscow and the regions. Unlike the governors of Khabarovsk and Sakhalin, Nazdratenko never attempted to negotiate a power-sharing agreement with Moscow. Instead, his relations with the national capital were consistently and virulently conflictual. Although the governor rarely advocated outright secession, Primor'e under Nazdratenko operated, in the words of Peter Kirkow, as a "fiefdom" unto itself. In Khabarovsk, Viktor
Ishaev's interpretation of "Subject" could not have been more different. As the Primore governor saw his region increasingly alienated from the national whole, Khabarovsk's leader persisted—despite his frustration with central unresponsiveness—in his vision of the krai as a dutiful subject to a distant (if uninformed) master. Thus he turned to Moscow for direction at every turn, eschewed regional innovation, and conscientiously took national concerns into account when formulating regional policy. The purpose of regional administrators, to Ishaev's thinking, was to serve the national whole. On Sakhalin, the regional governors also believed in serving the national interest, but they interpreted the substance that service in a radically different fashion: Regional pursuit of autonomous development, in their opinion, best served the national interest. Thus Valentin Fedorov explicitly portrayed his "experiment on the Pacific" as an effort to set an example for the rest of Russia to follow, a way of thinking which Farkhutdinov picked up on and expanded in his quest to make production-sharing a reality.

Finally, the meaning of "patriotism" in the new era was subject to multiple interpretations at the regional level. Steven Solnick has noted Boris Yeltsin's failure to devise a new "Russian national idea." In the provinces, the governors devised their own national ideas. For Primore's Nazdratenko, patriotism meant the eradication of foreign influence on Russian soil. Manipulating the vocabulary of the new era to fit his beliefs, Nazdratenko claimed that active opposition to foreign economic encroachment on his territory was both patriotic and "democratic." Sakhalin's governors understood patriotism in a radically different way. For them, regional economic development with the active participation of foreign capital constituted a patriotic act which would enrich both the
region and Russia as a whole. Thus, on Sakhalin, active efforts to engage foreign investors were the essence of Russian patriotism under the new Federation. In Khabarovsk, governor Ishaev defined patriotism in terms of regional allegiance to Moscow. Ishaev did not interpret foreign economic interaction as a patriotic endeavor as the Sakhalin governors did, but neither did he believe that eviction of foreign investment was necessary to prove allegiance to Moscow. Rather he sought to incorporate an understanding of the national repercussions of regional FDI into regional policy formulation. Patriotism, in other words, meant the consideration of national over particularist regional interests.

This comparative overview of regional interpretations of key concepts in the post-Soviet era shows how regional leaders conceptualized "reform," "democracy," "Subject of the Federation," and "patriotism," in radically different ways. As a result, the three Far Eastern regions developed divergent conceptualizations of the meaning and significance of the new institutions of the federal era. The next step in the model shows how this ideational variation translated into divergent FDI policy outcomes.

Part 4: What is to be Done? Ideas Generate Legitimate Policy Alternatives

This dissertation has been concerned with discerning the motivations which drove regional leaders to select particular FDI policies among a range of alternatives. The dissertation has argued that regional leaders held widely divergent beliefs—about the salient aspects of the crisis, its genesis, and key concepts in the new era. Variation in FDI policy outcomes, I argue, was a product of divergent belief systems. An examination of

21 Steven Solnick, "Russia between States and Markets: Transnational and Subnational Pressures in the Transition," in Aseem Prakash and Jeffrey A. Hart, Responding to Globalization,
those outcomes shows that they were in line with leaders' expressed beliefs, and indeed, that the governors explicitly and consistently explained their policy selection in terms of their beliefs.

In Primorskii krai, the isolationist policy which Nazdratenko developed to block FDI inflows fell in line with the governor's belief that the root of Russia's crisis was foreign influence and that post-Soviet patriotism demanded the removal of foreign influence from Russian soil. Indeed, the governor consistently explained his drive to evict foreign shareholders from the krai's shipping and fishing enterprises in blatantly racist and xenophobic terms. In Khabarovsk, Ishaev's nationalist policy focused on coordinating with federal authorities to devise the legal framework to accommodate foreign investment in a way which would benefit not only the regional economy, but the Russian economy at large. These efforts fell in line with his belief that the fragmentation of center-periphery relations constituted the most serious aspect of the crisis facing post-Soviet Russia and that a restoration of close ties between the krai and the center was the best way to serve the national interest. The Far East and Trans-Baikal Association which Ishaev chaired was explicitly designed to serve that purpose. On Sakhalin, the governors' proactive support for production-sharing legislation and their active involvement with foreign oil companies in establishing PSAs on the Sakhalin shelf fell in line with their belief that the most serious crisis facing Russia was the economic one, and that engagement with foreign capital was itself a patriotic act. Indeed, governor Farkhutdinov explicitly explained his drive to bring foreign investment to Sakhalin in terms of national enrichment—for both the region and for Russia as a whole.

