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TOPIC THE MULTI-NATIONAL CORPORATIONS' ROLE IN FOREIGN POLICY OF COUNTRIES IN TRANSITION: RUSSO-DE BEERS COOPERATION IN STATE-FIRM RELATIONS, 1988-1998.

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INTRODUCTION

Since 1988 the International Relations environment has undergone significant changes and transformations. In no two countries have these changes been more significant than in the Soviet Union/Russia and South Africa.

While the Soviet Union was traditionally involved with the liberation forces within and around Southern Africa due to the ommunist leanings of these forces and the Soviet policy of communism, the political transformation developed in Russia is to reflect a greater priority in improving relations with Western Europe and the United States. As a result of this, formal Russian-South African relations have decreased.

In the past the white South African government was extremely concerned and preoccupied with what they perceived as the expansion of the communist ideology in the African continent and the role that the Soviet Union had played in supporting the liberation struggle in South Africa. As a consequence of this, the ANC had been provided with significant economic and political support and therefore relations between the ANC and the USSR were very good. Although with the transformation of South Africa, the priorities of the new ANC government have changed and the level of relations with the Russian Federati has consequently decreased.

As foreign policy priorities have changed with the transformation in South Afr.ca and Russia, relations between De Beers Consolidated Mines of South Africa and the Russian Federation have played an increasing role in developing ties between those two countries.

In order to explain the above-mentioned phenomenon certain important questions about the formation, transition and execution of countries' foreign policies should be raised.

How did the Soviet Union's foreign policy influence the development of the ANC liberation struggle? What factors influenced the shift in foreign policy making in Russia and South Africa? To what extent did the changes in foreign policy affect the Russo-De Beers relations? How do recent fundamental shifts in the global economy impact upon the state-firm relationship exemplified by the Russian Federation and De Beers? What are the opportunities for future Russian-South African relations?

Indeed, one cannot ignore the fact that the shift in foreign policy formulation together with fundamental shifts in the global economy suggests that the unique state-firm co-operation may at some stage replace the state-firm relations. `To say that the world has changed markedly since the dawn of the 20th Century seems so obvious as to be disingenuous. Fundamental shifts have occurred in both the global economy and in the nature of international relations. One connection between the structural changes in the world economy and society on one hand, and international politics on the other hand, has gone largely overlooked'(1)

Chapter 1 of this paper is concerned with the establishment of Soviet Union-ANC/SACP relations, the shift in both countries' foreign policy in the early 1990's and factors is meant principally to illustrate the significance of these shifts in each states' foreign policy while adopting the interests of both the state (the Soviet Union) and the firm (De Beers Consolidated Mines of South Africa).

Chapter 2 examines the principals on which the state successfully co-operated with te firm for many years, accommodating changes in the political and economic environment. As the Republic of Sakha (Yakutia) promotes the instability in the diamond industry caused by political tensions with the Russian Federation and an expansion of its diamond cutting and secondary diamond related industries, its emergency as a new number of the diamond cartel will be described as disruptive.

In Chapter 3 of this report recent fundamental shifts in the global economy will be described in order to understand the changes in foreign policy making and the diplomacy related to it. Debra Spar's successful cartel participant characteristics will be introduced and employed to explain the Russo-De Beer contemporary state-firm relations. The role of Russia as a state in cartel participation and diamond market will be analysed within the context of this thesis.

Finally, the conclusion will be devoted to answering questions advanced at the beginning of the introduction.

CHAPTER 1

THE USSR/RUSSIA AND SOUTH AFRICA: THE EVOLUTION OF STATE-STATE RELATIONS IN THE COLD WAR ERA

The relationship between the Soviet Union/Russia and South Africa and especially with the African National Congress and its allies had a profound though contradictory effect on developments in both countries. The foreign policy of the Soviet Union /the Communist Party of the Soviet Union and South Africa / African National Congress has undergone a dramatic transformation in the last few decades and has resulted in certain common changes in their transition to democracy. This chapter will investigate the transformation of South Africa and Soviet Union state-state relations during Cold War Era by first examining the key points in the establishment of the Soviet Union-South Africa-ANC

Relations; secondly, locking at the USSR alienation from the ANC and its rapprochement with Pretoria in early 90`s; thirdly, identifying the countries common shifts in transition towards democratisation; and finally, investigating perspectives related to the recent visit of Nelson Mandela to Moscow in May 1999.

SOVIET UNION-ANC RELATIONS, 1960-1989

A lot has been said and written about the negative and positive effects on the South African liberation movement of the links with the Soviet Union. One has to admit that such features of Soviet society as leader-worshipping, dogmatism, the lack of broad discussions before taking crucial decisions, and limitations in inter-party democracy, were not the best to emulate. But even if some borrowing of these matters did take place, its influence was limited and was, from the perspective of the Liberation struggle, undoubtedly overwhelmed by the positive effects of co-operation with the Soviet Union. Perhaps the USSR's greatest contribution was not material assistance, the provision training facilities, or the other steps, described above, but the encouragement of non-racism in the ANC's ranks. In the previous two decades the Soviet Union proved to be a reliable supporter of the liberation movement in

South Africa, which rendered it valuable assistance in difficult times.

