Other International Issues

BREAKING THE BOTTLENECK:
THE FUTURE OF RUSSIA'S OIL PIPELINES

I. INTRODUCTION

Russia's immense oil resources may be able to attract the hard currency needed to fuel its economic recovery. However, the network of oil pipelines necessary to export Russia's oil deteriorated along with the rest of Russia's oil industry infrastructure in the final Soviet years. Furthermore, the ex-Soviet bureaucracy now managing the dilapidated pipelines is holding tightly to its control over the network. Progress in pipeline policy is complicated by the shifts in Russia this decade to a market economy and to constitutional federalism. In light of these obstacles, this Note examines the current regulation of Russia's oil pipelines and comments on methods that might assist Russia in formulating its future oil pipeline policy.

1. For much of the post-World War II period, the Soviet Union was the largest single producer of crude oil in the world. See Trade and Investment Patterns in the Crude Petroleum and Natural Gas Sectors of the Energy-Producing States of the Former Soviet Union, United States International Trade Commission Pub. 2656, Inv. No. 332-338 (June 1993) at 1-1 [hereinafter USITC Report]. Most of the former Soviet Union's oil is now found on Russian soil. In 1991, for instance, Russia produced 91% of the oil produced in the former Soviet Union. See id. at 2-3. The former Soviet Union's oil reserves are estimated at six percent of world totals. See id. at 2-1.

2. The dying Soviet government ravaged its prolific deposits in the 1980s when the need for short-term domestic fuel and exports to Warsaw Pact neighbors outweighed the need for equipment modernization and long-term development of the petroleum fields. See USITC Report, supra note 1, at 2-5. By the early 1990s, this lack of foresight, followed by the Soviet economic collapse, brought oil production levels down by over one-third. A petr paking at 11.4 million barrels per day in 1987-88, Russian oil production fell to 6.1 million barrels per day by 1994. See Komi Oil Spills, 1995: Joint Hearing on the Energy and Environmental Implications of the Komi Oil Spills in the Former Soviet Union Before the Senate Comm. on Energy and Natural Resources and the Senate Comm. on Environment and Public Works, 104th Cong., 1st Sess. 19 (1995) (statement of Patricia Fry Godley, Assistant Sec. for Fossil Energy, Dept. of Energy) [hereinafter Godley Statement].

3. See infra Part II.B.

4. See infra Part III.

5. This Note addresses regulation and policy within the oil sector, and not the natural gas sector. The natural gas industry requires much more sophisticated technology and planning than the oil industry, primarily because of difficulty in containing and transporting gas.
A vast network of oil pipelines now spans Russia's territory.\(^6\) The Soviet Union built these pipeline links to its remote oil fields to serve the complicated system of economic exchange that underlay its hold on power.\(^8\) However, even before the Soviet collapse, the pipeline network constituted a bottleneck in the oil industry\(^5\) due to pipe supply shortages.\(^10\) The poor maintenance of the pipelines which did

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\(^8\) The more sophisticated technology required for transporting gas also means that gas is much less attractive as an export, does not have the global market and price responsiveness that oil does, and is generally consumed on a regional basis with regional regulatory norms. These differences between the oil and natural gas industries have also meant that the debate over “energy security” has primarily been conducted in terms of oil supply, and not gas supply. See id. at 24-25.

The more sophisticated technical requirements in the natural gas industry have meant that Russia's natural gas infrastructure, although not beyond the help of Western technology, was much better maintained in the final Soviet years than the oil industry. See id. at 431-32. The state-owned entity Gazprom controls the production, processing, and distribution of all of Russia's natural gas not produced off shore or “associated” (produced simultaneously) with the production of oil. See International Energy Agency, Natural Gas Transportation: Organization and Regulation 322 (1995). The comments in Part IV of this Note concerning a possible restructuring of Transneft may, however, be applicable in a parallel restructuring of Gazprom's pipelines and the Russian natural gas industry.

\(^6\) The current network of trunk lines includes more than 30,000 miles of oil pipeline, over 90% of which are large-diameter pipes (over thirty inches), with about 600 pumping stations. See Patricia Fry Eldridge, Russia Energy Legislation: Regulating State Monopolies to Allow the Development of Competitive Markets, 13 Energy L.J. 1, 7 (1992). The largest pipeline in the former Soviet Union was the Druzhba (“friendship”) export line, which stretches 2,900 miles from the Volga-Ural fields across Belarus and Ukraine to refineries in Poland, Czechoslovakia, Hungary, and Germany. See Russia Grapples with New Tariffs, Oil & Gas Law, OIL & GAS J., Oct. 14, 1991, at 30.

\(^7\) The two petroleum fields which have supplied most of Russia's energy needs are in the west-central part of Russia's land mass. They are the West Siberian Basin, which runs along the Irtysh and Ob Rivers east of the Urals, extending to the Kara Sea, and the Volga-Ural Basin, which runs from a section of the Volga River halfway between Moscow and the Caspian Sea eastward to the Ural mountains. These two basins together accounted for over 85% of the oil and gas produced by Russia up to 1993. See generally Gregory F. Ulmishek & Charles D. Masters, U.S. Geological Survey: Estimated Petroleum Resources in the Former Soviet Union (U.S. Dept of the Interior Open-File Report 93-316, 1993). The West Siberian basin holds identified reserves of 60 billion barrels of oil and is estimated to contain the “largest undiscovered resources of both oil and gas.” Id. at 2.

\(^8\) Since the late 1960s, the Soviet Union transported large amounts of petroleum products over land from Siberia and central Asia to its European regions. See Robert W. Campbell, Trends in the Soviet Oil and Gas Industry 6-7 (1976). The development of petroleum transport avenues to Eastern Europe was motivated by the political need to support the economies of Warsaw Pact partners. “The Soviet Union typically has supplied 80 percent and more recently 90 percent of all East European petroleum imports.” Marshall I. Goldman, The Enigma of Soviet Petroleum 60 (1980). After the dissolution of the Soviet Union, only two of the five main Soviet ports of petroleum export remained on Russian soil. See USITC Report, supra note 1, at 2-7.

\(^9\) See Campbell, supra note 8, at 36-37.

\(^10\) Pipeline construction had been a constant challenge for the Soviet Union due, at least
exist meant that in 1991 the newly independent Russian Federation inherited a network annually suffering an estimated 700 explosions and leaking several million tons of oil. Now, not only is the network in poor physical condition, but a shift in export demand mandates the construction of pipelines along entirely new routes.

In 1992, the Russian government placed control of the oil pipeline network in the hands of a state-owned holding company called Transneft. The economics of large-scale oil shipment may indeed dictate that pipelines be regulated as a “natural monopoly,” owned or heavily regulated by the state. The Russian government took a different approach in 1992 with respect to the oil production enterprises, the customers of the pipelines. The oil producers were converted into joint-stock companies which have since been placed largely in private control, with the federal government maintaining only partial ownership.

This arrangement has created an inefficient and inequitable system of pipeline regulation. Pipeline regulation has moved from a failed attempt at price liberalization to the imposition and then total abolition of strict export quotas, and finally to a bureaucratic quag-

in part, to low-quality domestic steel. The effect of the deficiencies revealed the importance of the energy industry—Soviet imports in the 1970s of pipes for drilling and transport lines accounted for 15% of all hard currency imports. See Goldman, supra note 8, at 42.

11. See Environment: Growing Concern in Russia, EUR. ENERGY, Jan. 24, 1992. The most publicized oil spill since independence, in the Komi republic in late 1994, was not due to an explosion, but merely to deterioration of the pipeline. Estimates of leakage from that spill range from 100,000 to 2 million barrels. By comparison, the Exxon Valdez spill in Alaska’s Prince William Sound was approximately 240,000 barrels. See Godley Statement, supra note 2, at 16. “Public sources indicate that five to seven percent of Russia’s oil production is lost through leaks in its pipeline system.” Id. at 19.

12. Demand for oil along the major East European route has decreased while demand for export shipment to sea ports has increased. See Capacity Constraints on Russian Oil, PE-TROLEUM TIMES, July 8, 1995, at 8; Geoff Winestock, Market Forces Drive Export Focus in Ex-USSR, J. COM., Oct. 31, 1995, at 4B.

13. See infra Part II.B.

14. A natural monopoly occurs when the economies of scale of one large enterprise will outrun the benefits of competition among several. See Kenneth Nowotny, The Economics of Public Utility Regulation: A n Overview, in Public Utility Regulation 9, 10-11 (K. Nowotny et al. eds., 1989); see also BERG & TSCHIRHART, NATURAL MONOPOLY REGULATION 21 (1988). Western theories of natural monopoly regulation have been divided into two groups, (1) a conventional view, in which regulation is viewed as benefiting the public by protecting it from monopolistic exploitation, and (2) an alternate view of regulation as a balance between public and private interests, achieving a market price and supply somewhere between what would result from monopolistic and competitive scenarios. See JOHN R. BALDWIN, REGULATORY FAILURE AND RENEWAL 2 (1989). But cf. infra notes 52-54 and accompanying text (characterizing the creation of Transneft not as economically motivated, but as a political compromise in the wake of the Soviet collapse).