A comparison among regional responses to border disputes further demonstrates the ideationally-driven nature of policy outcomes in the Far East. Regional policy on border disputes has a direct relation to FDI because actively inflaming territorial issues has a profoundly negative effect on international trade and investment. All three Far Eastern regions addressed in this dissertation faced territorial dispute. In Khabarovsk, a number of small islands in the Amur River were slated for cession to China. The agreement on border demarcation which ceded the islands was reached in Moscow. In Khabarovsk, border demarcation barely made the local press, and was a virtual non-issue in the regional administration. As detailed in chapter 3, the response to centrally mandated territorial cession to China in Nazdratenko's administration was virulent. The Primor'ye governor inflamed the territorial issue and used it to oppose a prospective flood of foreign investment into the krai through the Tumen River Area Development Program. He explained his policy as a patriotic defense of Russian territory against the onslaught of rapacious "yellow hordes." Sakhalin too faced a serious territorial dispute—four islands which have precluded the conclusion of a peace treaty between Russia and Japan since the end of World War II. The territorial dispute on Sakhalin threatened Japanese FDI because for many years the policy of the Japanese government was to hold back on investment until the resolution of the conflict. The response of Sakhalin's governor Farkhutdinov to territorial dispute was the diametric opposite of that in Primorskii krai. Where Nazdratenko inflamed territorial dispute in order to block foreign investment, Farkhutdinov consistently downplayed the territorial issue and sought ways to mitigate dispute—such as supporting non-visa travel for Japanese citizens wishing to visit the four islands. On Sakhalin, there was no talk of "yellow hordes." Rather, the governor
explained that he sought local solutions to the problem and that cooperation with the oblast's powerful Asian neighbor would best serve the national interest—economic enrichment. In sum, faced with a similar challenge of territorial dispute, the leaders of the three Far Eastern provinces responded in radically different ways—ways which each leader explained in terms of his own beliefs.

**Step 5: Forward to a bright future! Ideas become embedded in institutions**

In line with the constructivist literature's argument that the enduring power of ideas depends on the extent to which they become "embedded" into institutional structures, this dissertation finds evidence that the ability of leaders to infuse institutions with ideas has a significant bearing on ideational longevity. While it is too soon to collect conclusive evidence about the durability of ideationally-inspired FDI policies in the regions, the evidence from the first post-Soviet decade shows that leaders who successfully enshrined their ideas in institutions, endured, while those who failed to effectively institutionalize their principles, perished.

In Khabarovsk, Viktor Ishaev enshrined his ideas in the Far East and Trans-Baikal Association—an organization which has so far endured for nearly a decade. The relative tranquillity of local politics in Khabarovsk and the strong mandate of the regional governor suggest that his policies are likely to endure. However, since Khabarovsk, unlike both Primore and Sakhalin, has yet to undergo post-Soviet gubernatorial change, it is too soon to determine the extent to which Ishaev's policies will endure when a new governor is elected in 2004.
The failure of Vladimir Kuznetsov's attempt to "internationalize" Primorskii krai illustrates the political consequences of non-institutionalization. When Kuznetsov came to power in 1990, the krai's political and economic elite supported him. The directors of the region's post powerful enterprises—under the umbrella of PAKT—supported the governor's plans for internationally financed development, and the krai soviet proposed and passed legislation which supported the governor's policies. Dissatisfaction with the governor arose from his failure to coordinate with regional elites—he did not visit a single large enterprise during his tenure and was away from the krai so often that he rarely interacted with, let alone supported, the initiatives of the krai soviet. When he was ousted, Kuznetsov's opponents did not complain about his policies. They argued that he had lost touch with the krai's inhabitants due to his frequent and lengthy absences, and that he had failed to follow through effectively on multilateral development plans such as the Tumen Project.