The establishment (or to be exact, re-establishment) of direct contacts between the USSR on one hand and the ANC and the South African Communist Party (SACP) on the other, took place in the early 1960s. The discussions with the leaders and officials of the ruling Communist Party of the Soviet Union resulted in political support for the liberation struggle, on the terms suggested by the South Africans themselves, including political support (from 1961) and practical support to Umkhonto we Sizwe (MK) (from 1963). From 1963-1965 hundreds of MK fighters came to the USSR to be trained in Odessa, Moscow and Tashkent. No other country in Africa, or elsewhere, was ready to provide such facilities. (2)

However, the assistance to Umkhonto and to underground activities of the ANC and the SACP, important as they were, represented just one sphere of co-operation between the USSR and the liberation movement. By the beginning of the 1980s many other spheres had developed as well. <u>Diplomatic support</u> for the anti-racist struggle in South Africa started when this issue was raised in the United Nations. The Soviet non-governmental organisations (NGOs) and in particular, the Soviet-based Afro-Asian Solidarity

Committee, played an important role in launching and sustaining several international solidarity campaigns, such as the creation of the International Committee on Southern Africa as a follow-up to the 1977 broad-based NGO conference in Lisbon.

Material assistance to the ANC, which began in 1963, included supplies of food, clothes, cars, trucks, stationery, sportswear, building materials and other goods, through both Soviet governmental channels and the NGOs. Although, it has been estimated that since 1963 to 1983 the ANC received US$ 64 billion financial support from the Soviet Union and other East European countries. (3) From 1962, ANC students went to the USSR for academic and political training. Two large waves of students went in the first half of the 1960s and immediately after the Soweto uprising of 1976. As at December 1981, 79 000 academic students from African countries being trained in the USSR (4).

Assistance in the medical field included training of dozens of doctors and nurses, the supply of medicine and equipment, the treatment of sick and wounded ANC members, and at a later stage, the despatch of Soviet doctors to the ANC camps in Angola.

Radio Moscow broadcasted its regular daily programme beamed to South Africa initially in English and later in Zulu and Afrikaans. The ANC statements and interview with its leadership were world-wide spread by the Soviet broadcasting, for example, by Radio Moscow, TASS, Novosti Press Agency, etc.

The patent failure of the ANC in exile to achieve concrete goals by the end of the 1960s brought about calls for a reorganisation and reformation of the liberation movement's strategy.(5) Certain difficulties resulted from the adjustments the External Mission, led by Oliver Tambo, had to make after the military underground was destroyed by arrests and repression. The External Mission was founded while the transition to armed struggle had been made and its primary task was to mobilise the international community against apartheid.

Responding to these developments, the ANC held a national consultative conference at Morogoro, Tansania in April 1969. The structure of the External Mission was reorganised and the ANC reformulated its revolutionary strategy, transforming itself into the national liberation movement preparing to fight a 'people's war'.

The impetus for the conference came from Chris Hani (Umkhonto's former Chief of Staff) who said it was after Morogoro that ANC `fully took into account the fact that our reverses at home had imposed on our external mission, the task of representing and leading our movement as a whole, including its internal units. We had to carry out the process of reconstruction from outside'.(6)

In order to operate as a `people's movement' and make preparations for the major changes and guerrilla warfare, the ANC required additional funding. It came to rely on the SACP's financial links with the Soviet Union and received immediate help estimated US$ 320 million for its military purposes. (7) The Morogoro conference marked the ANC's transformation into a revolutionary national liberation movement, reflecting its complete alliance with the USSR for another decade.

1985 was a special year both for South Africa and for the USSR. In South Africa mass protests starting in the Vaal triangle and spreading across the country reached new heights.The reaction of PW Botha government was to improve a state of emergency, which moved the international community closer to imposing a range of sanctions on South Africa.(8)At the same time, in the USSR the election of Mikhail Gorbachev to the General Secretary of the Soviet

Union Communist Party signalled the dawn of a new era in both internal and external policy.For details in the Gorbachev era, see Vladimir Tikhomirov in States in Transition:Russia and South Africa.This very period in Soviet relations with the ANC and its allies deserves special study. In many articles and books by academics, published both in South Africa and in the West, it is described mostly as the period of the USSR'alienation from the ANC and its 'rapprochement' with Pretoria. (9)

THE USSR RAPPROACHMENT WITH APARTHEID SOUTH AFRICA

The first years of the `perestroika' period thus had a definite positive influence on the Soviet relationship with the ANC. Ties were becoming more regular and versatile, and assistance grew in all fields. A common approach to the prospects of a political settlement in Southern Africa was worked out and sustained. Furthermore, the liberalisation of the political system in the USSR and of the methods of work of the ruling party affected the South African liberation movement. More critical attitudes to outgrown dogmas, more comprehensive and more realistic analyses of the situation characterised ANC (and SACP) activity in that period.

At the same time, the initiatives by Pretoria to establish relations with the USSR were primarily driven by its attempt to break economic sanctions and its political isolation, and to use Moscow as an instrument for pressurising the ANC and the Mass Democratic Movement. Moreover, the South African authorities could no longer convince the leading Western countries of the `communist threat' to the country. (10)

National Party leaders tried to approach the problem from the academic side first where they found a lot of support. In fact, in December 1989 Professors Apollon Davidson and Irina Filatova were the first to visit South African and participated in the Conference for the Democratic Future of South Africa.(11)

A clear indication of the thawing of state-state relations between Soviet Union and South African governments occurred in late 1990s. Russian Foreign Minister Edward Shevardnadze visited South Africa to hold discussions with FW de Klerk on the political settlement and eradication of apartheid. South African government as a politically dead mechanism could no longer influence the internal and external opposition. Closer links with 'former' enemy, the USSR, could be considered as an attempt to break economic sanctions together with the possibility to `keep the face' in the international community.

At the very time when several decades of the anti-apartheid struggle bores its first fruits, Soviet relations with the ANC and its allies started to cool down and later to deteriorate. The administrative problems became obvious: since for many years relations with the ANC were maintained mainly by the CPSU and by the Soviet Afro-Asian Solidarity Committee, the Foreign Ministry officials had a rather limited knowledge of and experience in dealing with the ANC. Moreover, their specialisation in intergovernmental rel.tions did not help them to understand the complexity of the anti-racist struggle in South Africa.