15. See infra Part II.A.
mire in which access to pipelines is doled out in collusion with a handful of major domestic oil producers.\textsuperscript{16} This confusing regulatory environment not only stifles efficient operation within the industry, it also inhibits foreign participation\textsuperscript{17} in an industry in dire need of capital investment and equipment modernization.\textsuperscript{18}

Russian oil transport policy is not only encumbered by the monopoly Transneft bureaucracy at the federal level. It is further complicated by a blurred distinction between the authority of the federal and republic governments. The 1993 Russian Constitution leaves open many questions about the role of the republics\textsuperscript{19} in governing both commercial entities and natural resources.\textsuperscript{20} Given the remote and widespread locations of the Russian oil fields, achieving an increase in exports will require a policy not only coordinated between the federal government and the oil producers, but also coordinated with the member republics in whose territory the oil is produced and over whose territory the oil must be shipped.

This Note considers what factors will influence Russia's efforts to modernize and expand its pipeline network to meet its current political and economic needs in a manner compatible with its legal and commercial culture. A successful infusion of foreign capital to help in that modernization and expansion will require foreign investors understanding of the complexities and conceptions on the Russian side of the pipeline. Because of the importance of oil exports in attracting hard currency, progress on pipeline policy may be an early indication of possibilities for cooperation in other key sectors of the

\textsuperscript{16} See infra Part II.B.


\textsuperscript{19} In this Note, the word "republic" will be used when referring generally to any of the member sub-units of the Russian Federation, including oblasts, krais, and autonomous okrugs.

\textsuperscript{20} See infra Part III.B.
Russian economy. Moreover, because an effective pipeline policy will require cooperation between the federal government and the member republics, pipeline policy may be an early indication of the stability with which Russian federalism will evolve.

Part II of this Note examines the post-Soviet restructuring of the Russian oil industry and the dilemmas Russia currently faces in attracting foreign investment to its pipelines. Part III discusses the regulation of oil transport within a federation generally before considering relevant aspects of the Russian legal culture. Part IV suggests methods that might assist Russia in formulating oil pipeline policy in light of successful economic turnarounds in other countries. This Note concludes that modernizing the Russian pipeline network will require an aggressive initiative by the federal government and suggests the use of regional councils to coordinate this initiative with a divided Transneft.

II. TRANSNEFT'S CURRENT PIPELINE MONOPOLY

The following sections describe the transformation of the Russian oil industry following the fall of the Soviet Union, paying particular attention to oil pipelines. Part A provides the context for a discussion of pipeline policy by describing the privatization of the Russian oil producers, the consumers of the pipelines' services. Part B then describes the evolution of Transneft and its policies since its creation in 1992, focusing on obstacles to efficient shipment and expansion of the network. Finally, Part C discusses the need for modernization of the pipelines by introducing foreign investment without destabilizing the industry.

A. The Post-Soviet Privatization of the Oil Producers

The dissolution of the Soviet Union in 1991 was followed by a massive initiative in Russia to privatize state property. The transformation of the oil industry was addressed in Presidential Decree


No. 1403 of November 17, 1992. 23

Under Decree No. 1403, the privatization of state-owned oil production enterprises, which had been and remain the main customers of the pipelines, was at first only partial, with the federal government maintaining control of a large part of the industry. Oil production enterprises were converted into joint-stock companies according to the plan implemented for the general economy. 24 Ownership of controlling shares of one group of the new companies was assigned to a new state holding company, Rosneft. 25 Controlling shares of the remaining new companies were placed in three large holding companies. 26 Forty-five percent of the shares of the three holding companies were assigned to state ownership for three years, 27 with the remaining shares to be sold immediately for privatization vouchers or through investment tenders. 28

Rosneft’s task, as envisioned from its conception, was to organize new vertically integrated companies out of the oil production enterprises it owned. 29 The break-up of Rosneft proceeded rapidly. Whereas in early 1993 Rosneft accounted for the majority of the oil production in Russia, 30 by late 1994 over seventy percent of oil production was attributed to four new integrated companies created from former Rosneft enterprises, as well as to the three other conglomerates created in Decree No. 1403. 31 A presidential decree of

23. Privatization and Conversion into Joint-Stock Companies of State Enterprises and Producer and Research Associations in the Oil and Oil Refining Industries and in Oil Product Supply, President’s Decree No. 1403 (Nov. 17, 1992), translated and reprinted in BUSINESS AND COMMERCIAL LAWS OF RUSSIA supra note 22, § 2.12.7.

24. See id. art. 1; see also Russian Federation Privatization of State and Municipal Enterprises Act, supra note 22.

25. See Decree No. 1403, supra note 23, art. 2 (designating 25% of shares of Annex 1 enterprises as preferred and non-voting); id. art. 5(a) (assigning 38% of the remaining shares of Annex 1 enterprises to the federal government); id. art. 4(a) (creating the state enterprise Rosneft to manage the shares of Annex 1 enterprises assigned to federal ownership).

26. See id. art. 2 (designating 25% of shares of Annex 2 enterprises as preferred and non-voting); id. art. 4(b) (assigning 38% of the remaining shares of Annex 2 enterprises to joint-stock companies Langedap-Urai-Kogalymneft (LUK oil), Yukos, and Surgutneftegaz).

27. See id. art. 5(a).

28. See id. art. 5(b)-(c). Foreigners may participate in these tenders up to a level of fifteen percent of ownership. See id.


31. See Profiles of Russian Oil Companies, APS REV. GAS MARKET TRENDS, Sept. 12, 1994, available in LEXIS, Nexis Library, ARCNWS File. The four new integrated companies were Slavneft, East Oil, Sidanko, and Tyumen. See id. The three conglomerates, as listed su-
April 1995 aimed at completing privatization in the oil industry was followed by a “bitter and apparently intractable struggle for control of the country’s best producers and refineries.” New integrated companies fought with the existing conglomerates over the remaining Rosneft structure, and Rosneft was eventually reduced to one production association and some refineries. As a result of its dissolution, Rosneft’s role in Russian oil policy has diminished. Russia’s oil production sector now includes twenty-one Russian companies as well as joint ventures with foreign participants. Among the Russian companies are those resulting from Decree No. 1403 and the subsequent dissolution of Rosneft, and also a few which arose separately in oil-rich regions of the Russian Federation. Two companies in this latter group are sizeable: Tatneft of the Republic of Tatarstan and Bashneft of the Republic of Bashkortostan together account for about fourteen percent of Russian oil production. Joint ventures in Russia account for about ten percent of production and

32. See Alexander Gordeyev, President Announces Shake-Up of Oil Industry, MOSCOW TIMES, Apr. 5, 1996.
34. See Russia’s Integrated Oil Companies Profiled, OIL & GAS J., Sept. 9, 1996, at 29. Some of these conversions were effected under a “shares-for-loans” scheme, in which shares were transferred in trust to investors in exchange for loans. See Russian State to Hold on Longer to Oil Firm Stakes, REUTERS FIN. SERV., Dec. 3, 1996, available in LEXIS, Nexis Library, CURNWS File (citing efforts of Russian government to retain these shares for two more years). See Russia’s Top Ten Companies, MOSCOW NEWS, Sept. 12, 1996.
35. Rosneft was left with relatively mundane tasks in Russian oil policy such as coordinating scientific research among the various bureaus under its authority. See Political Interests Clash over Energy “Plums”, CURRENT DIGEST OF THE POST-SOVIET PRESS, Sept. 27, 1995, at 10. Rosneft remains, however, the only company authorized to sell the state’s oil share derived from production-sharing agreements. On production-sharing agreements in Russia, see Mark Stoleson, Investment at an Impasse: Russia’s Production-Sharing Agreement Law and the Continuing Barriers to Petroleum Investment in Russia, 7 DUKE J. COMP. & INT’L L. 675 (1997).
37. Tatneft produced about 502,500 barrels per day and Bashneft produced about 360,900 barrels per day in July 1996. That year Russian production was 6.2 million barrels per day. The other three companies outside the former Rosneft system are Rostoprom, Ingushneftegazkhimprom, and Aztimirneftegazazovodka, none of which produce more than 13,000 barrels per day. See The CIS—The Russian Oil Producers, APS REV. GAS MARKET TRENDS, Aug. 12, 1996, available in LEXIS, Nexis Library, CURNWS File. Tatneft, which has the greatest number of oil production wells (20,700) of all the Russian oil companies, is 46% held by the Republic of Tatarstan and 42% by its employees. Its production levels rank it 11th among non-state oil companies, between the U.S. companies Amoco and Conoco. See Unknown Russian Giant, ENERGY ECONOMIST, Dec. 1996, available in LEXIS, Nexis Library, CURNWS File.
about twenty-two percent of exports. Rosneft’s share of production has been reduced to about four percent, and the remainder of Russian oil production is distributed fairly evenly among the major privatized conglomerates—each of the top six of those companies was producing more than six percent of Russia’s oil by the end of 1995, and no company controlled more than one fifth of the industry.