Nazdratenko was a master at manipulating regional institutions to his liking—so much so that he quickly out-manipulated his PAKT supporters and retained the mantle of leadership despite the rapid disintegration of his initial power-base. He manipulated the electoral system to his advantage, ensured that those directors who sympathized with his policies assumed control of the most powerful regional enterprises, and effectively controlled the appointment of Presidential Representatives and the regional heads of federal offices. So adept was Primore's second governor at infusing regional institutions with men and women sympathetic to his cause that even after his removal by President Putin, Nazdratenko was able to influence the outcome of gubernatorial elections and ensure that his isolationist policies persisted into the 21st century.
If the story of Primorskii krai's two governors is one of the failure to institutionalize ideas, followed by masterful institutionalization, Sakhalin shows that initial success in the institutionalization process can perpetuate ideas across administrations. Valentin Fedorov's ideas were very similar to those of Vladimir Kuznetsov, but where Kuznetsov neglected to bring his ideas into regional institutions, Fedorov actively sold his policies at both the regional and the national level. Where Kuznetsov failed to follow through in his negotiations for the Tumen River Development Program, Fedorov successfully introduced proposals for production-sharing legislation in Moscow and orchestrated an active campaign on Sakhalin in support of PSAs. Where Kuznetsov failed to cultivate support for his policies in the locality, Fedorov developed a strong alliance with foreign investors and promised concrete rewards to regional constituents. In this way, Fedorov tied the office of governor on Sakhalin to the success of production-sharing and laid the groundwork on which future governors built. By the time Igor Farkhutdinov assumed the governorship, production-sharing was gaining acceptance both in Moscow and on Sakhalin. Farkhutdinov took concrete steps to further institutionalize the process by establishing a department dedicated to off-shore oil development within the regional administration, solidifying relations with foreign investors, and ultimately pushing production-sharing through the national legislature and the regional oil company, Sakhalinmoreneftegaz. The efforts of Sakhalin's governors to institutionalize their ideas about FDI policy and production-sharing in particular make it likely that the direction of Sakhalin's FDI policy will remain unchanged over future administrations.
Theoretical Implications: Ideas and Interests

The primary theoretical contention of this dissertation is that to understand policy outcomes we must look not only to the objective circumstances—political, economic, institutional—in which actors find themselves, but also to their beliefs. In this way, the dissertation engages the widely-held assumption that actors are animated by "interests," that those interests are generally "self-interest," and that therefore, actors' goals are primarily self-serving. Instead, this dissertation contends that actors are animated by a variety of ideas, that self-interest is itself an idea about actor motivation, and that it is but one in a range of ideas that drive human behavior. By proposing that the genesis of human motivation is ideational, the framework this dissertation puts forth opens the door to a spectrum of possible actor goals and aspirations, one which I contend more closely approximates the realities of political and economic life.

In chapter 2, I noted two primary constructivist approaches to explaining policy outcomes. By one argument, ideas serve actors' interests by providing different ways to achieve assumed material goals. Indeed, most constructivist studies of foreign economic policy follow the rational choice practice of operationalizing actors' interests in terms of economic maximization, and then go on to show that variation in actors' ideas explains different strategies designed to maximize economic returns.\textsuperscript{22} The other argument,

\textsuperscript{22} See for example, Keith Alexander Darden, \textit{The Origins of Economic Interests: Economic Ideas and the Formation of Regional Institutions among the Post-Soviet States}, Ph. D. Dissertation, University of California, Berkeley, 2000. Darden assumes that states seek to maximize economic returns, but argues that the paths they chose towards that end vary according to the ideational framework which informs government actors. In his words, "...the intent of the study is to explain why different governments believed different economic institutions were necessary to obtain the same end goal of material welfare." (p. 98). In a similar vein, Goldstein and Keohane's analysis of ideational impact in foreign policy formulation adheres to the Weberian notion that material interests govern human conduct, and, as did Weber, see ideas as "switchmen" that "help to order the world" but do not independently determine goals. Judith Goldstein and Robert O.
supported by Alexander Wendt, Mark Blyth, and Daniel Kahneman, holds that ideas and interests are analytically inseparable and cannot be considered as mutually exclusive categories. This dissertation is in agreement with the latter perspective. The analysis offered in the dissertation suggests, as Blyth has argued, that "analysts should see interests as being necessarily ideationally bound."²³

Rational Choice and Self-Interest

The most widely held assumption about actors' motivation in political science today—and the assumption which underlies the materialist arguments addressed in this dissertation—is the belief that human beings have one primary interest—themselves—and that fundamentally, human beings are selfish, self-interested, and animated by a "me-first" mentality which holds concern for self to be paramount. This belief about the underpinnings of actor motivation is implicit in diverse approaches in the discipline, from structuralism to institutionalism, but broadly speaking it is most evident in rational choice theory. The rational choice literature is vast and diverse, and rational choice proponents vary in the strength of their commitment to self-interest as actors' primary goal. John Ferejohn distinguishes "thick-rational" approaches which explicitly posit self-interest, from "thin-rational" approaches which focus on rationally instrumental behavior, or the "rational maximization of utility" regardless of the ends pursued.²⁴ Here I argue that

