THE YAMAL GAS PIPELINE. A CASE STUDY IN THE POLITICAL ECONOMY

by

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CHAPTER I

INTRODUCTION

Few people may have anticipated the deep reaching conflict that surrounded the development of the Soviet Urengoi gas fields on the Yamal peninsula in western Siberia in the early 1980s. Conflicts were dominating the agenda internationally, as interests clashed. There was the ally versus ally conflict, the one of multinational corporations against states, their home versus their host government, and problems concerning the East-West relationship.

One of the more recent actors in the international arena is the multinational corporation. After the Second World War, multinationals have gained an important place, not just economically but politically as well. Aided by the technological developments of the time, they have increased in numbers as well as in size. Many multinationals are financially bigger than some of the traditional actors, the nation states, and some even have more people employed than some nations have citizens.

While primarily being an economic entity, multinationals have begun to assume a political role as

well. While it must be the multinational's primary concern to operate profitably, the more traditional unit, the nation state has to be concerned about numerous other issues as well. The security perception has always been a key concern for every nation state, meaning that besides the economical aspects of political decision-making there are others, such as defense, which play important roles.

Often enough the policy areas of economics and security begin to overlap. In the absence of what Hobbes once described as the absolute, omnipotent superpower that could keep all in awe, the international decision-making process has evolved into one of cooperation. This cooperation becomes increasingly important since different beliefs continue to clash, with power as a major variable.

The global development after the Second World War appears to fit this description. On one side there was the United States, perceiving itself to be in conflict with the other power, the recently emerged Soviet Union. This postwar period could be characterized as a renewed attempt at empire building, not in the sense of the nineteenth century imperialists, but rather as the extension through military as well as economic means.

This new methodology of the utilization of economic measures included a number of forms. While the Americans seemed to rely on their economic as well as military power, the Soviets had originally relied primarily on force. Both

super powers relied on their individual strengths. While the Soviets introduced their form of communism on a wider scale, the Americans attempted to widen the system of the free market economy. Again, each was attempting to implement the system that would be more beneficial to its own interests.

It may have been the first genuine effort to search for collective security, or non-military cooperation by economic means. By the implementation of a common system conflict is not eliminated. It may, however, be dealt with through established channels. Thus the case could be argued that economic and political decision making may have the same objectives, prompting the re-emergence of the field of the political economy. It seems as though a separation has occurred in the fields of political science and economics. It is not the argument of this thesis to deny the separate character of the two. It is, however, an attempt to propose that with the help of the rather newly emerged actor, the multinational corporation, the two fields developed a new common ground in the old field of the political economy.

Multinationals play economic as well as political roles, as this study will eventually illustrate. They have become separate entities within their own rights and there is a need to develop theories, especially concerning their rights and privileges.

This case study focuses on East-West relations and an issue in which the combination of the security and economic aspects appears to be difficult to deny--energy policy.

Both of the superpowers are keenly aware of the global energy supplies, which are basically trading goods in the various economic systems, yet highly political as this thesis attempts to indicate. The system of polarization between East and West, that is characteristic of the global political landscape is one in which the dependence of one side on the other seems to be avoided purposely, causing economic losses to both sides.

That there are areas of common interests is evidenced in this study of the energy concern. One participant, the West needs natural resources, which the other, the East, possesses. The East seems to be unable to develop these resources fully, due to its relative lack of know-how and finances, which in turn the West possesses. While it would be economically wise to use this mutual interest despite different political ideologies, the security factor may forbid or inhibit the collaboration efforts.

Those who will suffer in particular from this international problem are the new actors, the multinationals. They could expand and grow, but for political reasons they are prevented from doing so. Due to the combination of the political and economic decision making by the nation states, multinationals, who may enjoy

an economically advantageous position, are consequently disadvantaged in the field of the political economy. An area in which this competing of interests becomes apparent is in natural resources. While needing these resources, states look to their desired security first, unlike the corporations, whose primary objective is an economic one.

When the Soviet Union, the leader of the East, proposed the joint cooperation with the West in the development of its gas resources, the conflict of the different prerogatives of primarily political security policies and the economic policies became apparent. What makes the case of the pipeline from the Yamal peninsula to Western Europe particularly interesting is that the problem is not a new one. Throughout history problems of this kind have occurred and will do so for some time to come, unless there is a consistent body of theory that could be adhered to internationally.

CHAPTER II

THE ECONOMIC HISTORY OF THE PETROCHEMICAL INDUSTRY OF RUSSIA AND THE SOVIET UNION

One of the fields that has been within the merging zone of political economy is the continued search for energy resources. Energy resources such as oil, gas, coal, or wood are natural resources, and have historically been subject to different political as well as economic interests in the world arena.

Petrochemicals as an Energy Resource

With petrochemicals having assumed the role of the primary source of energy in the twentieth century, the search for these natural resources has evolved into one of the most crucial procedures for today's industrialized world. Locations which possess a vast amount of petrochemicals have consequently become the focus of international attention. In the case of Russia, or later the Soviet Union, that premise has not always been applicable: To say the least, the Soviet Union does not

hold superpower status due to its petrochemical resources (Hardt, 1988, p. 3). It is the purpose of this chapter to shed some light on the problems of the Russian-- and later Soviet--oil and gas production, or the lack thereof, by reviewing the history of this industry.

In 1926 Louis Fischer observed that coal had already lost its importance as a major source of energy in an age which he called the "Oil Age." The struggle for coal and iron, which he determined had dominated the First World War, would be replaced by a struggle for petroleum. He projected petroleum to become the single most important source of energy and concluded that the countries owning such a crucial asset would assume critical roles (Fischer, 1926, pp. 244-245).

The Soviet Union in the Energy Market

Today, over sixty years later, Fischer's prognosis is nothing short of being true. Petrochemicals are indeed the major source of energy and the countries producing them have become critical members in the world community due to their possession of these much desired resources. Acronyms such as OPEC (Organization of Petroleum Exporting Countries) have found a place in almost everyone's vocabulary.

Questionable, however, is Fischer's conclusion with respect to the importance of resources in connection with the role of the country possessing them. While he has been

proven correct in the case of the countries in the Persian Gulf area, considerable doubts may be entertained regarding countries outside of this region. While there may be a variety of economic reasons why some of these countries such as Mexico or Venezuela have not attained positions of major importance in today's global society, the question could well be asked why a country like the Soviet Union, a superpower and the world's leading producer of primary energy, is a price-taker and not a price-setter in the international market.

Since the Soviet Union is without doubt one of the most powerful nations in the world, why has it not attained the status of a price-setter in the market of primary energy? It certainly has enough resources to be in a controlling position. John P. Hardt sees this phenomenon as a combination of three major problems. There is the huge domestic consumption, along with the export to the soft currency countries within the Eastern Bloc, which raises little foreign income (Hardt, 1988, p. 5). Another major factor has been the lack of ability to exploit those resources. While they are present, they may be relatively difficult to obtain, because of climate and remote location. Without the know-how or the funds to obtain the technology needed, the potential treasure may be destined to remain untapped.

This problem of low productivity due to a shortage in technology and finances has historically rested at the heart of the Russian as well as Soviet production of oil and gas. With the possible exception of Stalin's autarchic collectivization efforts, it has been mostly through foreign assistance that noticeable progress has occurred.

Early Developments

The first major thrust in the development of the industry came from the outside. At the time of the first major production, Russia was industrially underdeveloped in comparison to other European States. The country was poor and one could argue that the people, mostly peasants, were in no position themselves to change much of that dilemma since the state was too autocratic to allow the people to accumulate any form of wealth that might have enabled them to invest in any form of modernization in their country (Lyashchenko, 1949, p. 427). While this Marxist point of view served as a justification for revolutionary activities, the fact remains that it must have been fairly difficult for the individual to succeed in this environment, making the start of the industrial revolution extremely difficult. This complex situation worsened after the assassination of Alexander II in March of 1881.

Consequently, the gigantic, resource-rich country was crippled through its agrarian poverty, unable to exploit its

own wealth. The apparent shortsightedness of the Tsarist regime did not promote the situation either, as the development of the oil industry was substantially discouraged by the disadvantageous lease system, which had been enforced from 1821 until 1872. In order to explore a natural resource, such as petroleum, one had to lease the land from the government, which had a monopoly on all the land, for the period of one year. Due to the lack of technology, however, drilling was difficult and results often took longer than a year to appear (Hassmann, 1953, p. 22). If an entrepreneur earned nothing, or only limited amounts, from his well, he was either forced to withdraw or utilize his savings. Because of the high levels of taxation by the government, these savings appear to have been rather minute (Rogger, 1983, pp. 77-79).

The results were subsequently meager at best. A total of only 3.74 million rubles was earned in Russia during this period in the sector of the petrochemical production. In Baku, on the Caspian Sea, one of the major areas of oil production, there were seventeen wells and twenty-three refineries after the first gusher in 1872. That year, Tsar Alexander II made a number of changes as he adopted a new method of apportioning the land with the introduction of the auction system. An oil base was sold to the highest bidder in parcels, and not in geological units, as had been recommended earlier. With regard to the small size of the

parcels, those who owned them led the effort vigorously to exploit the land.

This auction system, however, was later modified. In order to achieve higher levels of revenue, the Russian government demanded not only a price for the land but also a portion of the production from the land in the form of a royalty. These royalties inflicted levies upon production which sometimes reached as high as forty percent, causing Russian oil production to fall farther and farther behind that of the United States by the turn of the century, and demonstrating the Government's lack of understanding of the economic requirements of its own oil industry (Hassmann, p. 23). In light of the fact that the Russian Government, through its primary ownership and control of the railroads and other forms of transportation, was a major consumer of petroleum products, its position towards the oil industry became even more disturbing. This system, which lasted from 1896 until 1917, was never repealed by the Tsarist regime.

Foreign Investment and Competition

It was in the early period of the development of energy resources in Russia that the sons of Immanuel Nobel, a Swedish inventor, started the production of oil in the Baku area. Due to a variety of reasons that area was the primary producer of oil in Russia at that time. There was a vast amount of oil below the surface, which made the discovery

and production of the oil much easier. Also, the geographic area was fairly restricted, which promoted the drilling of many gushers. As of 1895, there were as many as forty-two, producing as much as 1,853,000 tons annually, which made it the leading Russian production site (Hassmann, p. 24).

It was in Baku that the Nobel brothers, Robert and Ludwig, acquired Balakhany Field in 1875 and founded the Societé Anonyme d'Exploitation du Naphte Nobel Frères, the joint stock company of the Nobel brothers. Not only were they the brothers of Alfred Nobel, the inventor of dynamite, but they were also first in production due to their innovativeness, as they continously attempted to update their technology, particularly in the area of the transportation of oil and gas. In addition, they sponsored the first Russian tanker, the Zoroaster, in 1877, and they were also responsible for the first pipeline (Tolf, 1976, p. 78).

One of the Nobels' main competitors was the Societé Caspienne et de la Mer Noire, which was sponsored by the Paris bank of the Rothschilds in 1892. It was acquired by Royal Dutch-Shell in 1912, which finally allowed the English to gain a firm entry into the Russian oil market. The leading position of the Nobel brothers, however, was solidified in 1914 when they bought the newly founded Russian General Oil Corporation (RGOC). The RGOC had been founded in 1912 by a group of Russian bankers and

industrialists, backed by a considerable amount of capital, some 123.2 million rubles ($66.5 million). The RGOC was the greatest among the Russian producers. The Nobel concern had capital to the extent of 43.4 million Rubles ($23 million), and Royal Dutch-Shell's capital amounted to 61.7 million Rubles ($33 million) in 1914 (Hassmann, pp. 27-28).