B. The Transneft Monolith

While the production side of the oil industry has undergone a dramatic break-up, the pipelines have remained united within a monolithic bureaucracy. Prior to Russian independence in 1991, pipelines were under the authority of Glavtransneft, a state enterprise within the Ministry of Oil and Gas. Under this system, the pipeline operator Glavtransneft acted as an exclusive private carrier, buying oil from producers and selling oil to refineries and state-owned exporters, all at prices fixed by the state planning agency. The individual oil pipeline enterprises within Glavtransneft were given shipment quotas which had to be met under threat of penalty.

Post-Soviet regulation of Russian oil pipelines began with a short-lived attempt at market liberalization. In early 1992, one month after Russia declared independence, the oil transport enterprises within Glavtransneft ceased operating as a private carrier and began charging rates for the shipment of oil. A series of problems ensued. First, uncertainty arose over the evolution of oil ownership

38. See The CIS—The Russian Oil Producers, APS REV. GAS MARKET TRENDS, Aug. 12, 1996; see also USITC Report, supra note 1, App. E (listing 56 U.S. energy-industry ventures in the former Soviet Union).

39. Production shares in 1995 were Rosneft (255,000 barrels per day), LUKoil (1,110,000), Yukos (707,000), Surgutneftegaz (667,000), Sidanco (453,000), Tyumen Oil Co. (451,000), and Sibneft (407,000). See Russian Petroleum Industry; Industry Overview, WORLD OIL, Aug. 1996, at 75.

40. Under a private carrier system, the pipeline operator buys and sells the oil it ships, negotiating each purchase and sale separately with the producer on one end and the refinery or other consumer on the other. This arrangement can be distinguished from a “fee-for-service” system, where the pipeline ships the oil for a fixed fee, and the producer negotiates with the refinery or other consumer for the sale of the product.

41. See V.D. Chernyaev, Pipeline Transport in Russia and Other CIS Countries, Address Before the Int’l Energy Conference on Natural Resource Management: Crude Oil Sector, Moscow (Nov. 23, 1992), reprinted in INT’L ENERGY CONF. ON NAT. RESOURCE MGMT.: CRUDE OIL SECTOR, MOSCOW, NOVEMBER 23-25, 1992 (Organization for Econ. Cooperation & Dev. 1993) at 216 (hereinafter Moscow Crude Oil Sector Conference). Chernyaev spoke as Vice President of Rosneftegaz and General Director of Glavtransneft.

42. See Eldridge, supra note 6, at 5.

43. See Chernyaev, supra note 41, at 215-16; see also Eldridge, supra note 6, at 8.
from producer to end user.\textsuperscript{44} Second, the fact that the oil supplies were still state-owned at the time meant that a flexible fee-for-service system\textsuperscript{45} did not develop.\textsuperscript{46} Third, Transneft’s continued monopoly over pipelines meant that the pipeline operators were “really not interested in improvements of the quality structure of supplies and in increasing their stability.”\textsuperscript{47}

These problems led to the reintroduction of tight state control of pipelines and a strict system of shipping licenses and quotas. This was accomplished through Decree No. 1403, which began the breakup of the oil producers.\textsuperscript{48} However, while the oil producers were largely placed in private hands, the decree granted controlling shares of the pipeline enterprises responsible for shipping oil and oil products to the new holding company Transneft.\textsuperscript{49} Transneft remains entirely federally owned in accordance with previous legislation prohibiting private control of oil pipelines.\textsuperscript{50}

This assertion of state control through a holding company is an approach common in a number of other states.\textsuperscript{51} In Russia, state ownership of Transneft was motivated by political as well as economic reasons, resulting from a compromise during the political struggle that followed Russian independence.\textsuperscript{52} While reformers pushed for restructuring and downsizing, reactionaries, represented by managers and bureaucrats within the ex-Soviet industrial sector,

\begin{footnotesize}
\begin{enumerate}
\item The appearance of local commodity exchanges throughout Russia gave rise to the presumption that non-state organizations were allowed to buy, sell, and transfer crude oil, but whether the production organization held title until the oil reached the refineries or exporter, or whether Transneft held title at some interim stage, was not consistently resolved. See Gochenour, supra note 18, at 708.
\item For a description of a fee-for-service system, see supra note 40.
\item See Chernyaev, supra note 41, at 218.
\item Id.
\item See supra notes 23-28.
\item See Decree No. 1403, supra note 23, art. 4(c) (assigning 51\% of the shares of Annex 3 enterprises to the joint-stock company Transneft “with the preservation of company shares in Federal ownership.”). A separate joint company, Transnefteprodukt, was created from the pipeline enterprises responsible for shipping oil products. See id.
\item See id.
\item See generally Ajali Kumar, State Holding Companies and Public Enterprises in Transition (1993) (reviewing state holding company structures in Europe, Africa, and Asia, with case studies of Italy, Egypt, Algeria, and Eastern Europe).
\item See generally William G. Frenkel, Commercial Law of Russia § III.E(1) (1996) (examining Decree No. 1392, “On Measures Aimed at the Implementation of Industrial Policy in the Course of Privatization of State Enterprises,” issued November 16, 1992 [one day before Decree No. 1403, the decree transforming the oil industry] as a point of departure for the “important question of how the Russian government intends to reorganize the colossal state industrial sector and to deal with the all-powerful lobby of Russian industrialists.”).
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held fast to vestiges of central planning and control. In particular, they argued that state industrial programs of "national economic significance" should not be disrupted. These arguments were adopted by several opposition parties in the heady days of 1992, resulting in exceptions to the aggressive privatization programs and compromises such as the creation of Transneft.

The continued government control of the monolithic pipelines thus stands in stark contrast to the break-up of the oil producers. The privatization of oil producers means that Transneft, an ex-Soviet bureaucratic holdover, is faced with the basic regulatory issues concerning oil pipelines in a market economy. Those issues include setting rates for the transport of oil, establishing a system of access to the pipeline network, and managing repairs and rights to construct new pipeline. Approaches to these regulatory issues vary widely in market economies. In the United States, a country similar to Russia as a federation in which domestic oil has historically played a key economic role, private pipeline operators are tightly regulated and subject to a "common carrier" requirement, mandating that pipelines accept all reasonable demands for shipment on a non-discriminatory basis. Pipeline operators in the United States are allowed to vary shipment rates charged within a limited range based on previous costs and specified economic indices. Oil pipeline regulation within Western Europe varies broadly from Italy, where pipelines are operated primarily by a state-owned company with no controlling legislation, to Britain and France, where government agencies exert heavy influence over operation of their domestic oil pipelines.

Only scant information is available on the inner workings of

53. See id. §§ III.E(1)-(2).
54. See id. §§ III.E(2)-(3).
57. See Gert Pansegrau, Regulatory Structure of Oil Pipelines in Europe, A address Before the Moscow Crude Oil Sector Conference, supra note 41, at 197-202.
Russian pipeline policy, but it appears that a chaotic battle for power and rents is underway. The opaqueness of Transneft's operations and decision-making processes is exacerbated by its exemption from the restrictions and regulations, such as quarterly reporting requirements, binding on other state holding companies. Despite the series of policy changes to be described below, Transneft's operations have continued to engender complaints of discriminatory and unreasonable charges for shipping oil, and of unfair systems of allocating access to the network. Furthermore, because the pipelines themselves are owned by the joint-stock companies within Transneft, while revenue is collected by the umbrella organization, very little of the transport fees are re-invested in the system. The political environment in which oil transport decisions are made is suggested by a report that Transneft contributed $100,000 to Boris Yeltsin's 1996 presidential campaign.