²⁴ John Ferejohn differentiates between "thin-rational" analysis from "thick-rational" analysis. Thin-rational analysis posits rationality in the sense that actors "efficiently employ the means available to pursue their ends." (Ferejohn, p. 282). In a similar vein, Jeffrey Friedman defines rational choice theory as the "claim that, regardless of what sort of ends people pursue, they do so
whether implicitly ("thiny") or explicitly ("thickly"), rational choice analyses do assume self-interest.

There are four reasons why I argue that self-interest is the primary way in which rational choice understands actors' motivations: First, in practice, most rational choice analyses operationalize goals in terms of self-interest. Donald Green and Ian Shapiro make this point in their critique of rational choice when they point out that "much of the rational choice literature rests on unambiguously thick-rational assumptions. For instance, the literature on party competition typically assumes that parties try to maximize votes and, in so doing, maximize power; the rent-seeking literature assumes that interest groups try to maximize a variety of goals, from profits to environmental conservation; much of the law-and-economics literature assumes that judicial decisions maximize the production of wealth; and the literature on legislators and bureaucrats assumes that they try in various ways to maximize career advancement." Beyond these examples, much of the international relations literature similarly assumes that states seek to expand national wealth or size, and the literature on international economic relations assumes that actors seek to maximize wealth and power.

Second, while many rational choice analyses in practice operationalize ends in terms of self-interest, those which do not, offer no alternative understanding of agent motivation. This is because rational choice is primarily concerned with context, not with the actors themselves. In their work on strategic-choice (a variation of rational-choice) and international relations, David Lake and Robert Powell make this point explicitly when they differentiate their approach from constructivist approaches: "The strategic-choice approach makes [the] bet...that we can explain many important and interesting aspects of world politics by focusing on information asymmetries between actors, the actions available to them, their preferences, and so on. By analyzing the strategic setting in which individuals make choices, rather than how they process information, the strategic-choice approach seeks to account more successfully and parsimoniously for many of the same patterns."27 I argue that the rational choice focus on context, even when it make no explicit claims about actor motivation, must assume some motivational framework, because without some understanding of how actors respond to external stimuli, it is impossible to draw conclusions about the effects of various "contexts" on actors' actions. Thus, the structure of rational choice's instrumental means-ends analysis demands some level of implicit assumption about actors' motivations and goals, and in the rational choice literature, that assumption is invariably self-interested.

Third, the rational choice contention that human behavior is instrumental—that is, "maximizing"—requires an implicit understanding of goals as self-serving. In other words, the argument that actors maximize utility holds only if we believe that utility is something worth maximizing. It makes sense to talk about maximizing wealth and power,

27 See David A. Lake and Robert Powell, "International Relations: A Strategic-Choice Approach," in David A. Lake and Robert Powell eds., Strategic Choice and International
but the argument for maximization becomes less tenable when we talk about explaining destructive behavior such as drug use or suicide bombings, or altruistic behavior—such as giving away all one's possessions to charity.\textsuperscript{28} Rational choice’s argument about maximization is derived from Bentham’s utilitarian argument which held that human beings seek to maximize pleasure, but even John Stuart Mill, utilitarianism’s most celebrated thinker, recognized the problem that the maximization argument posed for explaining altruism. Mill’s solution to this problem was to identify "higher" and "lower" pleasures and to attribute altruism to satisfaction of "higher pleasures."\textsuperscript{29} The distinction is tenuous, and in any case rational choice makes no such distinction. In this way, rational choice analyses focuses on a "utility" which, by the logic of maximization itself, is self-serving.