In addition, there were more serious reasons: the ongoing general change in the stance of Gorbachev and his collaborators. The talk about 'deideologisation' c almost everything - economy, international relations and so on - and about the supremacy of 'universal human values' became a camouflage for the process of 're-ideologisation' and for uncritical acceptance of Western values in both internal and external policies.

One more tendency appeared in this period. Since the economic situation in the USSR was rapidly deteriorating, 'the interests of the national economy' started to be a key phrase in choosing international partners. More often than not that phrase was again just a cover-up for the narrow interests of a group of officials and businessmen. With regard to South Africa, this approach was detrimental as well. Instead of profound preparation for co-operation in the future, when the sanctions would be over, `the interests of the national economy' were used as a pretext for violation, or at least relaxation, of sanctions.

DEMOCRATISATION IN SOVIET UNION AND SOUTH AFRICA

The transition period in both South African and Russian societies is probably the most dramatic in its development. Guillermo O`Donnell defines transition as a `process of dissolution of an authoritarian regime by the installation of some form of democracy' (12). Vladimir Tikhomirov goes further and explains that transition is not only an attempt to reform , but a revolutionary change of power in a society (13).The many analogies that exist between The South African and former Soviet situations exemplify that definition and create , to a certain extent , similar transitional frameworks , dynamics and problems.

In both countries, reform has eventually challenged the authority of the ruling elite and has brought a rapid decline in their power. One of the first results of the transition process in both countries was the emergence of contradictions between the state and the people, which resulted in resistance to any attempts at further reform by the ruling elite/classes/strata. In both cases, as soon as those who had initis the reforms realised that they actually undermined their own authority, they turned out to be the major stumbling blocks to the implementation of these and any further reforms. The initial ideas of both Soviet Union and South African reformers, therefore that is, to implement controlled changes to the social systems that existed at that time, greatly limited their outlook and flexibility. Their primary objectives were tactical in character and, in neither case, designed to challenge the fundamental principles of the former policies or state structures. This helps explain why as soon as the reform processes they initiated started to challenge their own rule, in both situations, the reformers turned out to be impotent at strategic social planning. The first phase of reform in the Soviet Union and South Africa witnessed many political shifts and later alterations to the initial plans, which often resulted in fierce struggles within both the ruling parties and in society.

In both cases, these incremental reform policies created huge problems that could not have been foreseen earlier and which, eventually, increased the existing crisis both in the society and economy. Moreover, reforms in the Soviet Union and South Africa were initiated at a time when crisis was foreseeable. The years of reform have thus also seen the most profound crisis in the modern development of both countries, which further weakened the positions of the reformers, as they were now also blamed for this crisis. Added to this were the consequences of the transformation of the global economy that was then taking place, and which brought about a decrease in demand for mineral products, traditionally the main sources of currency revenue for both the Soviet Union and South Africa.

The collapse of the previous failed ideologies as a result of the implementation of reforms combined with the lack of strategic planning on the part of the ruling elite, have led to the creation of the political and ideological `vacuums' (14) in both countries. The unity of the ruling elite was broken, while reform increasingly alienated the national leadership from their core powerbases. This vacuum was soon filled by other political trends, which were smaller in influence, but much more extremist in nature. The absence of a viable middle class served to strengthen this tendency.

The result was an appearance of a complex, fluid and, in many respects, uncontrollable political situation, where leaders of extremist political parties and organisations, communists, fascists, racists could easily gain support.

The experience of former discriminatory national/racial policies in the Soviet Union and South Africa has added an ethnic/racial element to this situation. The present nationalist upheaval in what used to be the Soviet Union is also being blamed completely on the reformers, while, in the reality, it is rooted in the communist policies of the past.

POST-SOVIET AND POST-APARTHEID STATE-STATE RELATIONS

In light of Nelson Mandela's recent visit to Russia in May 1999, the influence of this event on both countries relations is worth mentioning. As if it has been constantly delayed, the question of Madiba's visit to Moscow has been a disturbing factor for South African and Russian policy makers. Immediately after his release from prison an invitation `on behalf of the USSR leadership' was relayed to him through ANC Headquarters, together with a message of congratulations from Gorbachev. Coincidentally the ANC Headquarters suggested dated at the beginning of June which virtually clashed with Gorbachev's visit to the USA. Then the Soviet side planned Mandela's reception in September, but all foreign visits by the ANC leader for that month were cancelled. The ANC then wanted the visit to take place in October but at the last moment it was informed that the time was not appropriate. The same situation was repeated at the end of May 1991. (15) Unfortunately, in every case ANC officials were in a hurry to announce the dates of the visits before receiving confirmation from Moscow, and the eventual postponements added an emotional dimension to the problem.

Various reasons were given from Moscow for the Gorbachev's failure to meet Mandela in each case.(16) In order to justify `the protection of Soviet national interests and market economy' the meaningful support from the rich Western countries was vital. The newly born Russian democratic state could no longer support it's ideological allies.

Initially four times postponed, the visit of Nelson Mandela to Moscow has been recognised as a tribute not only to the Soviet government, but also to the Russian people who was supporting the ANC in `its darkest hours'. That help was proffered at a time `when there was not a single state in the West ready to give us the type of assistance which we wanted to overthrow white supremacy in the most effective way'.(17) President Mandela, who said political ties between Pretoria and Moscow were now very strong, added that deepening trade relations had also been a key feature of his much delayed trip.(18)

Taken together, all these changes marked a significant transformation in ANC and Soviet Union/Russian foreign policies. The scate-state relations had integrated itself fully within the framework of the global transition towards democracy, experiencing certain common political and economic shifts. In doing so, foreign policy and foreign policy decision making were transformed from elite ruled and minority orientated structures to the democratic movements, represented uniquely in each case. Added to this were the consequences of the transformation of the global economy that was then taking place, and which brought about a decrease in demand for diamonds and other minerals, traditionally the main sources of currency revenue for both the Soviet Union and South Africa. This left the Soviet and South African governments with decreasing funds and confused socio-economic programmes, allowing non-state actors and firms, such as De Beers, playing their role in foreign policy making.