A major battle for power has developed between Transneft and the rest of the federal government during attempts to manage the larger economy. In mid-1994, President Yeltsin responded to pressure from the International Monetary Fund to liberalize trade in oil by abolishing the system of strict licenses and quotas for oil pipeline shipments established in 1992. This, however, produced a system which "effectively [gave] . . . Transneft absolute power over who exports what." The new system was delayed from going into effect un-

59. See, e.g., Jane Upton, Transneft Sees Quality Bank for Exports in Months, PLATT'S OILGRAM NEWS, Oct. 12, 1995, available in LEXIS, Nexis Library, CURNWS File (quoting the manager of a joint-venture alleging that only foreign producers are paying the tariffs on some pipeline routes, and that the foreign producers are having to pay more as a result).
60. See, e.g., Breaking the Ice: Producers Look Back to the Arctic for a Possible Alternative to Transneft's Pipelines, RUSSIAN PETROLEUM INV., June/July 1996, at 29 (citing "[t]he steadily increasing cost of transporting oil through Russia's westbound pipelines, combined with the growing number of spills and leaks from Transneft's infrastructure.").
61. See, e.g., Lynneley Browning, Russia Crowds Oil Ventures out of Export Pipeline, Reuters Financial Service, Dec. 11, 1996, available in LEXIS, Nexis Library, CURNWS File (quoting a Western analyst as saying that "[a]ccess to Transneft pipelines is based on personal relationships with the Transneft people."); Russian Pipeline Won't Export Oil from J-Ventures, PLATT'S OILGRAM NEWS, June 9, 1993, at 1, available in LEXIS, Nexis Library, ARCNWS File.
62. See Russian Pipeline Won't Export Oil From J-Ventures, supra note 61, at 2.
64. Brian Killen, Russian Oil Exporters Ready for Pipeline Battle, REUTER EUR. BUS. REP., June 12, 1994, available in LEXIS, Nexis Library, ARCNWS File.
til January 1995, and efforts by the Russian government soon followed to rein in the liberated Transneft and keep domestic oil supplies and oil exports flowing. For example, a Federal Energy Commission was established to regulate access to the Russian oil pipeline system and ensure continuing priority for the fuel needs of the federal government. Yeltsin then proclaimed that all enterprises engaged in the transportation of oil and oil products along main pipelines were a “natural monopoly” subject to a regulatory system to be defined by the federal government. In mid-1995, the Minister of Fuel and Energy, to which Transneft had always been subordinate in name, was directed to conclude contracts between oil producers and Transneft, and exporting oil producers were granted the right to transfer their access rights to the oil pipeline network. In November 1995, Yeltsin announced an indexed rate-making system for oil transport tariffs, whereby the average monthly growth in the tariff price index would be limited by the growth in the general index for industrial products. Nevertheless, shipment rates have continued to climb.

The failed efforts to rein in shipment rates have been matched by an inequitable system of allocating access to the pipelines. In an apparent effort to mollify fears that Transneft would play favorites among the major producers, an interdepartmental government commission was established in 1995 to manage access to the system. The

67. See Some Measures for the State Regulation of Natural Monopolies in the Russian Federation, RF Presidential Edict No. 220, Feb. 28, 1995, available in WESTLAW, 1995 WL 157133 (defining natural monopolies as organizations producing and selling goods for which demand was satisfied in the absence of competition due to specifics of technology or the impossibility of replacement by other goods).
72. See supra note 61.
committee for regulating export access was to include representatives from the Fuel and Energy Ministry, the Ministry of Economics, and the Foreign Trade Ministry. However, at the same time, the Russian Fuel and Energy Ministry announced that shipment of oil through the major export lines would be formally "coordinated" by a handful of the major Russian oil producers in cooperation with both Transneft and the Ministry itself. This new arrangement gave an advantage to the major Russian oil producers, since other producers desiring to export would now have to negotiate export terms through the majors.

The Russian oil transport sector now includes an array of actors, including the privatized oil production companies, Transneft, the Ministry of Fuel and Energy, the Federal Energy Commission, and the interdepartmental commissions. Transneft is wholly owned by the federal government, but in practice it has flouted laws and implemented self-serving policies. If "public" and "private" labels are used, Transneft may be thought of as "quasi-public," charged with the public mission of regulating pipeline operation, but in fact more concerned with retaining the status it enjoyed under Soviet rule. The final director of Glavtransneft, who now serves as president of Transneft, described the inherent political position of Transneft in 1992:

Transneft will be able to become a purely transportation company only in some sufficiently distant future when oil prices become really stable, supplies of petroleum products are highly organized and refineries have stable ties with oil suppliers. But until then, the pipeline transportation facilities in Russia and in the CIS countries will be looking for their own way of survival in the process of changeover to a real market environment.

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78. Cherynyaev, supra note 41, at 219.
Transneft’s current monopoly control means that it will play a central role in Russian pipeline policy. However, it will more likely be an obstacle which other industry actors must accommodate than an initiator of progressive policies.

C. Breaking the Bottleneck on Russian Oil Exports

It is in Russia’s interest to accelerate repair and construction projects for oil export pipelines. The drastic decrease in domestic consumption of fuel in Russia has depressed the domestic price of oil after the Soviet collapse. Reduced domestic demand increases the incentive to export oil, but the export demand has shifted away from Eastern Europe, the main recipient of Russian oil in the Soviet era. This has put more pressure on the export lines leading to seaports. Meanwhile, the disastrous post-Soviet collapse in oil production appears to have bottomed out, and increases in production are forecast. Increased oil export capacity would bring in more hard currency, boosting Russia’s current programs for rebuilding infrastructure with oil export revenues.

Given the current desperate condition of the Russian economy, a massive infusion of foreign investment will be required to expand the pipeline network. However, while Russian legislation ostensibly encourages foreign investment, ambitious Western profit-seekers

79. Russian consumption of oil fell from 6.5 million barrels per day in 1987 to 2.9 million barrels per day in 1994. See Godley Statement, supra note 2, at 20.
80. See supra note 12.
82. See Russia Spearheads Small Upturn, WORLD OIL, Aug. 1996, at 75.
83. Russia currently relies on oil export revenues to support its “federal programs,” in which specific export quantities are authorized on the understanding that part of the hard currency profit will finance state investment programs. See Lynnley Browning, Russian Oil Firms Fight Traders for Export Market, REUTERS FIN. SERV., Jan. 28, 1997, available in LEXIS, Nexis Library, CURNWS File.
84. See supra note 18.
85. Foreign investors enjoy the right to own shares in joint ventures, found fully foreign-owned enterprises, acquire buildings and other property, and acquire the right to use land and other natural resources. See RSFSR Foreign Investments Act, July 4, 1991, art. 3, available in WESTLAW, 1991 WL 496569; see also Investment Activity in the RSFSR Act, June 26, 1991, art. 7(1), available in WESTLAW, 1991 WL 496608 (stating that investors have full rights to choose partners and define obligations and conditions of business relations). Foreign enterprises may also buy shares sold in state privatization programs. See Statute of Investment Tenders in the Sale of Blocks of Shares of Joint-Stock Companies Founded by Way of Privatization of State and Municipal Enterprises, RF State Committee for Management of State Properties
have been met by significant practical impediments. Initial optimism has given way to skepticism,\(^\text{87}\) due to “a steady progression of stiffer and stiffer terms and conditions . . . on potential foreign investors.”\(^\text{88}\) Resistance to foreigners is so pronounced that one observer even argues that the privatization program “has survived politically precisely because foreign investment has not played a large role in the process.”\(^\text{89}\)

These obstacles to foreign involvement may stem from different cultural values and commercial structures. For instance, different perceptions of egalitarianism and meritocracy\(^\text{90}\) might create different reactions to such practices as rewarding partners equally for contributions of time and energy. Western investors may also be surprised by the relationship between Russian enterprises and their surrounding community. The domestic oil production enterprises, for instance, “have a broad range of social responsibilities, such as building hospitals and schools and are, in many cases, very important to the social and economic well-being of the regions in which they operate.”\(^\text{91}\) The expectation to provide these services may be even higher after the demise of state services since the collapse of Soviet power.

\(^{86}\) See, e.g., Paul Lawrence & Charalambos Vlachoutsicos, Joint Ventures in Russia: Put the Locals in Charge, HARV. BUS. REV., Jan.-Feb. 1993, at 44.

\(^{87}\) The U.S. International Trade Commission reported that the heyday of excitement about quickly rebuilding Russia is over, that “Russians have been inundated by teams of Western investors who express great interest in participating in projects but ultimately do not proceed beyond the discussion stage,” and that fostering credibility now requires significant familiarity with the evolving Russian business environment and its differences from the West. See USITC Report, supra note 1, at 3-8; see also Eldridge, supra note 6, at 10-11 (citing “literally hundreds of Western companies [that] rushed to the main energy players among the CIS republics,” only to find “a legal vacuum frustrating all areas of commerce, including the energy industry.”).

\(^{88}\) Gochenour, supra note 18, at 711.

\(^{89}\) Schneider, supra note 17, at 697.

\(^{90}\) “[T]he Russian people genuinely distrust the economic differentiation of individuals by their skills or efforts. They fear and distrust someone who has ‘made it’ and become rich because of his personal will, hard work, or exceptional talent and skill.” Gochenour, supra note 18, at 709.