Location

There are two points of importance, however, with respect to these firms. First, all three operated in the Baku area, underscoring the leading position of that region in Russian oil production. Second, all three were started with foreign capital, whether it was the Swedish Nobel organization, which basically relied on French capital, or the English, as the entry of the Shell group would signify.

Baku, up to that point, had emerged as the leader of the production areas. There was more oil being produced in Baku alone than in the other major areas combined. The one field that was second among Russian fields was the oil district of Groznyy, northwest of the city of Groznyy, about 100 miles west from the Caspian Sea. Another field, on the northern slope of the western Caucasus, was not discovered until 1908, upon which a variety of companies, mostly British, settled about 90 miles from the Black Sea. Its production began sluggishly, rose to more than a hundred thousand tons in 1911 and 1912, but sank in importance

during subsequent years. The Emba area on the northern coast of the Caspian Sea was not explored until 1912, after which, however, it started to produce the third largest amount of oil. The Cheleken Island region off the eastern coast of the Caspian Sea reached its limits between 1910 and 1913, when it produced nearly 200 thousand tons of oil.

While all these areas were in the general vicinity of Baku, they remained far behind the output of the Baku oil region. From 1908 until 1916 Baku had produced as much as, or more than, 7,000 tons annually, while the combined result from these other areas was below 2,000 tons every year. Groznyy produced alone above 1,000 tons (Hassmann, p. 25). Despite a reduction in the overall production after 1901, the year that Russia was the world's leading producer of oil, Baku remained synonymous with oil production in Russia (Ebel, 1961, p. 62).

Whether due in part to economic or political necessity, more fields in the Soviet Union were discovered with time. During World War II, fields in the Volga-Urals area were developed owing to the fact that the Germans had occupied most of the western regions. The area had shortly before been discovered, after a decree of the Eighteenth Communist Party Congress in 1939 calling for a new oil base in addition to the Baku region (Ebel, 1961, p. 65).

While natural gas is to be found almost anywhere oil is located, the reason for its slower development has to be

seen in the ignorance concerning its applicability. Only after World War II had there been an increased awareness of the use of gas, which then continued steadily to increase its economic importance (Stern, 1980, p. 21). Without the exploration of the oil industry, however, the progression of the modern energy resources of the Soviet Union, such as gas, seemed only barely feasible.

Today there are several locations where oil and gas can be found within the Soviet Union. The primary locations are stretched across the entire country, making it one of the richest countries in terms of natural resources. Besides the Caspian Sea location around Baku, and the neighboring Ayzerbaijan region, there is the Volga-Urals area already mentioned (Ebel, 1961, pp. 64-65). Other locations in the western part of the Soviet Union include the Ukraine, as well as western Siberia, especially on the Yamburg peninsula, which is the origin of the gas over which the political controversy of this case study arose. Much oil and gas can also be found east of the Urals. The main locations are in Central Asia, Kazakhstan, Uzbekistan and Turkmenistan (Stern, 1980, p. 28).

Production Problems

One of the key problems today, besides the one of the need for foreign investment, is the same as it had been at

the turn of the century. Most of the oil produced in Russia remained there.

Whether as fuel, kerosene, or lubricating oil, as much as 80 percent remained in the country (Blackwell, 1982, p. 52). Apart from domestic consumption, Russian regulations encouraged the retention of oil within the country. In addition, until the development of means of transportation, it was fairly difficult to export the product. Again, the Nobel brothers were leaders in the construction of leak-proof barrels and tanker development, as well as creators of the idea for a pipeline in order to alleviate dependency on the shipping rates within Russia. The pipeline reached from Baku on the Caspian to Batum on the Black Sea and was completed in 1896 at a cost of 20 million rubles.

What remained important in that era was that the producers were private after the introduction of the auction system in 1871. Beginning with the emancipation of the serfs in 1861, Russia attempted to be somewhat more capitalistic with regard to its economic system (Von Laue, 1974, p. 201). The desire was to catch up with the more technologically advanced West, which achieved a leading role through the industrial revolution.

One of the ways in which the Russian state tried to improve its economic position was by foreign borrowing. Capital was necessary in order to advance the economy, which was lagging behind the foreign competition. Domestically,

there was not much capital available, particularly after an irresponsible tax policy which failed to raise enough money for the government to undertake big projects and did not leave enough for private citizens to enable them to take the initiative (Von Laue, 1974, p. 202). The search for capital was subsequently the most important item of the economic strategies after the Crimean War. Count M.K. Reutern, the Minister of Finance under Alexander II, had hoped to create enough capital within Russia's borders to advance the domestic economy. He had to realize, however, that the main problem was the weakness of the Russian currency (Blackwell, p. 31). Without much domestic export production the ruble remained weak, as there was little to offer by the government to back its currency. One of the few items that could have been useful was the natural resource base. These, on the other hand, were difficult to exploit without the necessary capital (Blackwell, p. 29). It seemed that the only method that could lead to any improvement was through the process of obtaining finances abroad. By borrowing abroad, on the other hand, Russia would subject itself to the influence of other countries that were still competitors. It was especially undesirable for Russia to borrow, considering the political influence to which it would subject itself. In order to remain independent, Russia had first to depend on some other country which was willing to lend her the capital to do so (Von Laue, p. 214).

Those, at least, were the sentiments of Sergej Witte when he became Minister of Finance in 1892. Until 1905 matters pertaining to industry and commerce were under the control of this ministry. Witte realized the urgency of an industrialization in Russia. Because of his belief that Russia would only receive new credits with a strong currency, he backed the Russian currency with gold (Witte, 1967, pp. 76-77).

It was his hope to attract more foreign capital through this move--and Russia was in need of capital. If Russia was to compete at all with her European counterparts, technology was needed desperately. The domestic production of technology within Russia was so weak that substantial developments in any industry was unthinkable to be without foreign capital and technology (Blackwell, p. 51). It seemed evident that Russia was still far away from similar achievements such as those of the capitalism of the Western world.

Economic Problems

How far the economy was away from the West emerged clearly as Witte kept his belief in an autocratic form of government, because of his conviction that a responsible, autocratic regime was required in order to ensure success in Russia (Von Laue, p. 211). In his view, the population was not ready for such a development. On the other hand, he

seemed to regard the granting of certain political rights to the people as unavoidable. He realized especially after the disastrous performance of the Russian forces in the Russo-Japanese war that a revolution overwhelmed Russia. Consequently, Tsar Nicholas II decreed in the Manifest of October 1905 the creation of the Duma, the lower house of the parliament, whose membership was elected and without which no laws should be made. Along with other reforms it seemed as though the Russian state would alter its government after all. Witte became the first Prime Minister. The First Duma was dissolved, however, in the same year. Witte, who by no means appeared to be a major supporter of an all-out liberalization effort and who remained loyal to the Tsar, started to fall into disfavor with the ruling family. Witte's view that reforms represented a necessity rather than a choice led to a growing lack of confidence between him and the Tsar. In 1906, Witte asked for and received his relief from his position as Prime Minister. As he put it, "... an interjection of relief was her (the Empress') only comment on the news of my resignation" (Witte, 1967, pp. 360-362).

In terms of capital formation, he appeared, however, to be on the right track. Of all the industries that were in operation after the turn of the century, as many as forty percent were founded after 1891 (Von Laue, p. 208). Another negative effect was the steady increase of the debt, which

amounted to as much as 3.5 billion rubles. With 1 billion of the debt being held abroad, Russia became the largest debtor internationally (Von Laue, p. 203).

Connected with this development was the external pressure on the country. Since foreign assistance was needed, Russia had to be sure not to offend any of her foreign creditors. Most of the capital came out of France, as much as 80 percent of it, while 14 percent originated in England (Feis, 1930, p. 211). Loans from Germany were only used occasionally, due to the reluctant attitude of the German leadership. The problem with respect to these foreign loans was that in time they took on a political character. France and Russia began to side together on international issues, and created a formal alliance, which lasted from 1894 until 1917, leaving the German government with a feeling of growing encirclement. The failing of the continuation of the Dreikaiserbund and of the Rueckversicherungsvertrag were indicative of the worsening of that relationship (Feis, p. 213).

That the Franco-Russian relationship was not very solid either became evident when the Rothschild bankers refused to extend any additional loans to the Russians because of alleged mistreatments of Jews inside Russia. Many of the French also had considerable difficulties with the thought that it was their money that was supporting the autocracy of the Tsar. One of the parties to suffer from

this dispute was the Nobel corporation, as a possible agreement with the Rothschilds failed to materialize and consequently temporarily halted the development of the petrochemical industry (Tolf, p. 92).

All in all, however, the oil and gas industry was doing well at the time. With a steadily increasing demand, the oil companies were able to continue to exploit the treasures of the area near the Caucasus. Along with the exploitation of the earth came an exploitation of the labor force as well (Blackwell, p. 47). The Nobels were, however, among the most progressive capitalists, providing medical insurance for the workers, as well as benefits with regard to the individual workloads. When discussing the capitalistic owners of the oil wells near the Caspian Sea, the Nobels should be mentioned as an exception due to their progressivism regarding their labor force. When the uprisings in 1905 occurred, it seemed as if the Nobels felt they had to pay for the sins of their fellow competitors.

Political Problems and the Revolution

When the First World War began in 1914, Russia was in the process of trying to become competitive with its European counterparts. As time went on, it became obvious that the attempted industrialization remained incomplete. Despite having the resources, Russia did not possess the capital or technology that such a role would demand.

With the outbreak of that war, Russia, since it was in no position to compete with any of the European powers, entered a phase that would alter the course of history. Due to the lack of Russian preparation, the internal economic structure was destined to collapse under the pressures of wartime activities. Production as a whole dropped significantly, which aided the setting of the stage for the revolution.

On December 30, 1916, Rasputin, the colorful adviser of the Empress, was assassinated by Prince Yusupov, triggering a number of upheavals, which culminated in the revolution of March of 1917. A month later, Vladimir Ilyich Ulyanov, better known as Lenin, arrived in Petrograd along with other leaders of the Bolsheviks.

It was the revolution of the Bolsheviks, which in November of the same year introduced the Soviet Union and finished the rule of Alexander Kerenski. In March of 1918, the new leadership came to terms with the German government, signing the treaty of Brest-Litovsk and putting a temporary halt to the fighting on the eastern front. This urgent striving for peace has generally been regarded as disadvantageous to the Soviet Union, as it lost land as well as part of their industrial base primarily in Georgia (Fischer, 1926, p. 23).

The ensuing internal difficulties of the new regime along with the consolidations procedures were substantially

increased by foreign troops. The Germans had to retreat after their defeat in the War, but the British or the Turks acquired the important energy base around Baku. It was not until the Red Army, lead by Leon Trotsky, captured Baku for good that peace was restored (Fischer, 1926, p.34).

It was not so much the war, but the internal civil strife between the "Red Russians," the Bolsheviks, and the "White Russians," the supporters of the old regime, which led to the downfall of the Russian economy, setting back production by as much as a third of a century (Blackwell, p. 56).

It took the newly formed Republic of Socialist Federal Soviets of Russia (RSFSR) an entire decade to recover from the various results of the period of "War Communism" following the Bolshevik Revolution in 1917. The period from 1914 until 1928, when Stalin introduced his first five year plan, represented more or less a phase of economic re-orientation. The subsequent restriction of foreign trade dragged the economy in a serious crisis (Blackwell, p. 58).

The NEP and the 1920s

Spurred by economic hardship and war weariness, the Bolshevik revolution ended the rule of the Tsars in 1917, establishing the Soviet Union. Shortly thereafter Lenin introduced a plan to foster economic recovery, which was accepted by the Tenth Communist Party Congress in 1921 as

the New Economic Policy (NEP). It had one serious flaw, however. The Bolsheviks were admittedly ignorant of economics due to the lack of much needed theories on which economic restructuring could be based (Blackwell, p. 67). Trotzki himself admitted that "there is a substantial difference between the destruction of a system and the construction of a new one" (Trotzki, 1933, p. 483). The NEP based the economy on small scale farming, resembling a form of petty capitalism rather than socialism. As Blackwell so prudently observed, "they were masters at the art of organizing workers for disruptive purposes, but knew nothing of the management of industry" (p. 67).

