REVIEW ESSAY

Privatization and Piratization in Post-Communist Russia

YURI MALTSEV

Marshall I. Goldman is the Kathryn Wasserman Davis Professor of Russian Economics (Emeritus) at Wellesley College and has been a member of the Wellesley faculty since 1958. He is also associate director of the Davis Center for Russian and Eurasian studies at Harvard University. Generations of policymakers, scholars, and students have regarded Goldman as the internationally recognized authority on Soviet and, after 1991, on Russian economics and politics.

His new book *The Piratization of Russia: Russian Reform Goes Awry* (New York: Routledge, 2004) focuses on the privatization of state property in the former USSR and in eastern Europe. It is a tale of the making of rich oligarchs in the wake of the collapse of the Soviet Union and of the mafia's role in these reforms.

It is also a story of intrigue, adventure, and the "incestuous relationship between government leaders and corporate directors and bankers [that] allowed for insider deals, golden parachutes, corporate jets, villas in Cyprus and Spain, and instant millionaire status for those who played along" (p. 2).

In addition to published materials, Goldman's sources include "over ninety personal interviews, conversations, and seminar presentations involving senior Soviet and Russian officials, including prime ministers, several of the oligarchs, and about twenty-five factory directors" (p. 11). Thus, *The Piratization of Russia* combines published academic research and investigative journalism based on anecdotal evidence.

With the collapse of the Soviet Union in December 1991, almost every member of the old Soviet ruling class, or *nomenklatura,* wanted to take advantage of privati-

Yuri Maltsev is a professor of economics at Carthage College.

The Independent Review, v. X, n. 3, Witner 2005, ISSN 1086-1653, Copyright © 2005, pp. 425–430.

zation. Only a handful of these would-be capitalists, however, succeeded in seizing the billions of dollars worth of assets and natural resources that would make them billionaires in post-Communist Russia. Goldman views the privatization of the Russian government's assets as a theft of immense proportions committed by greedy, unscrupulous, and unpleasant individuals. He claims that men such as Boris Berezovsky, Vladimir Gusinsky, Mikhail Khodorkovsky, Roman Abramovich, and Vladimir Potanin looted their country as it moved toward a market economy, and he insists that their fortunes represent the fruits of piratization rather than of any defensible privatization.

Goldman points out that much of what is happening in Russia today echoes not only the Communist-era culture, but Russia's czarist history as well. "Historically, Russian rulers, czars, general secretaries, and now presidents have had little regard for those who have gone into business. Good Russians ('our kind of people') simply did not do that kind of thing. Beginning with the czars, Russians of the upper class served in the court or in the army" (p. 38). The ruling elites cultivated an antibusiness, anticapitalist mentality from the beginning of the Russian state in the tenth century. Goldman notes, "that same attitude explains in part why Russians, despite or maybe because of their distrust of foreigners, were happy to relegate business activities to foreigners and minority groups. Poles, Germans, Jews, Armenians or Georgians were particularly active at the time. Given [the Russians'] traditional prejudices, this only increased the contempt they had for business" (p. 39).

Goldman concludes that "Russia in the pre-Revolutionary era was never able to develop a culture or set of institutionalized forces that might have contained or restrained the state" (p. 37).The Bolshevik Revolution of 1917 was thus not an isolated event in Russian history. The beginning of the twentieth century marked a qualitative change in this respect: the interrelationship and mutual influence of economic process and political power were significantly deepened. These changes meant more government intervention, more regulations, more social and ethnic engineering. The huge bureaucratic regulatory state created by the government of Nicholas II was the direct predecessor of socialism. Marxist doctrinaires' determination, coupled with the ruling elite's apathy under the Czarist regime, prepared conditions for the deadliest experiment in world history.

The stage was set, and the results were inevitable: Lenin created and Stalin tuned up the perfect killer state, which destroyed civil society and the economy, murdered tens of millions of Russians and others, and turned pristine expanses of the country into environmental wastelands. Competition was officially abandoned in the 1930s, with the formation of a system of industrial ministries solely responsible for the production of certain groups of commodities. The market-price system, necessary for an efficient economy, ceased to exist in Soviet official economy, but continued to operate in a fiercely prosecuted black market. Efficient allocation of resources became impossible owing to the lack of price information.

Goldman observes: "Granted it is presumptuous for an inhabitant of one culture to tell another that his culture is flawed. Moreover, even if all agree that a change in culture is needed, instituting such changes will be very difficult. Building up a large middle class may be the best way to do it, but that will take more than an ukaz by President Putin" (p. 239). Moreover, I doubt that Putin would be in favor of such a ukase. All Russian rulers, whether czars or commissars, have opposed the establishment of private-property rights, the prerequisite for any strong and prosperous middle class.