CHAPTER 2

THE SOVIET UNION/RUSSIA-DE BEERS ECONOMICALLY SUCCESSFUL COOPERATION

The fundamental shifts that had occurred in both the global economy and international politics since the dawn of the 20th century enhanced the influence of non-state organisations, firms and Trans National Corporations (TNC) influence in multinational relations. This chapter will investigate the state-firm relationship exemplified by Russo-De Beers co-operation by first examining the relations between two world major diamond producers; secondly, looking at the Russian government's diamond policy and its relationship with the former Soviet Republic of Sakha as an independent state; and finally, investigating the links between the Russian government, the Republic of Sakha and De Beers.

RUSSIA AND DE BEERS AS A MAJOR DIAMOND PRODUCERS

In 1995 Russia produced an estimated 8,500 carats of gem diamonds.(19) Its annual output represents more than 25% of global production by value. In addition, Russia possesses a massive stockpile of gem diamonds, the value of which is estimated at between US$8 billion.(20) If marketed carelessly, this stockpile could depress or even shatter the international diamond market.

De Beers too is a major diamond producer. It holds a controlling interest in nearly the entire production of Botswana, Namibia, South Africa and Tanzania. It maintains marketing agreements to sell the product'¬n from mines spread across four continents, including Aus:ralia's giant Argyle diamond mine. Firms owned or controlled by De Beers are believed to produce more than 50% of the worlds gem diamonds. Moreover, as a result of the CSO's marketing agreement with producer states, De Beers sells more than 80% of the world's uncut g-m diamonds. In 1995 the CSO's total diamond sales were valued at US$4.25 billion (down 2.7% from 1994).(21) Together, De Beers high production, nearly US$5 billion diamond stockpiled, and control of the majority of world sales give De Beers a hegemonic role in the international gem diamond market. De Beers can require al major producers to cut their production, thereby increasing the world diamond supply. De Beers can unilaterally raise international diamond prices.

Since the late 1950s when Soviet diamonds first reached the international markets, the Soviet Union (now Russia) has been the only diamond producer, including both states and firms, capable of mounting a credible challenge to De Beers' leadership of the world diamond market. Although the Soviet Union frequently used its position in the diamond world to improve the terms of its participation in the diamond cartel, the often-predicted challenge to De Beers' leadership of the cartel never developed. In the 1990s, however, Russia appeared poised to challenge De Beers for leadership of the international diamond cartel. A multi-billion dollar market hung in the balance.

Although, certain goals were achieved by the Soviet Union through its participation in the CSO:

Firstly, single challenge marketing. This strategy allowed De Beers to maintain the balance between diamond production and demand by using its cash reserves to purchase and stockpile any excess stones. In other words, the Soviet sided would benefit in hard currency from selling diamonds no matter what the situation on the market is.

Another benefit for Moscow was that the agreements `required' De Beers to purchase a set percentage of Russia's production of uncut gem diamonds (between 90 and 95%).

Thus, even in years when Soviet production increased markedly, or when demand was depressed, Moscow was still paid for its production. De Beers was required to stockpile the additional Soviet gems, or find new markets.

The USSR also benefited from De Beers more generals advertising campaigns. As a luxury item, demand for gem diamonds must be created. Another advantage came from the access to high-grade industrial diamonds. (22) Moscow originally sought diamonds because of their industrial uses, but only half of Soviet diamonds were industrial diamonds. Moreover, many Soviet industrial diamonds contained a high percentage of air bubbles, and thus they exploded under the extreme pressure of drilling and were unsuitable for other key industrial tasks.(23) De Beers remedied this by swapping some of its industrial diamonds for Soviet gem diamonds.

The benefits for De Beers were more obvious. Single channel marketing also meant greater profits for De Beers. De Beers claims to earn most of its profits from its efficient mining operations and from its prudent investments.(24) Its marketing of the diamonds from other producers it portrays as a market support activity. However, many Russians maintain that De Beers made a considerable profit from every Soviet diamond sold through the CSO. Also, by preventing a price war with the USSR, De Beers earned greater profits from all CSO diamonds.(25)

Soviet-De Beers co-operation was mutually beneficial in a variety of ways. For example, after 1976 the De Beers-Soviet agreements included clauses that provided for the exchange of technology. This allowed Soviet scientists to visit De Beers mines in Lesotho (and possibly in South Africa itself), while De Beers specialists Soviet mines. It appears that both sides profited from this technological co-operation.(26) De Beers eventually introduced an X-ray technique for diamond sorting similar to the one pioneered by the Soviets. Conversely, the Soviets acquired sorting tables and other technology and equipment from De Beers and its subsidiaries.

Another advantage was that both sides averted various political difficulties because of the discreet behaviour of their partner. Similarly, the secrecy with which Moscow guarded the terms of the agreement gave De Beers an advantage when negotiating with other producers.

A final benefit was the diplomatic assistance the two sides gave one another. In 1975 Angolan independence placed De Beers' control of Angola's diamonds in doubt. Angola's new Marxist-Leninist government was adamantly opposed to apartheid and supported the severing of all relations with South Africa. Yet, Moscow persuaded Angola to cancel its ties to one of De Beers' competitors. The Soviet Union also had some influence on other African diamond producing states.

Despite the co-operation, Soviet-De Beers relations were also intensely competitive in terms of violating agreements and taking advantage of increased demand on the diamond market.