The NEP put the economy on its feet again, but appeared to rid the country of the internal opposition's forces (Wesson, 1980, p. 99). As production levels reveal, the oil industry showed signs of recovery as well. With the development of the gas industry still being more than two decades away, the production of crude oil increased from 3,781 thousand metric tons in 1921, to 11,625 thousand metric tons in 1928, the year Stalin instituted his first Five-Year Plan (Ebel, 1961, p. 74).

Despite the economic difficulties and lack of necessary capital, the potential for industrial growth remained intact since the NEP had established provisions toward foreign investment. There was a variety of concessions called for by the NEP, depending on the type of industry that entered

the country. The so-called "concessions" ranged from royalty payments to the state by the purely exploitive corporation, to rewards for those corporations transferring new technology to the Soviet Union (Kosnik, 1975, p. 24)).

The main problem lay in the extraction and utilization of the abundant natural resources. This fact is evidenced by the constant struggle of various nations and oil conglomerates to gain a foothold in the resource rich Caucasus, particularly around Baku. Throughout the First World War and the ensuing Civil War much of the military activity was concentrated around this region. Countries such as Britain, Germany, and Turkey, sought control of the Baku oil fields. Great Britain, ever seeking to expand its empire, ultimately gained control of most of the Caucasus. Unfortunately for the British, possession of the Baku region was not permanent (Fischer, pp. 19-20). By the end of the fighting, this area had been occupied by several nationalities, and it was not until after the armistice had been signed between the allies and Germany that Great Britain was finally able to occupy Baku (Fischer, p. 29).

Unable to maintain its interests in the area, Great Britain eventually withdrew, leaving the door open for an invasion by the Red Army in February of 1921 (Tolf, pp. 208-209). Not surprisingly, the new socialist government seized all assets in the area and nationalized them. This gave many foreign holders of property the feeling their property

had been stolen from them. Subsequently, the fight for control of the region moved from the battlefield to the conference table, the first attempt occurring in Genoa, April 10, 1921. A later conference was held at the Hague, following the failure of that in Genoa. At issue during these conferences was the negotiations by the various parties involved to obtain valuable oil concessions from the Soviet Union. Also at stake was the possibility of receiving compensation or replacement of interests lost during the Soviet nationalization of the industries in the region. Conversely, the Soviets attempted to use their newly gained oil reserves as a bargaining tool to persuade the foreign powers to enter into compromises regarding Russian debt, and to obtain new loans, which would provide them with the capital they so desperately needed (Fischer, pp. 72-73).

For various reasons, these conferences were less than successful, particularly in light of the Soviets' unwillingness to compromise their position, and the hostility of the various oil companies to the Bolshevik takeover. Also undermining the effectiveness of these negotiations was the increasing rivalry between the Royal Dutch Shell corporation of Great Britain and the Standard Oil Company of the United States. A lack of cohesiveness among the parties involved made an agreement very difficult, if not impossible, to reach (Fischer, 1926, p. 79).

In the period of time following the oil conferences, many of the oil companies, in particular Standard and Royal Dutch Shell, backed by their respective governments, placed stringent trade barriers upon the fledgling Russian oil industry in an attempt to block any concession agreements between the Soviet Union and other foreign powers. Despite this fact, and the circumstance that no foreign capital was received, the Soviet Union became a net exporter of petroleum. To illustrate the important role Soviet oil played in the business of Europe at that time, it is important to note that four of the capitalist powers' navies--those of England, France, Italy, and Greece--received their oil supplies from this source (Fischer, pp. 110-113).

In addition to the efforts to develop the oil industry, the desire to revitalize the Soviet economy can be seen in the repeated attempts by the Soviet government to reorganize industry. These reorganizations were carried out with the help of diverse councils, most important of which was the Council of the National Economy (Vesenkha). Vesenkha assumed the role that the central economic administrations had under the former Tsarist government. It was in charge of planning the economy as well as controlling all other agencies. The council responsible for the entire oil industry was called Glavneft, and soon became a part of the large bureaucracy (Blackwell, pp. 72-73). This new

bureaucracy was faced with one problem in particular: while attempting to create more jobs in the industry, it had to search for an increased efficiency among those already employed (Blackwell, p. 76).

Armand Hammer, who was the first western investor to be granted any concessions, apparently saw many possibilities for outside corporations as well as the need of the people for an improvement in the standard of living (Kosnik, 1975, p. 26). Dealing primarily in asbestos, his Allied Chemical and Dye Corporation had only limited effect on the energy market.

After Lenin died in 1924, a struggle for power in the Soviet Union occurred, among which Trotsky and Stalin emerged as the key participants. When, in 1928, Josef Stalin had triumphed, he introduced the first five year plan and the NEP had come to an end. The new plan called for a collectivization of production, basically halting a period of limited free ownership, which had lasted since 1922. This second period of industrialization was marked, however, with different perogatives.

Stalin's Collectivization and Autarchy

While the industrialization under the last of the Tsars was dominated by the search for foreign capital to achieve progress in the economy, it was Stalin's declared goal to modernize Russia without any borrowing from abroad. His

desire was to focus on the domestic means of production, such as agriculture. Through a process of collectivizing the means of production--in this case the labor force--he hoped to achieve long lasting results that would place the Soviet Union on the road to recovery (Blackwell, pp. 90-91). It was his plan to feed those in the industries with the produce from the agricultural sector, consequently using domestic sources to supply all inputs into the growth oriented economy. This domestic sourcing, on the other hand, required a certain reduction in the already low standard of living of the Russian people, especially that of the peasants (Blackwell, p. 110). The subsequent reduction in consumption would be re-invested in the economy. Since, however, the resources were rather small in the beginning, they were limited, which appeared to be part of Stalin's plan of slow and controlled growth. With limited resources, the economy could not grow rapidly,thus the desired slow growth inevitable (Erlich, p. 221).

By insisting on domestic sourcing of inputs, Stalin had to rely on agriculture as his main source. This meant he invested in labor-intensive industries, using the outputs to spur the capital-intensive industries needing to be developed. But no matter how much he taxed the peasants, or how many peasants he could gather at one farm, technology could still be gained through two ways only: either by training citizens or by using foreigners. Both methods,

however, would result in a dependence on the West (Blackwell, p. 130).

The opportunity cost of such a program was high. The citizens of the Soviet Union would not willingly submit themselves to a system that would reduce their already relatively low consumption unless they were forced to, especially since the future promised only small growth. Stalin, therefore, had to be a forceful leader, firmly entrenched in his position as autocrat (Blackwell, p. 90).

In the long run, his attempts to mold Russia into a self-contained unit were successful, as the economy showed a slow growth. Although the Soviet Union became more autarchic it needed the West in order to advance technologically. Even Stalin admitted that a complete independence had not been achieved at the time that he delivered an address before the Fourteenth Communist Party Congress (Erlich, p. 224-225).

Despite much domestic opposition, especially by the kulaks, the more affluent peasant farmers, who refused to be collectivized, the economy had grown. The production of iron, steel, coal and chemicals had increased in 1937 in comparison to figures from 1913, before the First World War. The petroleum industry had grown as well, as the production in 1937 indicated 28,500,000 metric tons were produced, compared to 9,230,000 metric tons in 1913, the last year that Russia had an organized economy (Blackwell, p. 142).

It has been suggested, however, that the effects of Stalin's programs may, despite their overall positive effects, have been contrary to the original principles of the Bolshevik revolutionaries. While the Communist Party fought for socialistic reforms and bitterly opposed exploitation, the price paid for the industrial growth under Stalin was a high one--for not only had the extent of government exploitation of the people reached an all time high, but the share of overall income held by these same people had reached an unimaginably low level. Further evidence of this condition can be seen in the extent to which holdings of funds had changed. From 1928 until 1952, the amount of funds available to the state for expenditures had increased by more than eight times, while, for the people, total personal income had only risen by a meager one third. The:

> ...strangulation of consumption put such large funds in the hands of the state as to permit...greater militarization, despite loss and waste of every kind caused by wars, internal strife, mismanagement, and so on. (Jasny, 1974, pp. 295-296)

Despite the human cost, however, the Soviet oil industry seemed to have gained at least some benefit from Stalin's Five-Year Plans, in that oil production rose from a level of just over seven thousand metric tons in 1925 to 37,878 metric tons by 1950 (Ebel, 1961, p. 74).

The Problem of Opposition

The problem with Stalin's plan did not seem to be of an economic nature but of a social one. An almost exemplary case of xenophobia paired with his fears of a domestic uprising led to the deaths of many Soviet citizens during the "Russification" procedures. This period has often been termed the "All-Out Drive" and "Purge Era," and it has also been suggested that the actual production growth declined in the period between 1933 and 1937. It was also in this time that the total eradication of the kulaks as a class could be observed, as they were too slow to accommodate the leadership during the kolkhos movement, another description of Stalin's collectivization (McKay, 1974, p. 312).

Starting in 1937, the Soviet defense spending began to rise considerably, in view of developments in Europe (McKay, 1974, p. 343). The German government appeared increasingly belligerent, and with the general assembling of armaments across the continent it seemed as though the Soviets had no desire to be outdone. This in turn added more pressure on the already strained society.

The energy industry seemed to have suffered during this period as well. While still growing, the growth nevertheless appeared to be lesser, both numerically as well as percentage wise (Ebel, 1961, p. 74). Perhaps as a result of this development, or in anticipation of the coming struggle, it was decided by the Eighteenth Communist Party

Congress in 1939 to search for new locations of energy resources (Ebel, 1961, p. 65).

World War II and the Creation of Two Systems

The crucial role played by the Caucasus region during the First World War was, however, resumed during the Second World War, as the German army, in "Operation Edelweiss," attempted to capture Baku (Gruchmann, 1982, p. 198). The German army, which reached only as far as the North Caucasus, was prevented from utilizing the territory it had obtained. The Soviets accomplished this feat by employing the same tactic of "scorched earth" that had been used a century before, in the winter of 1812-1813, against Napoleon's army--that of burning and destroying everything left behind during the Soviet retreat. Thus, the Germans found themselves in possession of oil fields which were unusable due to the great extent of damage and disrepair (Dallin, 1981, p. 379). Following the decisive battle at Stalingrad the danger of foreign occupation of Soviet oil fields disappeared.

Following the German defeat, the Red Army claimed to be the liberator of Eastern Europe and Stalin used this opportunity to export the Soviet system beyond the borders of the Soviet Union. What indeed happened was the beginning creation of a separate economic system in the period between the end of the war in 1945 and 1949. One of a centrally

controlled economy, whose goal was the spreading of its form of Communism (Spero, 1985, p. 345).

The problems that occurred from then on seemed to be mostly caused by the East-West polarization. While the Western system is one which is supposed to work on the basis of a free market economy, the Eastern Bloc depends entirely on the planning of its economy. As a response to the American Marshall Plan and the Allied Bretton Woods Agreement, the Soviet Union sponsored the Council for Mutual Economic Assistance (Comecon) and the foundation of the North Atlantic Treaty Organization is opposed by the Warsaw Pact (Spero, 1985, p. 346). It would almost appear that the two apparently independent systems were never designed to cooperate.

By March 5, 1953, when Josef Stalin died, the Soviet economy as a whole had been brought from its previous agrarian state to that of a major industrial power. Because of the rapid industrialization of their economy during the 1950s, it has been suggested that the real period of Soviet industrialization did not occur until after the end of the Second World War (Blackwell, p. 152).