Fourth, the assumption of self-interest in rational choice is most pervasive in questions of economics; this is precisely the empirical focus of this dissertation, and the very area in which I argue actors are motivated by concerns other than self-interest. Rational choice analysis represents an effort by political scientists to adapt methods from the field of economics to the study of political phenomena, and the field of economics is overwhelmingly based on assumptions of self-interest. As Jeffrey Friedman points out, "in the modern West, it is widely assumed that personal gain is the legitimate goal of economic activity... Indeed, the economic realm could be \textit{defined} as the arena in which

\textsuperscript{29} John Stuart Mill, \textit{Utilitarianism}, 1861.
selfishness is considered legitimate.\textsuperscript{30} It is therefore to be expected that studies in political science which focus on economic questions—foreign economic policy formulation, trade and investment flows—should be the most likely to assume actor self-interest. Indeed, research in the specific subfield of international political economy into which this dissertation falls is dominated by rational choice studies which assume actor self-interest.\textsuperscript{31}

In sum, the rational choice perspective, and the materialist arguments presented in this dissertation, derive their explanatory power from external power configurations—such as the structure of economic factors or the configuration of political institutions. They rest on the assumption that actors are self interested—meaning that actors seek to maximize wealth and power.

**Ideationally-Bound Interests**

This dissertation argues that we cannot accurately deduce actors' interests from external circumstance. The dissertation does recognize that considerations other than ideas—economic structure, political institutions, historical legacy—also play an important role in determining the decisions and policies of political actors, but, I argue, it is actors' interpretation—their *perception*—of external configurations, not the configurations themselves, that drives actors' decisions. It is in the dynamic interaction between external circumstance and actors' ideas—in short, the ways in which actors


\textsuperscript{31} For an overview of these approaches and the dominance of the rational choice paradigm in international political economy see Jeffry Freiden and Lisa L. Martin, "International Political
variously interpret external circumstance—that perception emerges, and, I argue, it is that perception which dictates the goals actors set and the policies they develop to achieve those goals.\textsuperscript{32} Put simply, I argue that actors' goals cannot be singularly derived from economic, political, or historical "tools" alone—as the materialist arguments addressed in this chapter argue. Rather, given similar contexts, an object which appears to one person to be a useful tool, may appear to another as a weapon, while a third may have no interest in it whatsoever, and this is exactly what happened to the Far Eastern governors. Thus, while the main argument of this dissertation speaks to the importance of ideas and human agents in constructing political and economic goals, the dissertation does not suppose that this process takes place in a vacuum, but recognizes the interactive dynamic between external circumstance and ideas. In other words, objective realities surely "matter," but it is subjective reality which ultimately determines human action and reaction.

This dissertation does not dispute the argument that actors may be self-interested (in the sense that they value wealth and power)—many certainly are, and most are at least some of the time—but it does argue that self-interest as the sole or even the primary motivating force cannot be assumed. In this dissertation, I argue that actors who pursue self-interest do so because they are animated by a particular belief. Thus for example, Sakhalin's leaders pursued economic wealth in the form of oil development, but their

\textsuperscript{32} This argument about subjective interpretation of reality is well established in the constructivist literature. Peter Hall, for example, argues that economic interests "have to be derived via a process of interpretation." Peter A. Hall, "The Role of Interests, Institutions, and Ideas in the Comparative Political Economy of the Industrialized Nations," in M. I. Lichbach and A. S. Zuckerman eds., \textit{Comparative Politics: Rationality, Culture, and Structure}, Cambridge: Cambridge University Press, 1997, p. 197. Similarly, Craig Parsons posits an ideational approach in which "actors interpret their interests through ideas that can vary independently from their objective positions." Craig Parsons, "Showing Ideas as Causes: The Origins of the European Union," \textit{International Organization}, Vol. 56, no. 1, Winter 2002, p. 49.
decision to do so was not a product of external circumstance, but arose from a particular set of ideas. By my argument, therefore, the rational choice approach itself is in fact ideational because it is predicated upon one particular idea—that actors are fundamentally concerned with their own personal welfare above all else. In short, with Mark Blyth, the dissertation argues that interests are ideationally-bound.

An important conclusion in this dissertation is that "interests" are mutable—they can be created by political leaders. As Boris Nemtsov has spoken of "managed democracy," so the dissertation finds that economic interests can also be "managed." In the cases which this dissertation has examined, skillful regional leaders shaped and molded the "interests" of their regions. For this reason it does not make sense to see policy outcomes as the product of particular interests. Rather, the dissertation has argued, interests are the product of policy decisions. In effecting institutional change—such as the changes taking place in Russia in the 1990s—it is not enough therefore to set up particular institutions, and assume—as Russia's reformers did—that actors will respond "rationally" as "economic men." To understand the impact of changing institutional configurations as well as the way in which those institutions evolve and operate de facto, we must consider the ideational context in which they were placed.