The situation changed in the 1990s together with political and economic restructuring in both states. (27) Before Gorbachev's 1985 ascent to power, the Soviet Union was a demanding but stable partner. The subsequent collapse of the USSR brought numerous dramatic changes in Russian diamond policy. Soviet demands for better terms for its diamond sales became more frequent and more public. Public debates and bureaucratic struggles began to intrude on diamond policy. Since 1990, disputes over Soviet and later Russia, diamond policy have emerged at two levels:

1. between the Russian government and the Republic of Sakha; and
2. between the Russian government, the Republic of Sakha and De Beers.

THE RUSSIAN FEDERATION AND THE REPUBLIC OF SAKHA

The Republic of Sakha is one of the legitimate and independent sovereign states that inherited after the August 1991 break-up of the Soviet Union. Yakutia in eastern Siberia, is a vast, harsh land. Compromising more than 20% of Russia's total land area, it stretches from frozen tundra north of the Arctic Circle to mountainous taiga in the south. Sakha is infamous as the coldest place on earth that is inhabited by humans all year round and as producer of an estimated 99% of Russia's diamonds.(28)

Despite its leading role in the production of diamonds, gold, natural gas, coal, tin and fish, Sakha has historically received few of the profits from its resources. Instead, the people of Sakha were left with an underdeveloped infrastructure, poor access to consumer goods, a low standard of living and wages insufficient to compensate for the inherent difficulties of life in Siberia. Led by their President, Mikhail Nikalayev, Sakha's leaders demanded a greater degree of economic autonomy and a larger share of the profits from its resources. Towards the end, Sakha proclaimed its economic sovereignty in September 1990. Later it claimed ownership of its natural resources. To institutionalize these rights, Sakha's leaders reached an agreement with the Russian Federation that provide a clear division of economic powers and rights.(29)

In the diamond industry, after months of negotiations in July 1992, President Yeltsin proposed the formation of a new diamond enterprise, called *Almazy Rossii-Sakha* (Diamonds of Russia and Sakha) responsible for mining, sorting, grading, cutting and marketing all diamonds from Sakha. In essence, it maintains a domestic monopoly on the sale of all Russian diamonds. It was created as a joint stock firm; shares were assigned 32% to the Russian Federation, 32% to the Government of Sakha, 23% to workers groups, 5% to a retirement fund, and 1% to each of eight local governments. Profits were and still are, shared accordingly.(30) The company's executive board is composed of professionals, while its oversight board is made up of five representatives of the Russian Federation government, five representatives of the government of Sakha, two representatives from the workers' groups and the president of the firm.

However, Sakha now received a sizable share of the profits from its diamonds and plays a major role in the conduct of the Russian diamond industry. Shares assigned to Yakutia from the Diamonds of Russia and Sakha enterprise (32%) could promote the independent links and manipulation by De Beers, together with certain difficulties to reach a three-sided agreement among The Russian Federation, The Republic of Sakha (Yakutia) and De Beers.

THE RUSSIAN FEDERATION, THE REPUBLIC OF SAKHA AND DE BEERS

Sakha's independent entry into the Russian diamond industry promoted more problems than it solved. The initial difficulty was for De Beers to deal with two controversial parties at the same time, when relations between them were strained.

Sakha also promoted a dramatic expansion of the Sakha diamond cutting industry. Although the majority of Russian diamonds are mined in Sakha, the major cutting plants are elsewhere. Diamond mining produces relatively little employment. However, diamond cutting and finishing and other secondary industries, such as jewelry making and the manufacturing of diamond tools, provide considerably more employment and additional profits. Thus, 1991, the Sakha government launched a new firm, *Tuymaada* Diamond - a joint stock company - with the express purpose of expanding secondary industries in Sakha related to diamonds. *Tuymaada's* success has been remarkable. *Tuymaada* signed agreements with firms from Belgium, Japan and South Korea to build 16 new cutting factories and a host of related industries. De Beers itself agreed to become a partner in the construction of a major cutting plant with the capacity to cut 100 000 carats per year. These plants are expected to ultimately employ approximately 2 000 cutters, many of whom have now completed their training. By 1995 *Tuymaada* had opened six plants, with more than 900 employees, and had increased its capital from 10 million rubles to 1.837 billion rubles. (31)

The Russian government supported the expansion of the Sakha cutting and processing industry. Although De Beers' interests would inevitably suffer, there were no signs of opposition from the South African partner.

One of the effects of Sakha's entry into the diamond world is the instability in the diamond industry caused by the tensions between Russia and Sakha. As if Yelstin has signed the Siberian Declaration of Independence in October 1996, Sakha as a part of the Siberian region has certain control and licensing of Russia's mineral industries and objects to some statutes on mining. As a result, foreign firms are often left wondering as which parliamentary laws and presidential decrees will actually be implemented.Because diamond revenues account for 90% of Sakha's budget, Sakha's prosperity is intrinsically tied to Russo-De Beers relations. Thus far, President Nikolayev and his followers are content with concessions Sakha has received from Russia and De Beers. (32)

According to the interview with Valeriy Rudakov's (the former President of *Almazy Rossi-Sakha*) Press Attache, Yeugeni Simonov, Sakha recently began developing a small diamond deposit without the participation of either ARS or De Beers.(33) Moreover, concerning Sakha's economic problems and its dissatisfaction with the Russian Federation government together with its attractiveness for foreign partners, Sakha is becoming a confounding factor in present Russo-De Beers relations.

The shift from a state-centric international system to one, which allows for multipolarity as well as the emergence of non-state actors, highlighted the role of business in the conduct of International Relations. This trend towards a more prominent role of firms in the multinational system has given rise to state-firm relations as exemplified by the Russian Federation and De Beers. As politicians became more aware of growing interdependence of states and firms, which resulted in firms becoming more involved with governments and governments recognizing their increased dependence on the resources controlled by firms, so international relation scholars became more involved in studying such a typical sate-firm cooperation existing since early 1950s.