Moving toward the Future

Of particular interest was the administrative reform which occurred in 1957. This reshuffling of bureaucratic agencies serves as a prime example of the continual

reorganizational efforts of the Soviet government which have become so characteristic of their history. Generally, the main thrust of these reshufflings has been focused on either centralization or decentralization, the elimination of local vested interests, or the control of bureaucratic despotism. The very large industrial ministries developed during this time had been preventing the smooth flow of the economy "through the inevitable duplication of effort that such a highly centralized system promoted" (Blackwell, p. 157).

Suffice it to say that a large and complicated bureaucracy under the leadership of the Ministry of the Petroleum Industry, Soviet Union had been established by 1957. Its purpose was the overseeing of Soviet oil production and dealing with matters of concern to Soviet petroleum trade (Ebel, p. 13).

By the 1970s and 1980s, the Soviet Union had emerged as the world's largest producer of primary energy. Second only to Saudi Arabia in the production of crude oil, along with their possession of nearly 40 percent of the global natural gas reserves, the Soviets gained a larger share of the energy market. Gas had meanwhile achieved a position as a serious alternative to oil. Its production worldwide, as well as in the Soviet Union, grew substantially from 11.3 million tons, or 2.3 percent of the total energy output of the Soviet Union in 1950, to 264.6 million tons, or 19.5 percent in 1972 (Kosnik, 1975, p. 70).

Since the Soviets are trading primarily with countries in possession of "soft" currencies, such as their Warsaw Pact allies, their gain is not comparable to the OPEC nations (Hardt, 1988, p. 2). This has led the Soviet Union to reevaluate its energy policy. While in 1961 the importance of gas as an energy source was not estimated to surpass a quarter of the nation's supply (Ebel, p. 12), today's projection for the 1990's regards it as the leading source, with a share of nearly 40 percent (Hardt, p. 2).

The Soviet Union will have to make a decision in the near future regarding the utilization of its energy sources. Since there are three goals in connection with the use of that energy, a decision may be hard to come by. Besides their own consumption there are the shipments to the allies, who are not able to pay for it with hard currency. If the Soviets decided to trade it to the Western nations instead they would be able to obtain that hard currency which would represent an inflow of foreign capital, a familiar concern of the Soviet economy.

When, in the early eighties, an abundance of natural gas was believed to be located near the Yamal or Yamburg peninsula in Western Siberia, the Soviets realized that this could be their chance to obtain foreign currency by trading it to Western Europe, which was quite willing to increase its supply.

The Soviet Union has been shipping gas to Western Europe since 1970, when Austria was the first western nation to receive it. The Federal Republic of Germany followed a year later with the rest of its European allies joining shortly thereafter. When it became known that the Soviets were willing to expand their gas supplies, studies appeared, according to which the construction of new pipelines held the key to the production of further energy (Oil & Gas Journal, June 29, 1981, p. 40).

Should the Soviets decide to trade the gas to the West, they could in return obtain the technology and finances needed to build more pipelines, avoiding the "bottleneck" problem of not getting the goods out to the consumers.

Throughout the history of the petrochemical industry in Russia and the Soviet Union, the role of foreign capital has been crucial. Whether it were the Nobels, who wanted to expand their operations in Baku with the help of Rothschild capital, or the exploration of the Yamal gas fields, there has been a continuing interest in the international flow of funds in order to aid someone who can provide a desired service.

CHAPTER III

MULTINATIONAL CORPORATIONS

Major actors in the transferring of funds across national boundaries and the provision of foreign capital, have been the multinational enterprises or corporations (MNE). They are also the major link in this study, because they are the vehicle for the trade that occurs between the political blocs. If the West, who may need some of the goods that the East provides, is willing to obtain them, multinationals can provide this service.

The post World War II period in the Western Economic system saw the maturing of the MNE as a strong entity. With this maturing process the MNE emerged as a new actor in the international arena. MNEs were in a unique position in many different ways. They were an international organization, yet they had originally been organized and founded under the laws of one country, the home country. The original employees of that corporation were normally citizens of that particular country as well, and if the company decided to expand beyond its country's borders, it usually relied on the primary use of its original people, so-called

expatriates. MNEs were thus usually dominated by citizens of one country, which may seem common for business entities but not for international organizations.

By spreading their activities beyond the borders of their respective home countries the MNEs are able to enjoy a number of advantages. Not only is financing easier due to the availability of internationally diversified sourcing, there is also easier access to raw materials, labor, natural resources as well as technology and other useful information. They also have better access to a larger market.

These and many other advantages of the MNEs have created a unique position which allows them to gain certain advantages that are not available to those enterprises that are just domestically oriented, they must also contend with regulations that apply to them alone. Being an actor on the international scene makes them economically stronger, yet they are politically more vulnerable than their domestic counterparts. MNEs are the only form of enterprise whose internal flow of information, finance, technology, or any other data as well as people is carried on across national boundaries (Samiee, 1984, p 141).

This transfer process is indicative of the problems concerning regulations with regard to a company's multinational operations. While the identity of the nation changes, that of the corporation remains the same. Thus,

along with the transmission of data goes the transmission of the corporate interest and its objectives. Interests are perceived differently at different locations. What is favored in one country may be opposed in another. Obviously, that home country--host country situation can lead to complications that are generally dealt with by employing protective regulations on behalf of the governments involved, as the authorities attempt to curtail that flow across national borders (Contractor, 1983, p. 500).

It is a somewhat typical situation, when an MNE enters a so-called lesser developed country (LDC) and is met with mixed emotions. Along with the import of new technologies, and quite possibly finances, comes the threat of a new force that may exercise local power, due to its size, or the threat of exploitation by the new partner. Regulations by these host countries are thus necessities in order to retain some of the wealth created by the multinationals (Contractor, pp. 512-515).

Issue of Controls

In the case where a multinational invests in another so-called developed, or core country, the threat of exploitation may not be as important an issue as the more advantageous position of the multinational. The fact that the MNE is in an economically strong position has caused

critics to argue that multinationals are consequently in a situation in which they can do nearly anything that they desire in order to avoid the regulations imposed by the host government. That conclusion may, however, be fallacious as the ultimate political power rests with the host government.

Host countries have a number of methods to control MNEs ranging from ownership regulations to behavior control. Joint ventures, licensing agreements, technical assistance agreements, industrial cooperation, and varying degrees of expropriations have been used in order to control MNEs. Other methods include regulations concerning the use and training of the local labor force, level of employment, guarantees for the labor during strikes, participation of local people in the top management, as well as constraints regarding the capital flow. The political strength of the corporations is thus not as large as their economic position could lead one to believe they had. Corporations may have been forced either to cooperate with the host country or, indeed, to pull out (Hood and Young, 1979, pp. 241-242).

Host country controls are subject to bargaining between the MNEs and the host countries. Bargaining is also a method of the international labor unions. Due to their diversified interests in the different countries, they have largely been unable to represent an equal bargaining partner, much less exert any power or control (Taylor, 1984, pp. 212-213).

Little control over MNEs is applied through international organizations or treaties. Attempts have been made, such as the provisions under GATT, or the UN sponsored voluntary codes of conduct. Those have, however, failed to create any real restrictions since they were voluntary in nature without any consequences in the case of non-compliance. Regional organizations such as South American states have come up with more restrictive policies, as the Andean Investment Codes would show, but any time that code becomes too restrictive or mandatory the countries involved end up losing too much of their sovereignty and tend to scale back on the use of the same. The problems of the European Community would manifest this dilemma (Hood and Young, 1979, p. 245).

One of the basic problems that remains in regard with the multinationals is the one of forcing an MNE to comply with the regulations of the organization without losing the investment. It seems as though the combination of the voluntary character and the fear for the loss of sovereignty have rendered an international solution at this point rather useless (Hood and Young, 1979, p. 252). A good example would be the Declaration on International Investment and Multinational Enterprises from the Organization for Economic Cooperation and Development (OECD) in 1976, which was a follow up on the 1972 Guidelines for International Investment by the international Chamber of Commerce.

A situation in which there are no real alternatives is the case of home or parent country restrictions (Hood and Young, 1979, p. 306). While MNEs are in a better position with respect to the host countries that they operate in, they are still bound by the regulations of their home countries, the country in which the corporation was initially founded or under whose laws it is organized.

It is fairly clear that the home countries have a considerable interest in the attempt to regulate the operations of their multinationals for a variety of reasons. Some of the concerns are of an economic nature while others are politically inclined (Hood and Young, pp. 333-335). While it is difficult to assess the amount of importance attached to various concerns, the fact remains that there is a particular need to further investigate home countries' political reasons for attempting to regulate operations of multinationals. The post World War II period and its new actors, the MNEs, have linked the two policy areas of security and economic policies. The differentiation of politics along the line of security and economic affairs has become obsolete in the relatively new field of political economy. In East-West trade relationships in particular, a drawing of a separating line between the security oriented political decision-making and the purely economical ones would not only be difficult, it would also be counterproductive (Spero, 1985, p. 12). The problem is

connected with the issue of legislation, as there is no clear path in this critical area, as to which concern has to be regarded as superior. The main emphasis has to rest on the creation of a consistent theory which could enable decision makers to obtain a better picture of their options in order to avoid some of the tension created internationally (Shultz, 1985, p. 301).

Home Country Concerns

There are a number of concerns for home country governments with regard to the foreign investments by the MNEs. The United States, the leading home country in the world, exemplifies best the considerations of home countries in the time since World War II. Since the United States is also the home country in this particular case study, a review of the United States policies and concerns appears to be appropriate.

One of the reasons why home governments have recently become more critical of foreign investment is related to an outflow of capital that could have otherwise been used domestically. Since the 1960s in particular, as the post-war dollar shortage began to disappear, have the administrations of the United States chosen this policy, rather than the encouraging view that had prevailed in the 1950s (Hood and Young, 1979, p. 300). In the 1960s, after

the first balance of payments deficit in 1958, direct foreign investment was no longer regarded as a means of expanding the economy, but rather as an unwelcome outflow of domestic capital that exerted a negative impact on the balance of payments (BOP). The legislation that was adopted in this period reflected this attitude. In 1963, a portfolio restriction was introduced; in 1965, the Voluntary Credit Restraint Program called for a voluntary restraint on behalf of the MNEs regarding their financing and it was succeeded by a mandatory measure three years later, with the Mandatory Control Act of 1968 (Root, 1984, 473). That did little, however, to stop the dollar glut. MNEs started to use their international resources to raise the funds for their continued expansion. While the BOP showed a short term improvement, the long run effects turned out to be negative as the MNEs began to repay their international loans (Hood and Young, 1979, p. 311-312).

With the outflow of funds came an outflow of jobs, particularly in the manufacturing industries, as white collar labor increased and blue collar labor began to decrease from its previous heights (Chaudhuri, 1983, p. 267-268). The problem with regard to the labor issue is the perspective from which one looks. Numerous studies undertaken by labor unions pointed to the loss of employment on the domestic scene, while corporate sponsored research emphasized the creation of new jobs and the overall

retention of employment through complimentary goods and services (Chaudhuri, 1983, p. 273-274).

Furthermore there was an undetermined amount of tax revenue lost, as multinationals searched for tax havens and thus avoided paying taxes that would normally have been collected by the home country government (Blake and Walters, 1984, p. 208). These tax considerations have caused the United States to adopt regulations such as the 30-70 rule, which in brief calls for a full payment of US taxes if the tax rate of the host country is below thirty percent, an equalization payment if it is between thirty and seventy percent as well as no additional burdens if the rate in the host country is above seventy percent. Overlapping tax jurisdictions remain, however, a sizeable problem for the American lawmakers.[1]

MNEs producing outside the home country may also negatively affect the balance of trade as the product cycle model would suggest. After a certain product has been manufactured in the parent country and successfully exported, the company may look for a different location of production in order to increase its profits. Once the new

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[1] See Neil Hood's and Stephen Young's Economics of the Multinational Enterprise. New York: Longman, 1979; chapter seven gives a fairly good description of the United States interests in the taxation of multinationals.

manufacturing facilities have been installed, the original product may in turn be imported by the original parent country of the multinational (Hood and Young, pp. 60-63).