**Avenues for Future Research**

In conclusion, I suggest three ways in which the dissertation's findings expand our understanding of Russian politics and political science inquiry in general. The first examines Russian President Vladimir Putin's recentralization policies in light of the
dissertation's study of regional governors. The second shows how an ideational approach to political inquiry can further understandings of political change. The third explores the new role for local government under globalization, in view of the impact which the Russian governors exerted over foreign economic policy outcomes.

**Understanding Change**

In this dissertation, I have argued that ideas provided the guiding force behind the diverse foreign economic policy formulations of the Far Eastern governors. This ideational argument suggests four interesting conclusions about understanding political change in general, and in Russia in particular. First, while the dissertation argues that gubernatorial ideas and policies were driven by particular ideas, it does not mean to imply that ideas are fixed and unchanging. By their very nature ideas are flexible and malleable, so that the use of ideas as independent variables lends itself well to explaining change in the political arena. Second, the dissertation's emphasis on political leaders suggests that a greater focus on human agency can help us to better understand political and economic developments as they unfold in societies undergoing change, as Russia did throughout the 1990s. Third, the dissertation's focus on ideas and human agency suggests ways of understanding how change occurs in political institutions. Throughout the 1990s, Russian federal institutions were a "work in progress," and this dissertation's finding about the role of ideas and human agents provides some insight into the way those institutions developed, and about institutional change in general. Fourth and finally, the dissertation's finding that leadership's ideas interact dynamically with institutional configurations suggests that in order to truly understand the impact of "transplanting"
institutions from one setting to another—building democratic institutions, for instance—we must carefully consider the local ideational context in which the new institutions are planted.

First, by placing ideas at the center of its explanation for policy outcomes, the dissertation suggests that understandings of political change need to consider the ways in which ideas change. The dissertation has offered an explanation for foreign economic policy formulation based on the human capacity to interpret external circumstance. Ideas, and therefore, interpretations can, however, change. I have argued that it is the human capacity to interpret the outside world that accounts for policy outcomes. If we accept that human interpretive capacity forms the root of political outcome, we must also consider that it can explain ideational and political change. Several aspects of an ideational explanation lend themselves to addressing the question of change. Ideas are malleable: They can be created, they can be propagated, and they can be changed. The Far Eastern governors were masters at this process, for they both developed ideas of their own and also effectively imparted them to their constituents—effectively molding and changing constituent interests. In addition, the dissertation emphasizes the dynamic aspect of ideas—the ways in which ideas interact with the world outside. It is in that dynamism, I suggest, that change occurs.

Second, the dissertation points to the pivotal role that regional leaders played in determining the course of regional policy in the 1990s. This suggests that if we are truly to understand the forces that drive change in societies undergoing upheaval, we must pay close attention to human agency. In the post-Soviet Russian provinces, it was individual leaders, rather than economic and political institutional configurations, who played the
critical role in determining the course of policy. Human agency is especially important in
countries such as post-Soviet Russia, where institutions are still in their infancy. In short,
the dissertation's findings suggest that, under circumstances of change, when institutions
are weak or unformed, the role of individual leaders in determining political direction
becomes particularly important.

Third, the dissertation speaks to the importance of individual actors in building
and implementing new institutional arrangements. In countries undergoing change,
therefore, who heads up institutions is just as important, if not more important, than the
institutional configuration itself. In other words, in order to understand change we must
look to the ways in which individuals mold institutions, rather than the "new
institutionalist" approach which examines how institutions shape individuals. In this I
follow Marx' lead when he wrote in his Theses on Feuerbach: "The materialist doctrine
that men are products of circumstances and upbringing, and that therefore, changed men
are products of other circumstances and changed upbringing, forgets that it is men who
change circumstances...." Moreover, because, as I have argued, leaderships' ideas
generate outcomes, it is critically important to look to the ways leaders think, rather than
to the institutional structure within which they operate. To ignore leaders' ideas,
therefore, is to ascribe undue power to institutional arrangements, and therefore to
miscalculate institutional outcomes. In the Far East, Primore's autocratic governor closed
down independent newspapers, stifled dissent, and threw his political rivals in jail. Yet he
was the product of new democratic institutions and consistently won over 70 percent of
the vote in electoral contest. Until we understand how leaders think, we will not be able

33 Karl Marx, Theses on Feuerbach, in Robert C. Tucker, The Marx-Engels Reader, New York,
to understand how, (to continue the above example), democratic institutions produce undemocratic leaders. In short, without a solid grasp of ideational context, we cannot understand or predict institutional outcomes.