\(^{91}\) USITC Report, supra note 1, at 2-3 (citing a U.S. Department of State telegram of April 22, 1993).
However, a shared revenue arrangement is not new to the global oil industry; revenues in other countries have been directed back to local communities through direct agreement or by “earmark[ing] a significant part of the tax revenues to the local community by law.”

Russia thus faces the policy challenge of fashioning a stable environment for foreign investment in pipeline construction despite general resistance to foreigners and despite the intransigent Transneft monopoly that resists any effort to bypass its network. It is doubtful that any stable environment can be created if Transneft retains its current bureaucratic monopoly over pipeline policy. Despite recent musings over its privatization, Transneft remains one of “the most immovable and impenetrable of Russian enterprises.” Moreover, a mere partial privatization of the Transneft monopoly will not bring clarity to the confused policies currently plaguing Russia’s distorted oil markets. Breaking Transneft apart and privatizing it would only create more monopolies on smaller scales; each segment of the existing pipeline network would serve as its own bottleneck to export growth. Creating entities with the mere right to pursue pipeline expansion is not enough to foster pipeline construction if the risks attached are too high for investment. Increased exports through expansion of the network requires a stable environment for the large-scale introduction of foreign capital.

There has been one recent example of successful foreign involvement in the construction of a pipeline across Russian territory. After four years of negotiations, a settlement appears to have been reached on the Caspian Pipeline Consortium project to build a pipeline from northwest Kazakhstan to the Russian Black Sea port of...

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93. See Producers Look Back to the Arctic for a Possible Alternative to Transneft’s Pipelines, Russian Petroleum Inv., June/July 1996, at 29-30.

94. There have been recent indications of a restructuring of Transneft ownership. One task of a commission established in March 1996 was to develop privatization programs for the remaining monopolies within the energy sector, including Transneft. See Russian Energy Commission Emerges With Unclear Role, East Eu. Energy Rep., Apr. 1996, available in Lexis, Nexis Library, CURNWS File.


96. Foreign oil companies have also had limited success in constructing distribution lines connecting production fields to the main network, including the well-known “Polar Lights” project between Conoco and the Russian geology enterprise Arkhangelskgeologia. See Nican-...
Novorossiisk to export from the Kazak Tengiz oil field. The pipeline is to be owned by a consortium of governments and private companies, with Transneft ultimately operating the line. All obstacles to the construction of the pipeline, including demands for an equity share by Transneft, appear to have finally been removed. The construction of the pipeline will set a new precedent for foreign investment in and ownership of an oil export line on Russian territory.

The Caspian Pipeline Project demonstrates that creating a stable investment environment for the infusion of foreign capital will require an aggressive and unequivocal commitment backed by the full faith of the Russian government. That project was concluded only after extensive negotiations between governments and major oil companies. Moreover, U.S. oil companies had already invested heavily in the Tengiz field and desperately needed a route to export. Boosting Russian oil exports, in contrast, will require coordination with a panoply of Russian oil producers, most of whom lack experience with free market economics. The industry may be poised to respond to market forces, but the supply channels, the pipelines, need to be freed from the quagmire of the Transneft bureaucracy and the various other federal entities.

A commitment to progressive pipeline policy will require a comprehensive and credible system of pipeline management. Investors will stay away until a stable and transparent agreement establishes who will set shipment rates, allocate access to the network, and assure a return on the investment necessary for expanding the network. This will require at least a partial purging or reorganization of the Transneft bureaucracy. At the same time, a wholesale dissolution of the Transneft organization is not necessary or even advisable. Transneft employees have the greatest familiarity with pipeline condition and maintenance history, and it would be politically disastrous to dissolve the organization without a compensatory plan. Rather than dissolve Transneft, its capacities should be utilized while ad-

97. See Arthur Gottschalk, Pipeline Deal Nears Completion; Caspian Venture Took Four Years to Develop, J. COM., Feb. 19, 1997, at 1A.
98. The shares of the Caspian Pipeline Consortium will be divided between Russia (24%), Kazakhstan (19%), Chevron (15%), LUKoil, (12.5%), Rosneft (7.5%), Mobil (7.5%), Oman (7%), Agip (2%), British Gas (2%), Kazakh Munigas (1.75%), and Oryx Energy Company (1.75%). See id.
dressing its legitimate interests. Those interests include maintaining the long-term employment of its workers and managers and giving them a stake in the potentially highly profitable enterprise of oil shipment. Whether Transneft is privatized or not, a shift in power is required without destabilizing Transneft’s current operation of the pipelines.

A proposal for reorganizing the Russian oil transport industry is offered in Part IV. But first, a further concern merits discussion. The reorganization of the industry can naturally best be accomplished through a segmented geographic approach, deciding which major oil export lines will best serve each region of oil fields. Indeed, several of the oil producers are regionally based or are even owned by one of the republics, and even for geographically distributed companies, the nature of the industry dictates a division of operations along regional lines. However, if pipeline expansion is approached on the scale of the federal sub-units, republics may be tempted to initiate their own pipeline construction projects and export their oil directly, paying no heed to the Moscow government. At a minimum, republics will demand a stake in the venture and rents from the oil produced from their soil. Thus, expanding the pipeline network requires a transparent policy not only for the relationship among the federal government entities, the oil producers, and foreign investors, but also for the relationship between those groups and the republics. The prospects for regulating an industry as tied to the land as the oil industry within the newly constituted Russian Federation are discussed in Part III.

III. OIL TRANSPORT AND RUSSIAN FEDERALISM

Although the role of the republics is not addressed in the federal legislation that transformed the oil industry, oil transport is inherently prone to incite territorial battles over control and tax benefits. The post-Soviet struggle for authority between the federal government and the regional governing bodies was particularly tense in the petroleum industry. As the Soviet Union began to crumble, the Tyumen oblast demanded thirty percent of its oil and gas reserves. In the following year, the republic of Tatarstan threatened to cut off its oil output unless prices were raised, and the autonomous region

101. A settlement was ultimately reached at ten percent, with an indeterminate agreement to divide control over the development of the resources between Rosneftegaz and the local producing associations. See Order of the President of the Russian Federation, On the Development of the Tyumen Region, Ross. Gazeta, No. 198, Sept. 24, 1991.

102. See Tatarstan Wants Higher Prices to Hold Output, Platt’s Oilgram News, Sept. 18,
of Khabarovsk granted an exclusive exploration project for the continental shelf off the Sea of Okhotsck to a Western company.\textsuperscript{103} The conversion of oil production enterprises outlined in Part II above, through Decree No. 1403, has been shackled by ownership disputes between the federal government and petroleum-rich republics, including Chechnya, Bashkortostan, Komi, Tatarstan, and Sakha.\textsuperscript{104}

Legal issues relevant to governing oil transport within the Russian Federation are discussed below. Section A examines the relationship between Moscow and the republics as established in the 1993 Russian Constitution. Part B describes issues of oil transport likely to arise within a federal structure, as well as their resolution within the federal structure of the United States. Part C then discusses the limited applicability of Western models of federalism in light of the historically weak role of law in Russia.

A. The Role of Republics in the New Russian Federalism

The 1993 Russian Constitution provides for a separation of powers by enumerating certain powers of the federal government\textsuperscript{105} and leaving any residual powers to the member republics.\textsuperscript{106} Enumerated powers fall into two categories: those within exclusive federal authority and those within joint federal-republic authority, analogous to the German constitutional arrangement.\textsuperscript{107} Article 71 of the Russian Constitution lists authority falling exclusively within federal jurisdiction. Those appearing relevant to oil transport include “economic, ecological, and cultural policy”; “foreign exchange, customs control, and providing for a single market”; “federal transport, railways, and communication”; and “external economic relations.”\textsuperscript{108} Article 72, listing areas of joint federal-republic authority, is similarly

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\textsuperscript{103} The grant was immediately followed by a claim from the government of the province of Sakhalin that it holds those rights, along with the claim from the government of the Russian Federation that such an argument is moot since all offshore resources are within the sphere of control of federal authorities. See Gochenour, supra note 18, at 708.


\textsuperscript{105} Konst. RF art. 11(3) (1993) (the “[j]urisdiction and powers between . . . the Russian Federation and . . . the members of the Russian Federation shall be delineated by this Constitution, the Federation Treaty and other treaties on the delineation of jurisdiction and powers.”).

\textsuperscript{106} Id. art. 73 (1993) (“outside the limits of authority of the Russian Federation and the powers of the Russian Federation on issues under joint jurisdiction . . . the subjects of the Russian Federation possess full state authority.”).

\textsuperscript{107} See Grundgesetz arts. 70-72 (outlining distinction between exclusive federal jurisdiction and concurrent jurisdiction and appropriate federal and Länder action in latter area).