CHAPTER 3

RUSSO-DE BEERS RELATIONS AS AN EXAMPLE OF THE STATE-FIRM RELATIONSHIP

The world of International Relations has changed dramatically since the dawn of the 20th Century. The powers of most states have declined still further, so that their authority over the people and their activities inside their territorial boundaries has weakened. Non-state authorities, meanwhile, have impinged more and more on those people and their activities. According to Multinational Relations scholars, many seemingly unrelated developments in world politics and world business have common roots and are the result to a great extent of the same structural changes in the world economy and society. Partly in consequence of these same structural changes, there has been a fundamental change in the nature of diplomacy. Governments must now bargain not only with other governments, but also with firms or enterprises, while firms now bargain both with governments and with one another.(34)

This chapter will first examine the evolution of interdependence in the international system and its impact upon states as well as emergence of state-firm relations; secondly, it will apply these theoretical insights to the explanations of the case of Russo-De Beers relations.

THE RISE OF INTERDEPENDANCE IN THE INTERNATIONAL SYSTEM

The ideas of the world's interdependence were introduced first by the German scholar, Karl Kaiser nearly 20 years ago. (35) He suggested that the process of interdependence necessarily involve closer interaction among governments and firms and criticized the asymmetry of government power in transnational politics. His theory showed only a two-way relationship and indicated that some states have more influence than others do over the conduct of international organizations and firms. What he omitted was the nature of the interactions within the transnational society and how these affected the options and the power of states. More recent developments have shown that these interactions have developed strongly both to add a third dimension to the phenomenon and to suggest further limits to the power of the state.

Susan Strange introduced the 'three sets of forces in the old game of Diplomacy'. No longer can national boundaries define the rules, for the game is now one where negotiation and action is carried out on a triangular basis.(36) The traditional players in the embassies and foreign ministries are still in business, but they have been joined by the executives of firms, both local and multinational involved in bilateral and multinational negotiations.Figure 3.1 shows the three dimensions of the game in a simple form.

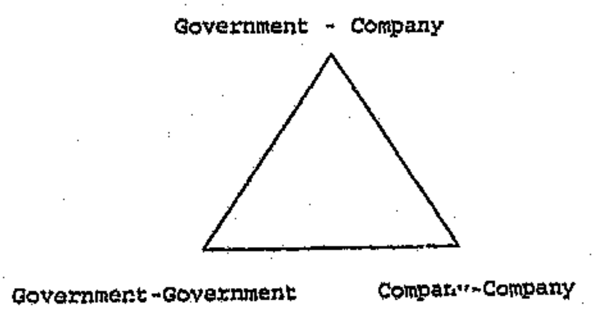

Figure 3.1 Triads of relationship.

Source: Strange, S. Rival states, Rival firms. Cambridge University Press. Cambridge 1992

Changes in international political economy create new sources of asymmetry in the relative importance of the three sides of the triangle. The growth of global competition can be seen as moving the world towards a position where events are conditioned more by an emerging managerial technocracy than by traditional notions of state power. In this new technocracy firms feature prominently but are only one component of a wider network that links them to the educational and skills infrastructure and the financial system. Competition is increasingly among different production and institutional systems and contrasting social organizations.

In the explicit bargaining between host governments and foreign enterprises, sometimes one and sometimes the other has the whip hand. Frequently, as in interstate diplomacy, elements of both conflict and cooperation exist simultaneously in the bargaini g process. The asymmetry of the process makes the choice of partner critical. For states, a sickly corporate partner may be just as damaging as an alliance with a weak state. Before the 1980s, corporations looking for compatible hosts shopped for tax breaks and docile, low-paid Labour. More recent experience has demonstrated that neither could compensate for administrative incompetence or for official intervention, either by internal price control or tariffs or other barriers to efficient operations.

Contemporary studies show that the nature of the competition between states has changed, so that macro-economic management and industrial policies may often be as important for governments than conventional foreign policies, that enhance the significance of firms as actors influencing the future course of transnational relations.(37) Thus, while state-firm relations cannot replace state-state relations in global politics, they provide an increasingly vital supplement.

RUSSO-DE BEERS STATE-FIRM RELATIONS

According to Susan Strange's definition, Russo-De Beers relations could be described as typical of contemporary state-firm relations. De Beers is a large firm that can provide Russia with technology, investment capital and, most importantly, market access. Conversely, control over Russia's diamonds is critical to De Beers'success. Because De Beers controls the international diamond cartel, Russo-De Beers relations are a special form of state-firm relations. Simply put, a cartel is an association among producers of a single product who cooperate in order to increase the profits of their industry by subjecting their competitive activities to collective control.(38) Cartels may be institutionalized by a formal organization, such as the Organization of Petroleum Exporting Nations (OPEC), or may they be informal In one sense, the CSO is a formal cartel. All major diamond producers who maintain formal contracts with the CSO profit from its success. Each year these contracts bring in millions of Rand, and in Russia's case billions of Rand in profit for its producers. The producers, in turn, support the CSO and allow it to set prices on their behalf. In another sense, the CSO is not a cartel, but a monopoly owned and operated by De Beers alone. While all major producers maintain formal and exclusive contracts that allow the CSO to sell their stones, the producers themselves do not own the CSO. While ownership of the CSO remains a matter of considerable speculation, in practice De Beers controls it. Among the major diamond producers, only the government of Botswana owns a significant percentage of De Beers' stock and hold seats on its board. Yet, Botswana's influence remains small and translates into little if any operational control of the CSO. Moreover, while producers usually co-operate willingly with the cartel, at times De Beers has bullied and threatened producers into selling through the cartel. In 1981, for example, when Zaire attempted to market its diamonds independently of the CSO, De Beers flooded the market with diamonds that closely matched the quality of Zaire's diamond production. As intended, De Beers' actions dramatically reduced the price Zaire received for its diamonds. Zaire returned to the cartel.(39) Thus, the CSO can be viewed simultaneously as a successful producers' cartel and a powerful privately owned monopoly.