Fourth, this dissertation has shown that governors from three different provinces reacted very differently to the same opportunities and constraints of the new federal system, and that the variation in their approaches was due to their different ideas. This means that a proper grasp of ideational context is critical to understanding why institutions in various settings operate differently. To generalize from this finding, if we are to properly understand the challenges of building new institutions, "nation-building," transplanting institutions from one national setting to another—as in building democracy, or different national approaches to multi-lateral institutions, we must consider the ideational context in which leaders operate. Only then can we understand how actors will interpret and respond to institutional arrangements.

**Decentralizing Russia**

Russians often say their country needs a strong hand. The Far Eastern experience suggests that they may be right. Boris Yeltsin came to power telling the provinces to take as much power as they could swallow, and he established a federal structure in Russia intended to facilitate regional autonomy. The new institutional configuration empowered regional executives. It was intended to unleash regional potential and free the provinces of the shackles of Communist Party control which characterized center-periphery relations under the Soviet system. The parameters of the embryonic federal structures were loosely defined and ever-changing, and devolving central control coupled with the
unprecedented power of local governors, set the stage for regional leaders to take their provinces whither they pleased. In this context, the role that regional governors played in policy-formulation over the course of the first post-Soviet decade was particularly important, and the Far Eastern governors took their provinces in very different directions.

In order to understand the direction which Russia is taking in the post-Yeltsin era, it is important to understand the dynamics of center-periphery relations and the evolution of policy-making within the provinces under Yeltsin. This dissertation has shown that the powerful regional governors were able to impose their own ideas about foreign economic policy on their provinces, and that this at times lead to disastrous economic outcomes. Under Yeltsin, there was little that Moscow could do about this state of affairs. When Vladimir Putin won the presidency he recognized this problem, and formulated a response: recentralization. Putin's centralizing policies—both their formulation and the obstacles to their implementation—can best be understood within the context of the chaotic decentralization of the Yeltsin era and the space this created for variegated regional responses.

In May of 2000, President Putin took steps to reign in the provinces. He dismissed the 89 presidential representatives in the Federation Subjects and set up seven new "administrative districts." The Russian Far East was designated one such district, headquartered in Khabarovsk, and Konstantin Pulikovskii, a former military commander who had fought in Chechnya, was appointed to lead it. The new districts, or "macro-regions," were explicitly intended to strengthen vertical control and curb excessive regional power. Directly accountable to the President, the new regional representatives were instructed to ensure regional compliance with federal directives—including
presidential decrees and federal legislation. Their primary mission was to integrate the new macro-regions into a federal whole, a task which required them to confront parochial regional governors, resolve inter-provincial dispute within the macro-regions, and develop linkages between the macro-region and the center.

The extent of gubernatorial power which this dissertation has examined provides an indication of the concerns which motivated the Russian President to establish the macro-regions, but it also gives an indication of the problems of implementing the new control measures in the provinces. Gubernatorial power, and the ideas which drove provincial policy in the 1990s, did not leave quietly. In the Russian Far East, Pulikovskii ran into trouble quickly. Predictably, his primary conflict was with Primor governor Nazdratenko. As Yeltsin before him, Pulikovskii blamed the governor for the deplorable state of Primor's economy—particularly the energy crisis—and mounted a campaign to unseat Nazdratenko. In July 2000, he sponsored his deputy, Genadii Apanasenko, to run in the gubernatorial race in Primor. Apanasenko lost, a blow to Pulikovskii which proved but a temporary set-back for the Presidential Representative. A teachers' strike in the Primorskii city of Ussuriisk in November of 2000 provided the catalyst that escalated the conflict between Pulikovskii and Nazdratenko, when the Presidential Representative blamed the governor for the strike. In December, as a result of this conflict, Nazdratenko filed suit against Pulikovskii, but by February 2001, Pulikovskii successfully used the strength of his office and his close association with the Russian President to secure Nazdratenko's resignation.

34 The new Presidential Representatives were assigned four primary tasks: ensuring conformity between regional law and federal legislation, overseeing cadres, developing regional economic strategies, and organizing new bureaucratic structures for the macro-regional including ones to
Despite Pulikovskii's victory over Nazdratenko, problems with recalcitrant and uncooperative governors continued to plague the Far Eastern Presidential Representative. This dissertation has argued that the Far Eastern governors had very clear ideas about the direction in which their provinces should head, and they persisted in those ideas in the face of the new institutional structure. In Khabarovsk, the headquarters of the new Far Eastern administrative district, governor Ishaev felt that the new Representative threatened the governor's position as leader of the Far Eastern Association and representative of the Far Eastern region to Moscow, and this was indeed the case. Ishaev resisted relinquishing this position, and while his relations with Pulikovskii have not been confrontational in the way the Primore governor's were, Ishaev's unwillingness to cooperate with the Presidential Representative has made Pulikovskii's job very difficult. This situation is unlikely to change in the near future. Unless President Putin is prepared to remove more governors from power, it is likely that gubernatorial resistance to the Presidential Representatives will continue to make implementation of the new administrative district powers problematic in the years to come.