\textsuperscript{108} Konst. RF art. 71(f), (g), (i), (k) (1993).
broad, if somewhat less ambitious. The provisions it contains relevant to oil transport appear to overlap with the previous list and include “matters related to possession and disposal of natural resources”; “nature management and environmental safety and protection”; “principles of taxation and levies in the Russian Federation”; and “the coordination of the international and external economic relations of the members of the Russian Federation.”

The balance between exclusive federal and joint federal-republic jurisdiction is also addressed by Articles 76 and 77. The first two paragraphs of Article 76 state that (1) federal legislation enacted under Article 71 is effective throughout the Russian Federation and (2) federal legislation enacted under Article 72 is to be followed by the individual republics as they enact corresponding laws. Optimism for such federally-weighted harmony is reflected by Article 77, which states that in matters of joint jurisdiction, the federal and republic governments will “create a single system of executive authority.” It appears that something akin to the German “administrative federalism” was envisioned, but the final two paragraphs of Article 76 reveal the compromise that was made. Those provisions state that while federal law prevails over a contradictory republic law, a republic’s “normative legal act” prevails over contradictory federal law. No guidance is provided for distinguishing a “law” from a “normative legal act.”

Establishing federal-republic divisions through such a vague set of overlapping spheres of jurisdiction sets the stage for a power battle. The undeveloped jurisdictional divisions in the Russian Constitution may tempt republic governments to glean profits through taxes that infringe on federal authority or that injure neighboring republics. In Russia, the current weakness of the federal government and the remoteness and recalcitrance of some of the republics make difficult any harmonization of policy over oil pipelines. Moreover, in the formative years when these jurisdictional battles will be fought, the Russian judiciary may be too inexperienced in applying, or not interested in enforcing, jurisdictional divisions. Even if the judiciary

109. Id. art. 72(1)(c), (e), (l), (n).
112. For instance, the regulation and taxation of oil shipment through a pipeline could fall within Article 71 as part of “economic policy” or “federal transport” but also under Article 72 as relating to “disposal of natural resources” or “protection of the environment.”
113. Nikolai Vedernikov, Justice of the Russian Constitutional Court, lamented in 1994 that
does take an active role in defining Russian federalism, the federal government may be too weak to ensure conformity with the judiciary’s decisions.  

Whether by force or by law, the eventual resolution of jurisdictional battles over oil production, transportation, and export will go far to define the inter-governmental relationships outlined in the 1993 Constitution.

B. Constitutional Federalism and Oil Transport

Because oil exports will offer an opportunity for acquiring badly needed hard currency, one area of likely federal-republic conflict in the Russian oil industry is the authority to tax exports. Any attempt to achieve a transparent policy for the various interest groups discussed in Part II will need to define clearly which government entities have the right to tax oil exports at each stage of storage and shipment. Taxation of exports is one of several areas vaguely assigned to both the federal and republic governments by the 1993 Russian Constitution: the federal government has exclusive authority over “foreign economic relations,” but “coordination of . . . foreign economic relations” of the member republics falls within joint federal-republic authority.

The corresponding provisions in the U.S. Constitution grant primary authority for taxation of exports to the federal government, through the Import-Export clause, with an exception for “what may

there is either an inadequate understanding or a real perversion of fundamentally established legal principles not only in the minds of the current Russian politicians, but also in the minds of some jurists. One cannot help but be perplexed, to put it mildly, by the appearance of jurists in our midst seriously discussing the priority of certain principles of law over the written law or even the unconstitutionality of the Constitution itself. Nikolai T. Vedernikov & O.N. Vedernikova, Problems of Constitutional Jurisprudence and the Formulation of a “Rule of Law” State in Russia, 38 St. Louis U. Int’l L.J. 907, 908 (1994).

114. The most widely reported weakness of the federal government has been its inability to collect federal taxes. See, e.g., Michael R. Gordon, On the Road to Capitalism, Tax Breakdown for Russia, N.Y. Times, Feb. 19, 1997, at A6.

Of course, this discussion may misleadingly imply an alliance of interests between the federal executive and the Constitutional Court. In fact, differences in 1993 led Boris Yeltsin to suspend the Court itself. See On the Constitutional Court of the Russian Federation, Presidential Decree No. 1612, 7 Oct. 1993. Under the subsequent 1993 Constitution, the executive appears to have ample powers to decide any differences in favor of the federation, see, e.g., Konst. RF art. 85(1) (1993) (granting President broad powers to “use conciliatory procedures” to resolve disputes between federal and state entities); id. art. 85(2) (granting President broad power to suspend acts of executive authority of republics), but in practice non-subservience by many republics could stretch federal resources, political and material, too thin.

115. Konst. RF art. 71(k).

116. Id. art. 72(1)(n).
be absolutely necessary for executing [a State's] inspection Laws." 117 The long history of litigation interpreting this clause in the United States anticipates the possible struggle awaiting Russia. Resolving this division of power in the United States has required determining at what point a product in transit “becomes” an import or an export and also determining the reasonableness of a provincial tax itself. 118 U.S. jurisprudence on imports, for example, now indicates that the proper balance is between preventing taxation of goods based on their foreign origin and preventing such goods from attaining preferential treatment by escaping taxes otherwise uniformly applied. 119 The Texas Supreme Court recently applied the federal test for weighing that balance 120 in an oil transit case, allowing an oceanside county in Texas to tax imported oil as it was pumped to a Texas refinery. 121

A separate relevant issue of constitutional federalism is the taxation of goods circulating within a federation, namely the effect of one republic’s policy on other republics. Article 74 of the Russian Constitution prohibits customs frontiers, duties, and other barriers to the free movement of goods within the Russian Federation from being imposed by the republics except to protect nature or culture. This provision is analogous to the “dormant” commerce clause of the U.S.

117. “No State shall, without the Consent of the Congress, lay any Imposts or Duties on Imports or Exports, except what may be absolutely necessary for executing its inspection Laws . . . .” U.S. CONST. art. I, § 10, cl. 2.

118. The U.S. Supreme Court began by establishing the “original package” rule, allowing states to tax imported products only after the product had been removed from its original package or otherwise altered from its original state, and thus lost its “distinctive character as an import.” Brown v. Maryland, 25 U.S. 419, 442 (1827). Oil, which is sometimes fungible and usually not “packaged,” is not a good candidate for such rule. An analogous standard proposed for determining when a product becomes an export is the “final journey” rule, where a product is considered beyond the reach of local taxation once it is “irrevocably committed” for shipment out of the country. See Laurence Tribe, American Constitutional Law, §§ 6-23 at 472 (2d ed. 1988). For discussion of the “final journey” rule as well as the “original package” rule, see L.P. Levasseur, Has the Fifth Circuit Adequately Defined “in Transit”? Tul. L. Rev. 926, 927 (1991).

119. See Michelin Tire Corp. v. Wages, 423 U.S. 276, 289-90 (1976). The particular tax in this case, a tax on imported tires held in inventory in Georgia which were found no longer to be in transit, was held to be constitutional, since it was reasonable and applied uniformly to all goods in the state, regardless of origin. See id. at 302.

120. That three part test demands consideration: (1) that the federal government must “speak with one voice” in its foreign commercial relations, (2) that the taxing power over imports is exclusively in the hands of the federal government, and (3) that any taxes imposed by states should not interfere with the free flow of imported goods among the states. See id. at 285, 286, 288.

Constitution, which, like the Import-Export clause has also produced a multi-part test after extensive adjudication. 122

In the short term, the exception in Article 74 of the Russian Constitution for “protection of nature” appears to allow sufficient pretext for a republic to enact transit barriers by taxing oil shipments. Also, the central government, with its limited resources, may be less inclined to intervene in regulatory battles between republics where it does not have a direct interest in the case. Thus, a possible challenge to coordinating a nationwide effort to expand the pipeline network is the fact that republics may have a relatively free hand to tax oil transported across their territory. A comprehensive policy must include bargaining and settlement among the republics affected by each export line.

It is possible that fostering cooperation between neighboring republics may most easily be accomplished by not imposing heavy controls. Given appropriate conditions, republics might cooperate with each other to reduce transaction costs, attract foreign investors, or even to evade federal authority. Groups of Russian republics could gain regulatory advantages over both the federal government and republics outside of their group by forming cooperative regulatory compacts for coordinating the construction and operation of pipelines. Such an arrangement would be analogous to U.S. interstate banking compacts of the 1980s, when groups of states opened their banking markets to each other, to the exclusion of other states. 123 Indeed, to extend this analogy, oil may be a more important currency than money in some regions of the Russian Federation, such as in the republics of the West Siberian basin. There, the breakup of the Soviet Union reinforced a pre-existing regional alliance, the Siberian Agreement, which aligned regional governments from Altai, Kemerovo, Novosibirsk, Krasnoyarsk, Tomsk, and Tyumen and later expanded to include nineteen republics. 124

122. See Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 274, 286 (1977) (requiring that a tax (1) be imposed on an activity having a substantial nexus with the taxing state, (2) be reasonable and fairly apportioned, (3) be non-discriminatory against interstate commerce, and (4) be fairly related to the services that the taxing state provides).