Two points appear to be critical regarding the behavior of national governments. First, they evaluate the position of the MNE by the economic benefits that the home country would stand to gain alone which causes the second phenomenon --that guidelines concerning foreign direct investment are more or less on a case by case basis. In the United States especially, legislation dealing with MNEs and foreign investment has been rather fortuitous at best (Hood and Young, 1979, p. 300).

Political Problems

At this point a certain incongruity with respect to the interests of the parent country and the multinational seems to become apparent. A multinational is an entity that is separate from the interest of the government of a particular country (Root, 1984, p. 512). With the new development among the MNEs, the trend is toward the transnational corporation. One can classify MNEs in three broad categories. The first one is the traditional multinational, one that is controlled from the home country, and whose decisions are primarily made in the home country. These home country oriented firms are called ethno-centric, while those that are more host country oriented are called geo-

centric. The new form of MNEs is one that is organized transnationally. It is neither home- nor host country oriented, its decisions are made on a global basis with funds from one affiliate helping to boost another (Drucker, Wall Street Journal, January 15, 1986). These corporations in particular have problems in identifying themselves with one particular nationality.

Sometimes the goals of the MNE and the official home country appear to coincide; often enough their goals are common. The problems arise when the objectives of the two are not the same or even oppose one another. Who should prevail? Or what should happen if the home government prevails and other countries are adversely affected by that move?

How critically this situation may develop is shown in the example of the transfer of technology. While it remains in the best interest of the multinational to produce at the highest level of technology possible, no matter where it is applied, the home country may regard this transfer of technology rather skeptically since it is losing a more advanced technological position to a possible competitor, economically as well as politically (Contractor, p. 515). The same applies to the flow of data which, while it is being transmitted internally by the firm, is still travelling across national boundaries (Samiee, p. 141).

Restrictions in this area are not only against the interest of the multinationals, they also reveal the separate character of the two. What causes the role of the MNEs to appear hypocritical, however, are the occasional calls for assistance once the firms have encountered a problem they could not handle themselves. Afraid of losing export markets or political influence, parent countries usually aid multinationals or their subsidiaries when called upon (Hood and Young, p. 331). Subsequently, it can be safely stated that multinationals are using their willing home governments to achieve their goals (Root, 1979, p. 512).

Economic Statecraft

This relationship between home country and the MNE becomes a problem when the home governments are trying to use the multinationals to assist them in attaining their own political goals. Conflict resolution by economic means for example has evolved into a serious option for policy makers. In the attempt to achieve foreign policy objectives there are basically four different options: Propaganda, the attempted influence through a variety of verbal symbols; diplomacy or negotiations; military statecraft, which may be defined as violence or at least the threat thereof; and economic statecraft, such as the use of economic pressures (i.e., sanctions). It may be defined as the reliance "...on

resources which have a reasonable semblance of a market price in terms of money" (Baldwin, 1985, pp. 12-14).

The main problem with this definition, however, is that it is all but definite. Just as there is no agreement internationally on who is "right" and who is "wrong", there is no agreement on the use of the term 'economics'. On the other hand, were one to define the economic method of statecraft based upon its results, almost anything would have to be considered 'economic' statecraft, because economics are affecting virtually every aspect of any society (Baldwin, 1984, pp. 29-31). Thus, by giving it a more narrowed definition in accordance with the methodology, a somewhat more tangible terminology can be used in order to enable any discussions toward its application.

There exist are as many identifiable forms of statecraft as there are definitions. Economic statecraft usually brings to mind the use of economic sanctions, negative sanctions in particular: (1) embargoes, which are prohibitions on exports or bans on all trade; (2) boycotts, which are prohibitions of imports; (3) tariff increases, which are simply a tax on imports from one country; (4) tariff discrimination, which means that imports from the so-called target country may be treated less favorably than those from other countries; (5) withdrawal of the so-called "most favored nation" treatment, which goes along with the previous method; (6) black lists, which ban enterprises of

target countries from doing business; (7) import or export quotas, which are quantitative restrictions; (8) denial of licences on imports and exports; (9) dumping, a method of selling certain products below market value in order to dispose of them, while destroying another countries industries; and (10) preclusive buying, which refers to the acquiring of a commodity in order to deny it to the target country.

While the above list constitutes trade restrictions, capital restrictions represent a different form of sanctions. A wide variety of options may be regarded as capital restrictions. They include such methods as the freezing of assets, which is a form of control over the export of foreign currency, since through the freezing process the assets have become inconvertible. Aid suspension will probably be used more when dealing with smaller entities; and expropriation, to which it is a response, also requires that the target countries have ownership of some property in the home country before it can be seized (Baldwin, 1985, pp. 41-42). The Hickenlooper Amendment is that sort of tool for the United States. It simply provides for the curtailing of all forms of U.S. aid to all governments that engage in the expropriation of U.S. MNEs.

The only difference between tariffs and the unfavorable taxation of assets is, however, that the former deals with

assets and not products of trade. Another controversial measures in terms of its overall strategical effectiveness seems to be the withdrawal of dues to international organizations.[2] Summarizing, it could be argued that the only differentiation between positive and negative sanctions is the fact that they appear to be somewhat reversed (Baldwin, 1985, pp. 41-42). An illustration would be the lowering of tariffs for one state, while raising them for one another. The granting of more or less foreign aid could be seen in this connection as well.

Past United States Policies

The government of the United States, the leading home country, has been using many of the prior mentioned options, making it apparent that economic measures have been regarded as useful in obtaining primarily political goals. Since the Trading with the Enemies Act of 1917, the United States has had a legal provision that enabled the restriction of trade for political purposes (Hood and Young, 1979, p. 300). This Act was reinterpreted by the Supreme Court in 1941, when it was ruled in Clark v. Uebersee Finanz Korporation that those U.S. citizens who control a foreign entity can be restricted

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[2] David Baldwin deals with the controversial nature of this action, as handled by the United States and its dues to the United Nations in the second chapter of his Economic Statecraft. Princeton, NJ: Princeton Univ. Press, 1985.

in their trading with that foreign country at a time that the United States is at war with that particular country (Thompson, 1983, p. 324).

Later, during Korean conflict, a similar legal position was adopted when the trade with China and Korea was restricted, which caused a straining of the relations with Canada, when the U.S. legislature sought to prevent an agreement between a Ford subsidiary in Canada and the People's Republic of China. During the same year, 1957, a similar incident occurred in connection with a French affiliate of the Fruehauf transportation corporation.

Some of these actions were also based on the Export Control Act of 1949 and the Mutual Defense Assistance Control Act of 1951, sometimes called the Battle Act. These Acts called for trade restrictions by the United States and its allies (Spero, 1985, p. 349). In 1963 the Cuban Assets Control Regulations were introduced, reflecting the disturbed relations between the United States and its neighbor.

In another form of extraterritorial control, the United States attempted to enforce a non-participation of American corporations in an economic embargo of Israel in 1977, called for by the Arab nations. The legislature did this by way of amending the Export Administration Act of 1969.

One area where the United States has continually sought to enforce U.S. legislation on an extraterritorial basis is

Africa. There were a number of MNEs affected by the trade restrictions following the application of U.S. legislation after Rhodesia's Declaration of Independence in 1965. Business for American was companies restricted particularly after the total trade ban raised by the Carter Administration in 1977, designed to achieve a majority rule in Rhodesia. Uganda in 1978, South Africa one year later and Libya starting in 1983, are further examples of the attempt of the American government to levy economic measures for a diplomatic purpose (Lindell, 1986, p. 30-31).

A number of options was chosen in 1979, during the Iranian crisis. Measures included a total ban on trade, a ban on bank lending, as well as a ban on the performance of all outstanding contracts. The corporations that were effected included Occidental Petroleum, Amerada Hess, and Brown and Root Inc. (Lindell, 1986, p. 30). This occasion provided the first use of the International Emergency Economic Powers Act, one of the major tools during the pipeline crisis of 1982 (Thompson, 1983, p. 357).

Most trade restrictions were, however, in the area of trade with the Eastern system. In 1978 there was a restriction on computers and energy exploration technology, followed by a phosphates and high technology ban in 1980. It was the same year that the infamous grain embargo was levied in response to the Soviet intervention in Afghanistan. The next year, the new Reagan Administration

repealed the widely unpopular grain embargo, but extended the high technology restraints due to the developments in Poland at the time. The corporations that were affected by these moves included a sizeable number of leading American producers of the various items.

With the interests of the MNEs and the home countries no longer the same, the multinationals were pointing to the fact that they would like to be regarded as separate entities (Lindell, 1986, p. 28). The additional legal questions involved in this area of foreign policy making continue to indicate the apparent lack of a consistent theory (Thompson, 1983, pp. 361-362). Should a home government be allowed to rule over the subsidiary of a multinational that is operating in another country? Or should the host government retain jurisdiction over the affiliate, and if so, to what extent?

The Yamal Gas Pipeline

The construction of the Yamal gas pipeline, designed to furnish Western Europe with Siberian natural gas in 1981, serves as one of the best examples of the need for such a theory. The pipeline needed to be constructed with the help of the European allies of the United States, who were favoring the project due to their efforts to diversify their natural resource supply. The administration in Washington,

however, seemed to be guided by different prerogatives (Hufbauer and Schott, 1985, p. 219).

There were a number of objections raised by the American President. First, the idea of supplying the Soviet Union with technology through the companies that were working on the project was regarded as inappropriate since it supplied a formal enemy with added capability. A second point raised was that through western payments to the Soviet Union for natural gas, the Soviets would gain possession of hard currency, something desperately sought by the Eastern Bloc countries, who were constantly short of it (Hufbauer and Schott, p. 244).

Of the greatest concern, however, was the situation that the Europeans were about to create for themselves. It was argued that through the construction of this pipeline, the American allies were putting themselves in a state of dependency. The fear was that once this pipeline was created the Soviets would be able to coerce the Europeans into actions that they normally would not undertake (Dun's Business Month, November, 1981, pp. 92-93). That the Europeans were free to act on their own was of special concern to President Reagan since a Russian intervention in Poland seemed inevitable at the time. Thus he would have liked European support in the event that sanctions were implemented against the Soviet Union should it indeed act (Hufbauer and Schott, pp. 227-229).

Different Perspectives

The view that prevailed in London, Bonn, Paris and Rome, was that there was no room for such fears since the Soviets needed the foreign currency worse than the Europeans needed the gas, and that through these efforts to diversify the supply of energy resources, the situation was by no means as desperate as outlined by the Americans (Minard, 1982, pp. 122-123). Since the pipeline was needed by the allies, they had hoped to keep it out of consideration in the Polish crisis (Oil & Gas Journal, July 5, 1982, p. 52).

Subsequently, in December of 1981, the Reagan administration announced the sanctions against the Soviet Union, part of which was an embargo of technology, a provision under which Western firms were prohibited by the United States from transferring any new technology to the Eastern Bloc. This decision was neither welcomed by the multinationals, nor by the European allies (Hufbauer and Schott, p. 226). While the companies were afraid to lose lucrative contracts, the allies refused to be ruled by an outsider (Thompson, p. 355).