The political and economic power of De Beers is often greater than that of countries in which it operates. Even the South African government has only limited control over the cartel's activity.

How do cartels benefit producers? Basic economic theory claims that in an ideal-type free market there is a direct and simple relationship between supply and demand. If supply decreases relative to demand, prices rise; if supply increases relative to demand, prices fall.(40) Micro-economy theory also suggests that luxury commodities, such as gem diamonds, are especially susceptible to price fluctuations. Luxury items are by definition the first purchases consumers will forego when they experience a reduction in spending power. Successful cartels, however, prevent price fluctuations by stopping excess production from reaching the markets. They can in theory even force price increases by maintaining production at levels lower than existing demand, thereby artificially creating scarcity.

If cartels are so beneficial to producers, why have they always been a relatively rare feature of economic life? One possible explanation is that states have sought to limit cartels. However, state actions alone cannot explain producers behavior in a variety of international markets that are relatively unencumbered by legal restrictions. Moreover, in some market states have encouraged co-operation. In others, they have participated in the formation of cartels.(41)

CARTEL PARTICIPATION

In order to explain the relative absence of cartels, economists have turned increasingly global to structural changes theory presented by Susan Strange.(42) The detailed examination of the problem on the microeconomic level has been presented by Debra Spar. She identifies five structural factors that are important in the formation and maintenance of cartels:

- a high concentration of production in the hands of relatively few producers;
- high barriers to entry for new producers;
- relatively few smaller producers outside the cartel;
- a product for which no inexpensive substitute exists; and

- non-differentiation.[43]

While these conditions facilitate cartel formation and maintenance, they are neither necessary nor sufficient. Even under near ideal structural conditions cartels do not always form, and cartels sometimes form under less than optimal structural conditions. Thus additional factors must be considered.[44]

In a seminal study, Debra Spar examined four commodity markets, all of which provide fertile structural conditions for cartel formation. What she discovered, is that despite the structural similarities of these commodity markets, the level of cartel activity varied markedly. Spar concluded that the producer co-operation is best explained by the differing internal structures and characteristics of producers themselves. She found that five producer characteristics are especially favorable for cartel participation.

First, producers must have a long-term stake in the market. Without such a stake they will likely submit to the temptation to undermine the cartel by either selling more of their production than cartel agreements allow, or by selling production at less than agreed on prices. Second, producers must have considerable financial reserves, because when demand decreases or supply increases, they must collectively decrease their production, and thus forego the income they would have otherwise earned. Third, the major producers must be autonomous. In other words, whether the producer is a private firm or a state, it must be able to make credible agreements and adhere to them. Fourth, at least one major producer must have the capacity to punish those members of the cartel that violate its agreements. For example, if a state breaks an agreement by covertly selling more than its quota, the stability may well depend on the ability to punish the violator by temporarily flooding the market with product similar to that being sold by the violating state. This would decrease the price of that particular item, and thereby decrease the profitability of cheating on agreements. Finally, producers must have the political will to participate in the cartel.(45)

Spar also points out that centralized authoritarian states and firms are generally better suited for successful cartel activity.(46) They can make credible threats and promises with little concern as to the reaction of internal groups or factions. Similarly they can maintain secret agreements, free from public access.

In order to examine the changes that affected Russo-De Beers state-firm relationship and the international diamond cartel, we would try to implement Debra Spar's five internal characteristics of successful cartel participants.

First, successful cartel participants must have a long-term stake in their markets. Russia's long-term interests are still served by maintaining the maximum prices for world diamond sales. In practice, however, the individuals and institutions involved in the creation of diamond policy may not share this priority. In the Soviet era, the officials responsible for diamond policy typically spent their entire career in the industry. When the policies they implemented proved successful over the years, the same officials remained to reap the benefits. Contemporary Russian politics, however, are fraught with instability. Ministers, their deputies and top bureaucrats are shuffled or replaced on a regular basis. Public perceptions of a failed policy can bring one's career to an abrupt end. In this climate those who ignore short-term gains and immediate political payoffs may not remain to reap the kudos for a prudent long-term policy. Thus, the overwhelming temptation may be to forsake Russia's long-term interests for short-term, more visible gains.

Spar's second characteristic was that successful cartel participants must have considerable financial reserves, so that they can afford to forego the short-term benefits of cheating on their partners. While the Soviet Union could once afford to withhold its producers during periods of slackened demand or excess supply, Russia cannot. Its immediate financial concerns are considerable and at the front of Russia's political agenda. In general, the more democratic a state is, the less insulated it is from short-term economic concerns.

Spar' third and fourth criteria were the major producers must be able to make credible agreements and credible threats. The successful participant must be able to authoritatively sign agreements and its partners must be confident that it will honor the agreements it signs. A necessary condition for such credibility is the ability to insulate cartel policy from the influences of internal groups with competing preferences.(47)

CONCLUSION

The aim of this research was to assess the impact of political changes on the economic development process and the creation of diamond policy for two major role players in the industry, the Russian State and South Africa's multinational firm De Beers. In the course of this study it has been demonstrated that the state-state relations have been crucially important. A number of relevant additional observations been mentioning as well and are listed below. One could state that Soviet foreign policy influenced the liberation movement in Africa by providing strategically important financial, ideological and diplomatic support. The liberation struggle could hardly be successful without Moscow's assistance.