124. See James Hughes, Regionalism in Russia: The Rise and Fall of Siberian Agreement, 46 Eur.-Asia Stud. 1133, 1134 (1994) (examining Siberian Agreement as example of ex-Soviet governing regional elites responding to political crises with “reinforced local particularism”). The Siberian Agreement was formed in the later Soviet era to coordinate reforms, but the re-
However the federal and republic governments resolve their jurisdictional disputes, an aggressive policy initiative is needed to establish the stability required for foreign investment in pipeline construction. Recent intransigence by Transneft in opposing efforts to develop a pipeline land link that would bypass its controlled network has prompted oil exporters to consider establishing a shipping route through the Arctic ocean. \(^{125}\) The privatization of the oil producers created many market forces, but the oil export market cannot thrive without a coordinated policy fostering the construction of export pipelines.

C. Is Federalism Compatible with Russian Legal Culture?

It is likely that oil transport policy in Russia will vary by region, depending on the quantity and prospects of local oil producers, the local pipeline capacity or access to the main pipelines, the relationship between a given republic and the federal government, and the extent to which a republic government promotes liberal or restrictive policies for its own oil industry. This regional variation will respond to variations in legal culture, and each legal culture will evolve as it assimilates to a market structure. However, there is one widespread attribute of Russian legal culture that must be taken into account.

The preceding discussion of legal relationships in a federation rests on an important assumption for which little evidence currently exists in Russia, namely that the legal constructions comprising the new Russian federalism enjoy any legitimacy within Russian society. Russia suffers from a basic lack of legitimacy conferred on law and legal provisions, stemming from the historical inability of citizens to observe, and to appraise for fairness, the procedures through which authorities have made decisions. This aspect of Russian society caused one reviewer to estimate recently that “voluntary compliance [with the law] on . . . normative bases . . . is, for the foreseeable future, extremely remote.”\(^{126}\) These anti-legalistic roots result not...
merely from three generations of command economy and communist totalitarianism, but also from (1) the historical absence of Roman influence with its accompanying principles of multiple authorities and lines of jurisdiction; (2) a five-century tradition of absolutism; and (3) a historical emphasis on communal ownership of land and animosity toward intrusive government officials. 127

The weak role of law and jurisdictional divisions in Russia will pose difficult problems in any attempt to manage an economy along federal lines, where many matters can fall within the jurisdiction of multiple governing authorities. The economy of the oil industry will inevitably cross many of those jurisdictional lines, and until the newly established governments gain strength and legitimacy, there may exist inextricable limitations on approaching the exploitation of the widespread fields as a “national” problem. The unalterable conditions that have shaped every Russian government over the last millennium include “[t]he vastness of the area to be governed, the existence within that area of a multitude of diverse peoples with different languages and traditions, the very low standards of material and of cultural life,” and susceptibility to invasion from virtually all directions on the compass. 128 If such a segment of the earth’s territory can be governed at all, it begs for authoritarian rule, not for the balanced jurisdictional separation of powers familiar in many Western states.

These impediments to a federal structure founded in the rule of law place even more importance on formulating a transparent policy that accommodates the interests of all concerned parties. The approach of the federal government, which, despite its current weakness, enjoys international legitimacy and maintains the broadest organizational base, will be crucial to any reform. Any initiative to introduce foreign capital for pipeline construction must serve the needs of the republics as well as provide revenue for the federal government. Whether the federal government can pursue such a policy successfully will be a litmus test of the future of Russian federalism.

IV. THE FUTURE OF RUSSIA’S PIPELINE POLICY

The end of the Cold War ushered in high hopes of a new global energy regime. 129 For example, the 1991 European Energy Charter,

127. See id. at 3-8.
129. Edward L. Morse, former U.S. Deputy Assistant Secretary of State for International Energy Policy, stated that we were “at the start of the emergence of a more rational global regime governing oil and gas investments and trade that will make the system of rules, regu-
ultimately leading to the European Energy Treaty, aspired to create an international framework for energy investment and an increase in oil production in the former Soviet Union. The project was part of a growing vision of Eurasian oil relieving the West from its economic dependence on the Middle East. The countries of the former Soviet Union also recognized the need for a coordinated transportation and maintenance regime after gaining independence.

The transformation envisioned would require, of course, not only international optimism but also a patient rethinking of patterns of commerce to allow market mechanisms to function in a way compatible with local norms. In the Russian oil sector, both the truncated public sector and the emerging private sector contain visionary reformers and entrenched interest groups. As Russia moves towards a liberal market economy, any attempt to implement regulatory models must be amended by considering these factors. Progress in the oil industry requires that the efficient production and circulation of oil, through expansion of the pipeline network and equitable policies of setting shipment rates and allocating access to pipelines, consider each party’s interests. To achieve this goal, the federal government should implement a pipeline expansion policy not through a heavy-handed policy but by establishing clear relationships with all interested parties.

130. The European Energy Charter was not designed to be binding but was regarded as nevertheless useful by the Director of the International Institute for Energy Law “by virtue of its summary of basic principles governing international investment, trade, and transportation in energy.” Dr. Peter Cameron, Creating a Legal Framework for Investment in the Commonwealth of Independent States Energy Sector: Lessons from the Energy Charter Experiment, 1 Tulsa J. Comp. & Int’l L. 233, 235 (1994). The European Energy Charter project was launched at a 1990 European Union meeting, envisioning an exchange of Western technology and capital to help develop petroleum supplies which would allow European consumption to be less dependent on OPEC-controlled sources. See id. at 243.

131. “[U]nharnessed by Western investments, Soviet oil and gas resources could make Europe virtually self-sufficient. That would spell an end to the region’s dependence on imports from the Middle East and could marginalize OPEC’s role.” Morse, supra note 129, at 489.

132. Summits in 1992 and 1993 resulted in an agreement between Transneft and its Ukrainian, Belarussian, Latvian, and Lithuanian counterparts to authorize Transneft to propose such a regime in response to the needs of oil producers. See Elena Kirillova, Rights of Transit and Intervention in the Oil and Gas Industry of the Former Soviet Union, 11 J. Energy & Nat. Resources Law 262, 270 (1993). The agreement was then ratified by the Russian Minister for Fuel and Energy. See id. at 271.
A. Lessons from Abroad

A recent strain of academic literature on the role of law and government policy in developing countries is particularly illuminating with respect to Russia. The secret to economic development is no longer thought to reside merely in the proper molding of Western models of liberal government and market-driven commercial relations. Formalism has given way to a new respect for the social channels that have always been the basis for commercial success. The key to economic success, under this analysis, lies in the existence and utilization of “social capital,” or the “networks, norms, and trust, that facilitate coordination and cooperation for mutual benefit.”

This social capital has traditionally resided in strong traditions of civic engagement. Civic engagement builds common ethical norms; “[i]f people who have to work together in an enterprise trust one another because they are all operating under a common set of ethical norms, doing business costs less.”

Unfortunately, among the world’s long-established cultures, the Russian state is arguably the most bankrupt in terms of voluntary trust. The totalitarian government that ruled for most of this century built its legitimacy through fear; truth was anathema to state policy and proclamations. The artificial Soviet societal relations were founded on Stalin’s purges that stifled all public expression and broke the trust of even the marital vow.

Frances Fukayama, in a comparative study of social capital in his recent book Trust, com-

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133. Robert D. Putnam, The Prosperous Community: Social Capital and Public Life, AM. PROSPECT, Spring 1993, 35, at 35. See also FRANCIS FUKAYAMA, TRUST 26 (1996) (“social capital is a capability that arises from the prevalence of trust in a society or in certain parts of it.”).

134. See Putnam, supra note 133, at 37 (identifying this civic engagement historically in “guilds, religious fraternities, and tower societies or self-defense in the medieval communes; cooperatives mutual aid societies, neighborhood associations, and choral societies in the twentieth century”). See also FUKAYAMA, supra note 133, at 25 (“communities depend on trust and will not arise spontaneously without it.”).

135. FUKAYAMA, supra note 133, at 27.

136. Francis Fukayama has commented on the effect of this stifling on social and economic transactions:

By the time of Stalin’s consolidations of power in the late 1930s, the Soviet Union exhibited a “missing middle”: the complete dearth of strong, cohesive, or durable intermediate associations. That is, the Soviet state was very powerful, and there were many atomized individuals and families, but in between there were virtually no social groups whatsoever.