The corporations involved in the project, such as General Electric (U.S.A.), AEG-Telefunken (FRG), John Brown (GB), Nuovo Pignone (Italy), or Dresser France, were primarily worried about not being able to live up to their contracts, the consequences of which would not only include the loss of anticipated income, but, much worse, their

reliability with regard to future contracts (Lindell, p. 33). Would any of the firms receive bids in the future if they decided not to live up to their contractual agreements in order to avoid being put on the "blacklists" of the American administration? Neither had the question of legal liabilities, as well as their extent, in the case that there were any, been explored.

Extraterritorial Jurisdiction

The concern of the European allies was much more politically inclined. Since they sought after the pipeline and its benefits, they were faced with the possible alteration of their policies by an outsider. Should they allow such extraterritorial legislation, or should they ask the multinationals' subsidiaries to carry on with their business and complete the project?

The problem originated in the absence of mutuality of goals on behalf of the home government (U.S.A.) on one side and the multinationals and the host country (Western Europe) on the other. When the home country then attempted to control the actions of its nationals beyond its territorial reach, it not only interfered with the interests of these nationals, but also with the interests of other sovereign states.

> The fundamental precept that states are sovereign and equal leads inevitably to the conclusion that each state has a duty to

> refrain from intervention in the internal or external affairs of other states. (Marcuss and Richard, 1981, p. 440)

Seemingly, the U.S. had acted against the concept of sovereignty and independence. But had it really? The Europeans, of course, were quick to point out that this form of legislation was against international law, since they were negatively affected by it. Furthermore, were they retroactive and sought to prevent the fulfillment of already existing contracts (Blinkin, 1987, p.112).

There are, however, different principles with regard to the dilemma of extraterritorial jurisdiction. The problem is that there is no such thing as only one international concept or theory to which everyone adheres (Marcuss and Richard, p. 481). The first and most commonly understood principle is the territorial principle which suggests that a nation has sole jurisdiction over all the activities within its physical boundaries. Discussions that have evolved regarding that principle have centered around the possibility of extending this theory to the point where a state has the right to legislate as far as acts outside the physical territory are affecting the state itself.

An example of this "effects doctrine" is the anti-trust legislation of the United States. The U.S. reserves the right to interfere with any business combination that is affecting U.S. trade in an anti-competitive way as defined by the Sherman Act (Root, 1984, p. 488). One occasion in

which the U.S. judiciary intervened was when Gillette, in 1968, attempted to acquire Braun, a German electric razor manufacturer. Braun had a licensing agreement with the American manufacturer Ronson under which Braun refrained from selling in the United States. The U.S. courts regarded Gillette's attempt to buy Braun as potentially anti-competitive and therefore prevented the acquisition (Root, p. 489).

A case in which a host government took offense to this form of judicial imperialism occurred in 1969 when the Justice Department prevented a possible merger between British Petroleum (BP) and Standard Oil of Ohio (Sohio). After strong protest by the British, however, the Americans allowed the merger to proceed. In the eyes of the British, the establishment of this particular cartel was acceptable, since it was a "good" cartel (Root, p. 490). The assumed privilege of the United States to rule over the entire multinational has consequently led to a form of judicial imperialism (Root, p. 489).

This "effects doctrine," however, would lead away from the clear path that the territorial principle is primarily aiming for. It remains particularly questionable since it is unresolved whether these effects are measured to the primary, secondary, or even tertiary degree (Marcuss and Richard, pp. 441-443). Moreover, whose interpretation is the one by which the degree is being measured? As

originally stated, the territorial principle provides a certain amount of clarity which seems to be needed in the area of international legislation.

Another suggestion is the nationality principle, by which a state would be allowed to govern the conduct of its nationals, no matter where they would be located. That rule, however, presents a problem with the sovereignty of other states (Marcuss and Richard, pp. 443-444). Not only would any agreement have to be reciprocal, but it would also seriously interfere with the legislative process of other countries. Its more or less infrequent use has been for protection services, or in the case of the pipeline, for the enforcement of national foreign policy objectives.

Of a much more protective character, is the so-called security principle. It would allow a nation to protect either its own interests or that of its citizens from beyond its borders. For example, a crime that had been committed against a national of a particular country could thus be punished by the judiciary of the victim's nationality (Marcuss and Richard, p. 445). It is comparable to the "primary effects" doctrine under the territorial principle. Apart from the fact that it would open the door to vengeful activities by the victim's state, it is also denying the state in whose territory the crime occurred the capability of dealing with it on its own. As long, however, as reciprocity remains unsolved in that theory, it is nothing

more than another, merely theoretical, approach that is far from realistic.

While the security principle could include actions committed against the state itself, the passive personality principle would allow a nation to prosecute crimes committed against individuals only (Marcuss and Richard, p. 447). Its feasibility, on the other hand, is not much greater than the security principle.

Contrary to the last two principles, the universality principle would recognize the right of a state to punish aliens where there is no real, or formal, authority in the surrounding circumstances. One example of this phenomena is the appearance of piracy (Marcuss and Richard, p. 447).

After the review of these major principles concerning the issue of extraterritorial jurisdiction, it seems to be evident that the main problem a policy maker faces is the one of how to govern its citizens once they have left the physical boundaries of that country, or how to include them in a form of policy to which all the citizens of the same country must adhere. Should those living and operating abroad have the privilege of being subject to another country's legislation? If so, are they able to enjoy the same protection that the citizens residing domestically are able to enjoy?

In the case that a certain protection is indeed enjoyed, the government can reasonably expect those

individuals to support the legislation of the home country. Once the home country's policies are actively supported by the corporations in the host country, the policies of the host country are subject to an outside influence that may end up directing its legislation. What would the Western European countries have done if the multinationals had not lived up to their contracts and preferred to go along with the stand of the American administration instead? As the situation developed, the Europeans stood firm in their belief of exercising territorial jurisdiction, according to which fulfillment of the contracts did not represent a problem.

Lack of a Consistent Approach

The United States Executive believed in the exercise of control in accordance with the nationality principle, which led to the dilemma for the multinationals involved. They were caught in a no-win situation. To go along with the desires of the European governments would have meant to violate American law, since most of the subsidiaries had signed acknowledgements concerning the origin and ownership of American technology. On the other hand the European governments were pressing for the completion of the contracts, since they regarded the retroactive sanctions as illegal (Blinkin, 1987, p. 113). If there had been one

theory to which everyone could agree, a situation like the one in 1981-82 could possibly have been avoided.

When, however, a country such as the United States, which is the leading parent country in the world, is not even certain about which principle to follow, what can be expected from the other countries in the global community? The problem is not that the U.S. has not followed these principles, but that past legislation has pieces of many principles and has repeatedly been unclear in terms of which principle to follow (Marcuss and Richard, p. 481).

Concluding, it remains to be seen which principle will succeed on the international level. The only certainty at this point seems to be that without a definition of a clear course, problem situations like the one involving the Yamal gas pipeline are bound to occur again. This may not warrant the fact that one could easily be obtained, but without the necessary studies to pinpoint the dilemma a solution would be even further away which could lead to unnecessary complications in the international community.

CHAPTER IV

THE CASE OF THE YAMAL GAS PIPELINE

The case of the Yamal gas pipeline serves as an excellent example for the difficulty that may begin on the international level, when such issues as the extraterritorial jurisdiction over the subsidiaries of multinational corporations emerge from the overlapping of security as well as economic interests. This argument gains strength in light of the fact that the issue of extraterritoriality regarding foreign policy goals remain unresolved.

Trade relations between states of opposing ideologies may be difficult enough; when, however, partners on one side disagree on how to deal with the other side, the situation can easily evolve into chaos. One of the most recent examples, as indicated earlier, was the agreement between Western Europe and the Soviet Union to develop the Urengoi gasfields of the Yamal, or Yamburg peninsula in western Siberia in the early 1980s, which led to disagreements and conflict among the members of the Western alliance.

A Simple Plan

The eleventh Soviet Five Year Plan, from 1981 to 1985, had provided for the exploration of the Siberian energy resources (Fortune, June 1, 1981, p. 78). The reserves were apparently quite sizeable and needed only to be tapped. One of the problems that the Soviet Union experienced, however, was its difficulty in the exploring these reserves. Being a leading producer of primary energy in the world, the Soviets were facing the dilemma of having to modernize their production process, especially the transportation of the oil and gas once it had been won from the ground, or else certain market losses would have been unavoidable (Oil & Gas Journal, June 29, 1981, pp. 39-43).

While the Soviets insisted upon their ability to produce the needed technological equipment on their own, they realized that the same technology was quicker to obtain from someone who already possessed it. One of these places that was in such a position of technological advancement was Western Europe (Oil & Gas Journal, November 2, 1981, p.59). In addition, the Europeans were also in need of new sources of primary energy (Dun's Business Month, November, 1981, p. 94).

The Europeans felt that they needed to diversify their resource base in the energy sector, and since their primary source of energy, the Persian Gulf region, seemed fairly unreliable politically, they were more than willing to

listen to the Soviet proposal (Fortune, June 1, 1981, p. 78). In the eyes of the Soviets the Europeans were qualified for future agreements for another reason as well. Not only would they have the technology and the desire to supply it, they were also wealthy enough to pay for the goods and services supplied as well as for the development of the resources in western Siberia (Economist, June 6, 1981, p. 85).

Consequently a compensation agreement, a typical method of East-West trade, was in the making. Compensation agreements follow the principle of "pay-now-and-receive-later." The Europeans were supposed to supply the money and technology necessary to develop the Yamal gas fields and the transportation of the gas by pipelines to the West. The Soviets promised to give contracts to firms from those countries receiving gas after the completion of the pipeline. All the qualifications for a compensation agreement were thus met. After contracting for the sale of technology, equipment, and its installation to start up, there was a contract providing for the raising of the necessary funds, all of which were to be repaid in the form of the services provided (Loeber and Friedland, 1983, p. 54).

The Soviets knew that they were making a good deal. For one thing, they were aware of the need to explore their resource capabilities, and for another they were receiving

much desired hard currency. The main foreign recipients of the Soviet gas were the states within the Warsaw Pact, which were, much like the Soviet Union, continuously short of hard currency. Thus the foreign earnings from the energy resources in the Soviet Union were not nearly as great as they were desired to be (Economist, June 6, 1981, p. 85). Another beneficial circumstance was that the Soviets did not have to pay for the new development, they simply put it off until the newly won resources paid the bills (Loeber and Friedland, p. 51).

European Desires an Needs

The Europeans, on the other hand, felt as though they had struck a good bargain as well. Always searching for methods to diversify their energy sources, they welcomed the thought of increasing the amount of gas they received from the Soviet Union. It was argued that the Soviets have generally proven themselves to be reliable trading partners, most certainly more reliable than the nations in the Middle and Near East (Fortune, June 1, 1981, p. 79).

The circumstance that was most important to the Europeans, however, was not just the diversification of their natural resource supplies, but the projected economic gain resulting from the orders to the Soviets for the pipeline equipment (Business Week, September 14, 1981, pp. 44-45). The proposed pipeline was supposed to run from the

Urengoi fields in the southern half of the Yamal peninsula to Uzghorod on the Czechoslovakian-Russian border, altogether about 4,500 to 5,000 kilometers (2,794 to 3,105 miles). It was, following a building period of three years, supposed to furnish Western Europe with forty billion cubic meters of gas annually (1.412 trillion cubic feet), in addition to the gas that the Europeans were already receiving. Gas from the new pipeline itself would eventually provide twice the amount of gas that the Europeans were receiving from the Soviet Union, consequently tripling the total prior amount (Oil & Gas Journal, November 2, 1981, pp. 60-61).