The factors that influenced the shift in foreign policy-making in both countries are numerous and controversial. Most notably these factors center around the fall of communism, the rise of the democratic Russian government, the demise of Apartheid system in South Africa and the election of the ANC government in 1994. As a consequence of transformation in both South Africa and Russia the foreign policy priorities have also changed to reflect the interests of states in transition. This has resulted in a relative decline in the traditional relations between the states and the firms.

However, this is not to suggest that changes in foreign policy affected the Russo-De Beers relations tremendously. In the context of new foreign policy priorities where South Africa and Russia no longer play as large a role for each other as before, Russo-De Beers state-firm relations are of increasing importance.

In terms of the future of Russian-South African relations, Russia and South Africa can cooperate in several important areas. Most notably the fact that both countries are major world producers of strategic minerals and active diamond cartel participants presents many opportunities for the future.

In the context of the environment in which formal diplomatic relations are no longer playing as important a role, economic relations between Russia and South Africa present opportunities for bringing the two nations closer together. Understanding the importance of economic development within both Russia and South Africa as a means of supporting the transformations that have occurred, the economic possibilities resulting through international trade of such commodities as diamonds, platinum and other strategic minerals should be explored and developed in the future.

Presently, Nelson Mandela's visit to Moscow in May 1999 considered as a `turning point' in setting up future economic relations. Now that the situation is improving in both countries, such cooperation becomes a welcome imperative, particularly from the Russian side.

Finally, the upheavals of the International Political economy during the last decades have altered the relationships among states and firms. As a result, firms have become more involved with governments and governments have come to recognize their increased dependence on the resources controlled by firms. Despite all the ideology clashes, economical, political and ethnical differences and relative absence of democracy, the controversial, but mutually beneficial cooperation between the Russian State and South African Cartel had operated successfully for a number of decades and had replaced the financially and ideologically motivated Russian government-ANC collaboration.

While the central actor in International Relations remains states, as illustrated by President Nelson Mandela's visit to Moscow in May 1999, the role that Multinational

Corporations play in the International Environment is increasing in importance. This is effectively illustrated in the complicated dynamic existing between the Russian Federation and the Republic of South Africa where De Beers has in may respects played an instrumental role in developing and supporting Russian-South African relations.

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15. [illegible] op cit p. [illegible]

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APPENDIX 1

TABLE 1

Natural Diamonds : Estimated World Production

by Type and Country

(Thousands of carats)

Country	1994 Gem	1994 Industrial	1994 Total	1995 Gem
Angola	935	65	1 000	800
Australia	21 000	21 000	42 000	21 000
Botswana	10 000	5 000	15 000	10 000
Brazil	600	900	1 500	600
China	200	800	1 000	200
Ghana	175	525	700	200
Namibia	1 500	50	1 549	1 500
South Africa	4 400	5 750	10 156	5 000
Russia	9 000	9 000	18 000	8 000
Zaire	3 000	12 000	15 000	3 000
TOTAL	**52 063**	**55 703**	**107 771**	**51 700**

Source: Diamond International, March-April 1996.

APPENDIX 2

TABLE 2

RSA Polished Diamond Export Revenue, 1990-1994

Year	Mass Carats	Value R million
1990	556 244	1 199,6
1991	391 078	1 071,5
1992	262 949	890,0
1993	203 497	955,2
1994	274 296	1 093,0

Source: South African Diamond Board, 1995

APPENDIX 3

TABLE 3

Industrial diamonds : exports and imports

	Exports (million US $)						Imports (million US $)					
	1991	1992	1993	1994	1995	1996	1991	1992	1993	1994	1995	1996
WORLD DEVELOPED MARKET	345.6	375.3	435.4	454.4	382.3	402.6	341.0	358.7	783.0	496.9	348.2	272.7
ECONOMY COUNTRIES	190.0	191.9	150.9	174.9	168.5	170.3	279.8	261.9	603.8	402.1	248.2	220.7
THE REPUBLIC OF SOUTH AFRICA	38.5	35.0	30.0	27.2	15.7	16.0	3.5	4.3	6.5	11.6	2.5	5.0
DEVELOPING COUNTRIES AND TERRITORIES	135.5	162.4	264.3	259.3	193.7	182.2	58.9	94.9	178.1	91.5	96.4	49.9
THE RUSSIAN FEDERATION	20.0	20.0	20.0	20.0	20.0	50.0	0.0	0.0	0.0	0.0	0.0	0.0

APPENDIX 3

TABLE 4

Diamonds, rough, uncut : exports and imports

	Exports (million US $)						Imports (million US $)					
	1991	1992	1993	1994	1995	1996	1991	1992	1993	1994	1995	1996
WORLD DEVELOPED MARKET	2012.7	1822.3	1824.7	1896.2	1892.2	1935.8	2200.5	1902.1	1851.7	1887.4	1832.2	1856.9
ECONOMY COUNTRI[illegible] *	862.4	773.1	1094.0	885.8	848.0	1294.8	2033.0	1725.9	1588.0	1614.5	1539.3	1528.6
DEVEL[illegible]PING COUN[illegible]IES AND TERRITORIES	1129.3	1028.5	629.3	238.0	48.2	41.0	165.8	174.2	261.8	272.2	292.6	327.9
THE REPUBLIC OF SOUTH AFRICAN	100.0	100.0	140.0	144.7	219.5	120.0	60.0	55.1	72.1	96.5	40.9	65.0
THE RUSSIAN FEDERATION	20.0	20.0	100.0	800.0	1000.0	600.0	0.0	0.0	0.0	0.0	0.0	0.0

Source: Handbook of World Mineral Trade Statistics, United Nations, 1997.