Regional Governments and Globalization

This dissertation has shown that regional governors had a decisive impact on foreign economic policies at the local level, and that through their actions, foreign capital either flowed into the province—as on Sakhalin, or out of the province—as in Primore. The impact of local actors on international trade and investment flows has yet to receive serious attention in the international political economy literature, although some studies

have been conducted of successful local efforts to bring in foreign investment. This dissertation contributes to our understanding of the role that regional actors have to play as economic globalization progresses. Most importantly, to date, studies of local government interactions with foreign capital have focused on the ways in which local actors court foreign investors, but few have considered the possibility that local governments would react to foreign capital in the way in which Primore, or even Khabarovsk leaders did: with hostility or indifference. The dissertation contributes to our understanding of local actors in international economic affairs in three ways. First, in line with other studies cited above, it identifies local leaders as increasingly important international actors in their own right. Second, through its study of Sakhalin, it provides a fresh example of the ways in which local governments can work directly with foreign investors to increase capital flows at the regional level. Third, it shows that in regions where capital did not flow, the explanation for a poor foreign investment showing can lie with the attitude of regional leaders, as it did in Primore and Khabarovsk.

First, the dissertation shows that throughout the 1990s, Russian regional leaders had the power to exert considerable influence over trade and investment flows through their provinces. That power may be somewhat mitigated in the post-Yeltsin era by the establishment of the macro-regions discussed above, but both domestic and international

circumstances militate against a substantial reduction of gubernatorial power in the economic realm. So far, the Far Eastern administrative district apparatus has focused mainly on establishing administrative controls, but has made few inroads into the economic realm which remains the province of regional governors. On the international front, investing firms have grown increasingly sensitive to local context—and concerned with local political and economic conditions—as economic relations grow increasingly complex. For this reason, foreign firms are themselves increasingly likely to engage local, before national, leaders.36 In sum, Russian regional governments are likely to continue to exert a powerful influence over foreign economic activity in the localities.

Second, while foreign investment levels in the Russian Federation were decidedly low throughout the 1990s, Sakhalin's example shows that it is possible for regional leaders to successfully court foreign investors and implement foreign-sponsored projects. Sakhalin is one of the few success stories in Russia today. While most of Russia's 89 provinces remain dependent on Moscow for subsidies, Sakhalin's rise suggests ways in which other provinces too, may begin to develop their regional economies.

Third, this dissertation has shown that regional governments can exert a negative, as well as a positive influence over foreign capital flows. In two of the three cases, regional governments knowingly took actions which stymied the flow of foreign investment into their provinces and negatively affected foreign trade relations. Most studies of Primorskii krai, for example, argue that the province failed to attract significant foreign investment, and that this constituted a failure on the part of regional government.

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36 For a discussion of this trend, see Brian Hocking, Localizing Foreign Policy: Non-Central Governments and Multilayered Diplomacy, St. Martin's Press, 1993.
While it is true that foreign investment levels in the krai were low, the regional governments' policies—which were designed to evict foreign investors—were a great success. Examples such as Primorie, and to a lesser extent Khabarovsk, show that if we are to properly understand foreign investment distributions, we must consider the attitude—the ideas—of host regions. We cannot assume, therefore, as many studies of foreign investment flows do, that the failure of a region to attract foreign investment can be remedied by new institutions or regulations. It may simply be the case that regions do not want foreign economic ties.

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This chapter opened with a quote from Mohandas Gandhi. In it Gandhi argued that we cannot gage the power of an individual from physical capacity alone. Rather we must look to individual will. This dissertation has argued that we cannot gage actors' interests from their capabilities alone—their access to economic factors, the institutions at their disposal, the place they occupy in political power structures. Instead we must look to the beliefs that motivate them to action. To explain the diverse approaches which the Russian regions took to foreign investment, this dissertation looks to the belief systems which animated the regional governors. It was those beliefs, I argue, that determined if regions developed effective policies to draw foreign capital or else elected to expel foreign investors. In the end, it came down to individual will.
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