A Technological Challenge

The proposed pipeline was technologically quite a challenging undertaking, as numerous rivers, foremost the Volga, the Dniepr, and Don, had to be crossed. The extreme temperatures that prevail during the Siberian winters demanded equipment of the highest quality and most superior reliability and durability as well. Other items needed were turbines strong enough to propel the gas along the pipeline which was, aside from being one of the longest of its kind, also one of the biggest, with a diameter of fifty-six inches. The power needed for these turbines was in the neighborhood of 1,102 to 1,469 psi, with the stronger

turbines located further north along the line (Oil & Gas Journal, November 2, 1981, pp. 57-62).

With all these superlatives in the pipeline technology, the Soviets were obviously interested in obtaining Western technology, especially since the Europeans were willing to comply. Also of need, besides the material for the pipeline itself, were the capital goods necessary to lay the pipeline, such as pipe laying and welding instruments. Additionally, it was important to create an infrastructure that would permit the construction of a pipeline that size. Off-road vehicles, as well as building materials for the housing of the workers appeared to be needed. The only item the Soviets were initially intending to supply was the labor, while contracting out for the other tasks. One of the methods by which a contractor was selected was in accordance with the projected amount of gas that contractor's particular country was planning to order. The project as a whole was priced somewhere in the neighborhood of ten to fifteen billion dollars (Oil & Gas Journal, February 22, 1982, pp. 50-51).

It was clear that the European industries would jump at this opportunity for new production after being caught amidst a deep recession. For the Europeans the pipeline contract with the Soviet Union meant more than just a desired diversification of energy resources. It represented a boost for their lagging economies as well. Suddenly, new

jobs could be available, and individual corporations, such as the West German AEG, could try to pull themselves out of the economic trouble they were in (Business Week, September 14, 1981, pp. 44-45).

A Financial Challenge

The finances for the whole project were to be supplied by the West as well, under the provision that the loans to the Soviets would be paid back in the form of the gas once the pipeline was in operation. After the signing of the original agreement in November of 1981, the Soviets negotiated with the German banks for so long that by the time the Soviets were ready for a definite contract, West German interest rates had risen sharply in early 1982. With interest rates near thirteen to fourteen percent, the Soviets signalled that they would be unwilling to pay double-digit interest rates. The German private banks, led by the Deutsche Bank, proposed a compromise, letting the Soviets pay the old rate of seven and three quarters percent, while raising the prices for the equipment bought in West Germany to the point where the amount paid was equivalent to nine and three quarters percent interest. The loan itself was insured through the West German government insurance, Hermes AG. While Germany refused to let the Soviets pay too low a rate, countries such as Italy went

ahead and loaned at a substantially lower than market rate, which was finally subsidized by the government, who paid the difference (Economist, August 1, 1981, pp.60-61).

Once the financing was cleared, the Europeans prepared themselves for some of the biggest contracts in their history. Much of the desired technology, however, that the Europeans had to offer originated in the United States. Companies such as Nuovo Pignone of Italy, or Alsthom Atlantique of France, and John Brown of Great Britain were either subsidiaries or sub-contractors of General Electric, an American multinational. AEG-Kanis of West Germany was in charge of the assembly of the turbines, while Mannesmann and Thyssen (FRG) manufactured the pipes for the pipeline itself (Economist, October 31, 1981, pp. 82-83).

The Europeans had subsequently filled order books with prospects of renewal contracts, especially since repairs on the all-important turbines, as well as on the line itself, seemed to provide some profit for future times. While the Europeans were busy celebrating the preliminary end of their recession, the American allies raised a few concerns regarding the pipeline. The new administration in Washington, under Ronald Reagan, voiced strong doubts over the contracts.

American Opposition

At the Ottawa Summit in late July of 1981, the newly elected leader of the United States urged his European counterparts to rethink the pipeline idea, particularly the provision of the technologically advanced equipment to the Eastern Bloc. He also pressed for tighter restrictions by the members of COCOM (Coordinating Committee for Multilateral Export Controls). While it was generally accepted to review the conditions, the Europeans failed to comply with President Reagan's wishes in connection with the pipeline (Hufbauer and Schott, 1985, p. 225).

The Americans had different reasons for their negative stand on the pipeline. For one, they felt that the Europeans, as members of the Western Alliance, should not receive vital energy resources from the Soviet Union. It was pointed out that this would lead to a form of dependency which was not only undesirable for the Western allies, but could also prove to be an obstacle in their decision making process (Engineering News Record, January 7, 1982, p. 11). While it was clear that the two allies differed in their evaluations of the situation, the U.S. administration appeared to use its position in trying to convince the Europeans not to enter into the proposed venture.

The Europeans did not agree with the American argument at all. They pointed to the record of the Soviet Union, which had proven itself to be a reliable partner on numerous

occasions. They found the Soviets to be more reliable than the Middle East, from which they were receiving the bulk of their primary energy. In addition, the contract with the SOVIET UNION provided for lower prices for gas than Algeria or Norway, the other main, non-OPEC producers had to offer (Fortune, June 1, 1981, p. 79). The receiving of the gas was generally regarded as a step toward less reliance in Europe since it diversified the sources of primary energy even more. The Federal Republic of Germany, which was to receive more gas than anyone in the agreement (about ten billion cubic meters annually), said, for example, that the Soviet gas would contribute about thirty percent to their total annual gas earnings, which in turn represented about seventeen percent of their total energy needs. The Soviet gas would thus cover about five percent of the energy needs of West Germany. This amount, it was pointed out, was easily replaceable and was not significant enough to pose a threat of political influence from the Soviet Union (Fakten, Tendenzen, Konsequenzen, 1987, Introduction).

Opposing Arguments

The Europeans had basically three replies to the American notion of the threat that the Soviets may use the pipeline to exert political pressure. First, they have not done this in the past; second, the gas is easily substituted for in the case that it should happen; and finally, they

pointed to the fact that the Soviets were too much in need of foreign currency to cut off suddenly the gas supply to Western Europe (Forbes, June 7, 1982, pp.122-123).

The American administration was still not convinced. Instead, it offered U.S. coal supplies to the Europeans, which was, if noticed at all, quickly turned down. Then it was suggested by the U.S. to explore the Norwegian Troll gas fields, which were supposed to contain a sizeable amount of gas. While the Europeans agreed that the Troll fields did have a large quantity of gas available, they also pointed to the fact that they would not want to wait until these fields were explored. The Norwegian government suggested that the gas was fairly difficult to reach and that the earliest that anyone would be able to receive gas from this source would be in the mid 1990s. Before the gas would be extracted, one would have to get through the oil reserves which were above the gas, and the oil would have to either be used immediately or wasted.

Furthermore, the new government in Oslo stated that it was important for Norway not to deplete its resources. Strategically, it could be necessary for Norway to hold on to its resources. Once asked about their gas fields near Gronningen in the North Sea, the Dutch reply followed the same reasoning. The Netherlands did not stand ready to deplete its resources when there were other sources readily available. With the limits of their own energy supplies in

sight, the Europeans even felt that they were making a strategically sound move by obtaining gas from the Soviet Union in return for hard currency (Der Spiegel, August 2, 1982, pp. 19-22).

It was this exchange for hard currency that the Reagan administration did not like either. The hard-liners in the American administration around the Pentagon and the National Security Council were convinced that the Soviets could be brought to their knees economically if forced to choose between "butter and guns". The pipeline contract was criticized in two areas. First, with the contracting of Western corporations, the Soviet Union could obtain Western technology, and second, it would provide the East with hard currency which would allow it to purchase more weapons for its arsenal (Forbes, June 7, 1982, p.125). While Europe had no quarrel accepting the technology argument, it was somewhat reluctant to go along with the reasoning of the White House on the second issue.

American Economic Statecraft

Reagan had hoped that through the withholding of foreign currency, the Soviet economy would eventually fail to provide the resources to continue its pressuring policies toward Poland. Some of the administrators supported the claim that one of the reasons why the SOVIET UNION had not intervened in Poland up to that time was because of the

threat of another economic embargo, compared to the time of the Soviet intervention in Afghanistan. Poland was going through a period of domestic turmoil at the time, due to the activities of the later outlawed "Solidarity" labor union. The Movement had found considerable support in the West while the Soviet authorities threatened to subdue it. It was part of the new plan of the Reagan government to coerce the Soviet Union into accepting "Solidarity" through economic measures (Hufbauer and Schott, p. 226).

It was at that point that Western Europe began to disagree with the hard-liners in the Reagan administration. While they recognized the reasoning behind the American position, they failed to agree with it due to the benefits they stood to gain from the pipeline project. Their steel and technological construction industries were in the midst of a recession and the pipeline contracts represented a possible solution. The feelings grew almost hostile, however, when the Americans pointed out that through the hard currency supplied by the Europeans, the Soviets were able to stock up their arsenal against the West. The reply came swiftly. Was it not the same administration that lifted the grain embargo against the Eastern Bloc in April of the same year? The Americans replied that through the grain sale to the Soviets, they were really absorbing their foreign currency, while the Europeans would be supplying it (Economist, September 4, 1982, p. 13).

If anyone had regarded that argument as plausible to begin with, it was even harder to believe after the Wharton School of Business clearly indicated that the Soviets were actually saving money through the importation of wheat from the United States because of the immense cost of domestic production (World Oil, November, 1982, p. 5). The truth simply seemed to be that with an upcoming Congressional election in November of 1982, no American politician would have pleaded in favor of another grain embargo. Those at least, were the sentiments of the Europeans (Der Spiegel, August 2, 1982, p. 20).

The Gap Widens

After Martial Law had been declared in Poland on December 13, President Reagan in his Christmas Address ten days later, announced sanctions against Poland. On December 29, it was made clear by the U.S. Secretary of State, Alexander Haig, that these sanctions would include technological equipment that the Europeans were anticipating using, in order to fulfill their newly signed contracts. In accordance with those declarations, General Electric was denied an export license for equipment in January of 1982, worth about $175 million. The parts were originally to be delivered to Nuovo Pignone of Italy, AEG Telefunken of West Germany, and John Brown of Great Britain. Later in the same month, France signed an agreement to receive Soviet gas and

Italy signed a tentative one (Hufbauer and Schott, pp. 226-227).

During the Summit in Versailles in early June of the same year, subsidized trading with the Soviet Bloc was the main subject of the discussions. A final communique that called for a more careful approach concerning trade with the Soviets was published. As it turned out shortly afterwards, its ambiguous wording seemed to allow different interpretations. The Europeans did not alter their policies, which prompted the American President to extend the sanctions, feeling the Europeans were not supporting the common cause.

Extraterritorial Control over the Subsidiaries

On June 18, the most controversial of all the sanctions was made as the President, under the provisions of the Export Control Act of 1979, warned the European subsidiaries of the American MNEs or those who operated under an American license, not to export any of the technological items of the prior sanctions to the Soviets. Any company, foreign or domestic, could expect to be put on so-called "blacklists", which would preclude them from the transfer of American technology in the future. Furthermore, those managers of the companies found guilty of violating this ban, might have

to count on personal punishment, such as fines or even prison terms (Economist, July 10, 1982, pp. 59-60).

What the United states in essence did was to block not only the shipment of technology from the United States, but to attempt to block the shipments of the Europeans as well. It did not take the Europeans long to denounce these measures. They felt as though the United States had illegally interfered with the internal policies of sovereign states (Oil & Gas Journal, August 23, 1982, p. 89). While it was stated by the European governments that they regarded the sanctions as illegal, multinationals in Europe were still not clear on what to do. Should they deliver the parts already produced, or should they hold off in fear of being punished?

Reactions

The European governments reacted fairly quickly. Italy decided to put the contracts temporarily on hold, stating, however, that they intended to honor the existing agreements. France was in a bind more than any other nation. The only parts that were truly in need as a result of the American embargo were the rotor shafts and blades needed for the gas turbines, whose parts were manufactured by Alsthom Atlantique and assembled by the AEG in West Germany. These turbines were the essential parts of the 41 compressor stations along the pipeline. Alsthom Atlantique,

which was the French subsidiary of General Electric, was the only company licensed and capable of producing these parts. Rolls Royce in Great Britain had the capability to produce turbines as well, but it needed too much time for their completion and the turbines produced would have been less powerful as well. A few had already been delivered before the sanctions, but most parts, however, remained yet to be produced (Business Week, February 1, 1982, 34).