FUKAYAMA, supra note 133, at 55.

137. See FRED COLEMAN, THE DECLINE AND FALL OF THE SOVIET EMPIRE 18-19 (“[o]nly in Stalin’s Russia, millions of husbands and wives never talked seriously with each other, so that if one was arrested and tortured, he or she could not incriminate the other.”).
ments that

communism created many habits—excessive dependence on the state, leading to an absence of entrepreneurial energy, an inability to compromise, and a disinclination to cooperate voluntarily in groups like companies or political parties—that have greatly slowed the consolidation of either democracy or a market economy. People in these societies may have given their intellectual assent to the replacement of communism with democracy and capitalism by voting for “democratic” reformers, but they do not have the social habits necessary to make either work.\(^\text{138}\)

Russia thus faces an urgent need for reform but lacks the societal institutions for channeling market forces.

If the societal institutions for channeling market forces do not exist, they will have to be created. Filling the vacuum of trust left in the wake of Soviet power will require a careful rethinking of commercial communications and commitments. An approach to this problem may be found by examining the post-World War II “economic miracles” of Southeast Asia. In a recent book analyzing the sources of economic success in eight of those countries, Jose Campus and Hilton Root identified government initiatives that could forge relationships of trust.\(^\text{139}\) At the heart of these initiatives lay a government commitment, to all parties involved in a given industry, that long-term benefits will be shared.\(^\text{140}\) Campus and Root found that the government must concede sufficient policy-making authority to allow the industry actors to settle on a workable policy.\(^\text{141}\) The government must remain committed to that concession and unequivocally adopt the policy agreed upon by affected parties.\(^\text{142}\)

Essential to these policies was the creation of a forum for establishing these long-term economic arrangements and for exchanging the information necessary for making sensible policy. These “deliberation councils” offer a transparent negotiating environment that fosters honest expression of policy proposals.\(^\text{143}\)

\(^{138}\) Fukuyama, supra note 133, at 40.


\(^{140}\) See id. at 29.

\(^{141}\) See id. at 54-56.

\(^{142}\) See id. at 78.

\(^{143}\) See id. at 79-80.
The principal task of a council is to assist the government in formulating policies that would enhance the performance of a particular segment of the private sector . . . . [I]t's cooperative format reduces the cost of obtaining and transmitting information . . . . [I]t provides private sector participants with a transparent forum in which to bargain over the rules that determine how rents are to be allocated . . . . [I]t gives the government a mechanism to instill confidence among investors that policies will not be altered without appropriate consultation and support from the private sector . . . . [P]rivate sector participants gain a forum to express their views about policies . . . .  

Underlying the success of these policies was the perception of economic success as a shared goal. In Southeast Asia, each country's leaders were able to mobilize the population by conveying the importance of economic growth, touting it as even a national security concern.  

By painting economic growth as a broad goal in which all parties could benefit by cooperating towards its achievement, the Southeast Asian leaders were able to encourage settlement at the policy-making negotiating tables. The commitment to shared economic success acts as a surrogate for a legalistic economic framework: "The use of deliberation councils . . . creates . . . a de facto constitutional framework to direct economic decisionmaking . . . ."  

This approach stands in sharp contrast to the zero-sum game among Russian oil producers if Transneft maintains its exclusive control over limited pipeline capacity. The importance of perceiving economic success as a shared goal demonstrates the importance of introducing foreign capital to expand the Russian pipeline network. Only with increased oil exports will revenues be sufficient to provide a satisfactory return to all industry participants.

B. Applying the Lessons Learned Abroad to Russian Oil Pipelines

Without trying to answer whether or not the establishment of deliberation councils can be credited with the success of the Southeast Asian economies, the model derived from those success stories may provide answers to the problems faced by the Russian oil transport industry. A ny successful policy will require communication between the array of parties described in Part II and the republic governments discussed in Part III. Decisions regarding shipment rates,

144. Id.
145. See id. at 5.
146. Id. at 103.
access to pipeline routes, and repair and expansion of pipelines should be made only after receiving and sincerely considering the views of all affected parties. Listening to all affected parties, whether considered to be “private” or “public” interests, would mark a revolution in Russian policy making, by building legitimacy based on something other than fear.\footnote{147} Furthermore, doing so may be able to play off of the Russian tradition of communal culture by allowing affected community organizations to participate in the negotiations.\footnote{148} Oil transport policy would result from all affected parties meeting at one forum characterized by the transparency found to be so successful in Southeast Asia.\footnote{149}

The vastness of the Russian territory and the geographic distribution of oil within it dictate that these negotiating councils be established on a regional basis. Transneft, which has thus far held jealously to its central control, showing no interest in the broader economic goals of the new Russian state,\footnote{150} would likely resist any regional divisions. Dissolving Transneft outright would unnecessarily shred the social fabric in which much of the minimal remaining “social capital” in Russia resides, and would waste an organizational structure that may still be useful in implementing the physical reconstruction of the pipelines. However, some restructuring will be necessary in order to achieve change. Regional divisions already exist among the enterprises owned by Transneft, corresponding to the geographical distribution of oil within Russia. However, the lines as they currently exist were built to serve a centrally planned economy; the new geographical divisions within Transneft should be redrawn to respond to Russia’s privatizing domestic markets and today’s global oil export markets. The restructuring of Transneft must not be equivocal; breaking the intransigence of the ex-Soviet bureaucracy will require a painful decapitation and strict segmenting of Transneft. Once Transneft is restructured, however, new leaders of the regional pipeline authorities must be fully confident of a regional council arrangement for the establishment of new export routes. They must also be ready to make long-term commitments to all parties, including the oil production enterprises, the republic governments, and the citizens of affected republics.

These regional commitments to shared wealth cannot be made

\footnote{147}{See supra notes 136-137.}
\footnote{148}{See supra notes 91-92.}
\footnote{149}{See supra notes 140-145.}
\footnote{150}{See supra Part II.B.}
until the zero-sum game of limited pipeline capacity disappears. The path to offering a chance for all parties to benefit lies in a commitment to rapid expansion of pipeline routes. Increased pipeline capacity will allow credible promises to be made to a divided Transneft that its organizational and pipeline-servicing expertise is needed; this promise will help to convince Transneft that pipeline expansion, which will break their current tight monopoly, is in their interest. Once a reliable, greatly expanded pipeline network is in place, oil production enterprises will enjoy an unimpeded path to sales.

The agreements formed in the regional councils must guarantee rights of access and shipment rates, fix regional and federal taxes, and return benefits to local communities. An equitable balance will be difficult to strike; the regional councils will have to meet regularly to respond to the changing needs of their constituents. By including affected communities and the segmented Transneft bureaucracy in negotiations with the oil producers and the federal and republic governments, a progressive pipeline policy can obtain the confidence of all necessary groups.

C. Conclusion

The rehabilitation of the Russian economy requires hard currency from abroad. Russia’s own oil deposits can attract that hard currency, but only if a new industry organization and new norms of commercial commitment are implemented. The Transneft monopoly is a bottleneck which will only be broken through the expansion of the pipeline network. The need for a reliable link for exporting Russian oil mandates that the Russian government take an aggressive policy toward the repair and expansion of Russia’s oil pipelines.\footnote{See supra Part IV.B.}

In pursuing a policy for modernizing its pipelines, Russia will have to find its own brand of federalism and its own role for federal regulatory agencies. These decisions will reflect Russia’s inexperience with market economics, its legal culture,\footnote{See supra Part III.C.} and the social importance of communal relations there. A pressing concern is how that policy will vary by region and how the republic governments will attempt to exploit their oil deposits or strategic locations along major pipeline routes.\footnote{See supra Part III.B.} The vague enumeration of joint legislative powers in the recently adopted constitution will allow the republics signifi-
cant leeway if no clear initiative is taken in Moscow.\textsuperscript{154}

These considerations are presented in the hope of promoting commercial reform in the Russian oil industry while recognizing and respecting Russia’s legal traditions and recent past. A key element of the proposals offered in this Note is a set of regional deliberation councils where all affected parties can commit to increasing oil export capacity in return for a share of the wealth generated. Essential to this arrangement is the employment of Transneft to operate and maintain the network. Expanding the pipelines will give Transneft an important role and offer a way to engage the local communities of workers in modernizing the Russian economy. The bedrock of such an arrangement is a commitment by the Russian government to provide a transparent decision-making forum where policy can be openly debated and equitably determined. By making a commitment to increased pipeline capacity, the Russian government can make a credible commitment to the republic governments, to domestic oil producers, and to foreign investors that they will benefit from open and active participation the Russian oil industry.

Dylan Cors

\textsuperscript{154} See supra Part III.A.