The French were really in a bind more than any other of the Europeans, because they were forced to make a move before any of their partners had to, which was prior to the Commerce Department deadline of August 21, 1982, the date on which the embargo would go into effect.

Fortunately for the French, they were able to come up with a piece of legislation, dating back to 1938 and updated by Charles De Gaulle in 1959, requiring French companies to act in the interest of France. President Francois Mitterand had no quarrels in declaring that the pipeline was in France's interest. Thus corporations such as Alsthom Atlantique, Dresser France, and Creusot Loire could deliver their products under the claim of being compelled to it by law (Economist, August 28, 1982, p. 47).

The British, after declaring at first that they would not act, adopted a similar position. They based their requirement on Section three of the Protection of Trading Interests Act of 1980, which did not give any of the

companies any other choice but to follow the desires of the British host government. The British Prime Minister, Margaret Thatcher, did not leave any doubt that she regarded the pipeline to be in the best British interests and the American sanction to be in violation of international law. This was essentially the feeling of all the European countries (Oil & Gas Journal, July 12, 1982, p. 50). West Germany, which did not have such a provision, informed its corporations, however, that the government was interested in the Soviets' receiving of their materials. The West German government also offered its corporations compensation in the case that they should be penalized by the Americans (Der Spiegel, August 30, 1982, pp. 91-92).

The best example of how difficult the situation had become were the events that developed in Italy. While halting the negotiations on the current contract, the Italian government maintained its willingness to abide by the current agreements. Because of the inability to come up with decisive measures, however, a crisis in the coalition emerged and led to the downfall of the 41st post World War II government in Italy (Oil & Gas Journal, August 16, 1982, p. 44).

The Soviet Union, meanwhile, responded rather angrily that it was quite capable of producing the needed turbines and compressors on their own, without the Western technologies. The construction of the pipeline itself was

moving along quite well, which led the Soviets to believe they would be able to finish the project before its scheduled conclusion (Oil & Gas Journal, June 21, 1982, pp. 112-113). While these statements were regarded with skepticism in the West, it was also clear that the Europeans were not going to let opportunities slip away and neither were they ready to surrender their political sovereignty to anybody, including the United States.

Delivery

In August of 1982, Alsthom Atlantique delivered the first three of twenty-one compressors for the pipeline. As soon as the Soviet ship left the French seaport of LeHavre, the American administration placed the General Electric subsidiary, along with Dresser France and Creusot Loire, who were involved in the production of these parts, on its "blacklists", excluding them from American technological imports (Hufbauer and Schott, p. 228-229).

While the Dallas based Dresser corporation sought to obtain an injunction against the Temporary Denial Order (TDO) in a Federal District Court in Washington D.C., the administration placed Nuovo Pignone on the same list for the shipping of three turbines with American made parts to the Soviet Union. The Dresser suit was rejected due to Judge Thomas Flannery's refusal to interfere with the foreign

policy of his government (Der Spiegel, September 6,1982, pp. 101-102).

The British considered it to be their foreign policy when they ordered John Brown Engineers, Ltd. to deliver their turbine parts. The delivery by the British subsidiary was promptly answered by its placement on the embargo list of the United States (Hufbauer and Schott, pp. 228-229).

Criticism came not from foreigners alone. Realizing that the restrictions against the Soviets cost American companies new contracts and subsequently jobs, concerns grew with respect to the pipeline. In August of 1982, the House of Representatives' Foreign Affairs Committee rejected the sanctions with 22-12 votes. The hard-liners in the Pentagon were apparently still in firm control of the decision making in the executive branch (Nathan and Oliver, 1986, p. 88). After the West German corporations Mannesmann, Thyssen, and AEG-Kanis were slapped with sanctions, it emerged plainly that the Europeans were determined to build the pipeline, despite the American objections (Oil & Gas Journal, August 16, 1982, p.48).

It was in the midst of this internationally confused setting that a West German based human rights group raised the allegations that the Soviets would use political prisoners on the construction of the pipeline. While the Americans gladly added that notion in their argument to pressure the Europeans into a non-compliance with their

contracts, the Soviets responded that aside from the fact that they did not have any political prisoners, the work on the pipeline was technologically too demanding to be handled by prisoners. Amnesty International, who observes the human rights violations in East and West, suggested that there was a possibility the Soviets would use forced labor in the construction, estimating the total number to be around 10,000 workers, rather than 100,000, as it had originally been reported. Amnesty maintained, nevertheless, that this was nothing new or unusual for completion of major projects in the Soviet Union. The governments in Bonn and Paris simply promised to investigate the matter (Der Spiegel, August 16, 1982, pp. 92-94).

Reconsiderations

Facing a heavily united front of the European allies, however, may have had an affect on the administration in Washington D.C. More moderate administrators, such as the new Secretary of State, George Shultz, and the Secretary of Commerce, Malcolm Baldridge, appeared to have gained more influence with regard to American policies (Nathan and Oliver, 1986, p. 91)). Suddenly, the embargoes were limited to include only oil and gas related products, and the harsh tone appeared to have given way to a more conciliatory language (Oil & Gas Journal, November 8, 1982, pp. 127-131). In October of 1982, the President, himself, considered a

cancellation of the sanctions altogether, despite a lack of improvement in the Polish crisis, which had previously been synonymous with an improvement in the trade struggle. The only real improvement in the eyes of the Americans was the reclassification of the Soviet Bloc countries by the OECD members in July of the same year. This meant that the Soviets and their satellites would have to pay more, beginning at that time, in interest on loans obtained in the West. These countries' status had been upgraded from intermediate to relatively rich, putting them into a higher interest bracket, 12.15 percent to 12.40 percent, compared to 10.5 percent at the time (Hufbauer and Schott, 1985, pp. 228-230).

As it stood, the downscaling of the sanctions had few far reaching effects. The inability to import American oil and gas technology had affected companies such as Dresser France and John Brown severely, since their only business was in these areas. Insiders gave Dresser France, which had already lost one contract with an Australian contractor, not much more than two months to survive (Der Spiegel, October 11, 1982, pp. 130-131). The only companies that remained largely unaffected by the embargo were the West German Mannesmann and Thyssen, who were in charge of the pipe production and did not receive any material at all from the United States (Der Spiegel, October 11, 1982, pp. 130-131). Most of the other companies, however, found themselves in

precarious situations, which affected their American parent companies as well.

In November of 1982, the American President lifted the sanctions due to what he called a "substantial agreement", which in his eyes reflected a better understanding by the Europeans of the alliance. What he was referring to was the OECD decision of July, 1982 to reclassify the Eastern Bloc countries in the international loan process, as well as the promise of the Europeans to confer with their allies before making any new substantial agreements with the Eastern Bloc. The U.S. government maintained the right to issue export licences, desiring to be in a position where it would be able to monitor the flow of its technology to the Communist Bloc, which was to be avoided, however, in the case of oil and gas related technology (Oil & Gas Journal, November 22, 1982, pp. 65-66).

The Europeans, satisfied for the time being that they were "permitted" to carry on with their original business, were quick to agree. The quarrel among the allies had been too long and deep, and Helmut Schmidt, the former Chancellor of the Federal Republic of Germany, seemed to have been proven correct, after he had projected in July of 1982 that the whole problem would have been solved by the end of the year. The Europeans delivered their products, while the United States still maintained some control over the type of products that left the country. Inclement weather delayed

the pipeline construction temporarily, failed, however, in preventing the pipeline from being completed on time (Oil & Gas Journal, September 12, 1983, p. 76).

CHAPTER V

CONCLUSION

After having examined this application of economic sanctions a multitude of questions appear. Why did the allies let the situation evolve into one nothing short of a trade war? Who was at fault when home and host countries attempted to legislate over the same entities, based on different principles of law? Aside from the legal issues are the ones concerning the usefulness of economic statecraft to achieve diplomatic goals.

Furthermore, how much can a home country expect from its citizens, especially those that operate in different areas? They appear to be the ones who suffer most from this policy gap. As the political economy developed, multinationals have had to subject their economic interests continously to the political concerns of their home countries. The more a particular country perceives that its vital security interests are endangered, the less will be the importance of economic concerns in the decision-making process. Multinationals are subsequently in a disadvantaged position regarding the freedom of their operations.

The multinationals are among the major actors in the political economy and despite the fact that they are in a situation in which they appear to possess certain economic advantages, as long as the national security interest prevails over the economic interest, it seems as though that MNEs will have comparatively little power politically. Consequently, they suffer from the predominant role of political concerns in this field. That is not to argue that multinationals are without any political power, but as in the case of the Yamal pipeline, the security interests as perceived by the nation state will dominate. A domination which discriminates against the multinationals in the political economy.

The problem emerges as one of conflicting security policies. Competing political interests are currently stronger than economic interests for the nation state. For the multinationals, on the other hand, economic benefits outweigh the political considerations.

What became increasingly clear in the pipeline case was the different perception of the political interest by the different actors. While the Europeans felt no threat of a dependency, the Americans regarded the pipeline as a step toward the subjecting of an ally to the opposition for economic purposes.

Had there been a clear policy regarding the extraterritorial jurisdiction over the subsidiaries of

multinationals and had there been a clear rule to follow, determining whose nationality these corporations would bear, i.e., the territorial principle, then the problem within the political economy of whose claims supersede could have been solved considerably easier. The problem remains, however, because nations may be willing to negotiate in economic policies, in security related areas, or those that may be perceived as such, there seems little hope of improvement, much less hope for an international solution. The fear of a loss of sovereignty still appears to dominate the nations' leaders.

This case seems to prove that point exactly. While the United States may not have succeeded, the right and privilege to interfere in the legislative process of other countries was maintained once again when national interests appeared to be in danger. This perception will eventually lead to a security dilemma and encourage each individual nation to participate in the international cooperation under its own rules.

Accordingly, the prognosis for the MNEs fails to indicate any improvements. Questions concerning the regulations of business remain unanswered. Another political conflict caused by economic interests seems to be programmed, unless one of the key participants from among the nation states would make a move that will encourage the

increase of international cooperation for economic benefits under the security dilemma.

The current setting in particular may offer new possibilities, as glasnost and perestroika may introduce a new phase in East-West relations. In order to achieve more effective cooperation, it may appear as a necessity to form a united front among the allies, who had quarreled, rather than a continuation of the political chaos that nearly divided the Western alliance permanently.

In the case that the East is indeed willing to open the channels of trade with the West, it appears to follow logically that the West should entertain serious thoughts concerning that relationship. In the case of the Yamal pipeline, both the Americans and the Europeans felt as though they had considered the deal thoroughly. With different results emerging from the two independent evaluations, the allies began to counteract against one another, which represented the most serious danger in this case.

In the end both partners put a part of their differences aside as they came together and portrayed unity. The problem of the issue of extraterritorial jurisdiction still remains, as it had throughout since the Second World War. This should sufficiently indicate that in order to retire this particular issue to the satisfaction of all of the participants, there needs to be a comprehensive body of

theory that everyone could agree to if security oriented policies clash with economic policies. Occasional political solutions remain only temporary, and have at least so far failed to provide for the necessary consistency. Studies concerning the relation of the two policies areas seem to be highly recommendable, particularly concerning the decrease of economic importance during the increase of the importance of security matters. Before a solution may be reached, however, it seems to be evident that the analysis would acknowledge the re-emergence of the political economy, as illustrated by the struggle for the Yamal gas pipeline.

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