In brief, the story of Russian privatization goes as following. After the demise of the USSR, Prime Minister Yegor Gaidar and Anatoly Chubais, who was put in charge of privatization, decided in 1992 to create stakeholders in the new regime so that people would not strip the assets and tear the place apart. People with a stake in the new system presumably would also fight off the Communists and prevent restoration of the Soviet system.

First, the privatization planners transferred 51 percent of the stock in each company to its directors and workers. Because the workers were not organized, the factory directors gradually took over this entire amount. One class of oligarchs, the factory directors, told the workers: "Sell me your stock or you'll be fired or shot." Most of the workers were happy to get rid of the stock: "What is this piece of paper?" For seventy years in the USSR, they had been told that such pieces of paper are worthless, that thinking corporate stock has value is a capitalist delusion. Some workers thus gladly exchanged their stock for a bottle of vodka.

The remaining 49 percent of the stock was to be transferred to the public at large by allowing them to obtain it in exchange for vouchers. "But how does one provide the general public with a share of the country's industrial and commercial wealth? Chubais did just that—he calculated the value of the country's industrial and commercial assets and divided it by the number of the citizens of the country" (p. 86). Each individual in Russia was given a voucher with a nominal value of 10,000 rubles. Ultimately, 146 million vouchers were distributed for a very small price to a population of 148 million, so more than 98 percent of the population ended up with a voucher (p. 87). This method is the same one by which successful privatizations were implemented in the Baltic states, Poland, the Czech Republic, and elsewhere in the post-Communist world. In Russia, however, things went wrong: "Setting such a low value for the voucher was a mistake," writes Goldman. "Inflation continued to eat away at real values so that within a year or two 10,000 rubles was worth only about $25, and for a time voucher holders sold their vouchers for less than $10" (p. 87). To most people, their $10 "stake in Motherland" looked like an insult, and "the Russians once more saw themselves as the victims of another scam" (p. 87).

The people asked, "What are these vouchers? What do they mean?" Some burned them; lucky ones exchanged them for vodka. However, a few thought, "Nobody knows what these things are. If I could gather a million of them . . . ," and they did.

Boris Jordan, a man of Russian parentage who grew up on Long Island and worked for Credit Suisse First Boston, went to Russia and managed to buy between 7.5 million and 14 million of the newly issued vouchers. He thereby gained control, or at least a voice, in several of the properties set aside for privatization (p. 89).

Goldman was the first Western critic of the Yegor Gaidar economic reforms of 1992, including the transfer of public property to a small number of "oligarchs." He deplores the "shock therapy" and its architects, Harvard professors Andrei Shleifer and Jeffrey Sachs (now at Columbia), who consulted with Russian authorities in the early 1990s and advocated almost instant privatization of the state property.

Goldman's anger against "shock therapy" is misplaced: in fact, Russia got the shock without the therapy because neither Yeltsin nor Putin ever listened to his economic advisors, whether foreign or domestic, or introduced any genuine free-market reforms. Instead, they built a neofascist economy in which private-property rights are blurred, the Federal Security Service (formerly the KGB) is the government, the government bureaucracy is omnipotent, and nobody (including Goldman's "greedy" oligarchs) can be sure that their lives and property are secure.

Goldman is dismayed that in the past few years Russia has "delegated" nineteen billionaires to the *Forbes'* World's Richest People list—more than Great Britain or France, for example. Tracing the genesis of Russia's "oligarchy," he emphasizes that the oligarchs propelled themselves to riches after the start of perestroika in 1987. Coming from the ranks of Soviet government officials or black-market dealers, these people took advantage of immature regulatory environment to build wealth, first through establishing financial and export-import operations and then by privatizing the country's natural resources and mass media. The oligarchs reached the peak of their influence in 1996, when they ventured into politics and helped reelect Boris Yeltsin. In 2000, they united again to back his successor, a former KGB colonel named Vladimir Putin. Their choice of Putin was very shortsighted: he is successfully undoing the results of the privatization and other reforms of the Yeltsin era. (In any event, we should not overestimate the scope of Yeltsin's privatizations: "the Russian government still owns significant shares in many partially privatized or wholly government-owned enterprises" [p. 238].)

Goldman focuses his anger on the personal character flaws of new Russian oligarchs who, unlike most of their meek compatriots, dared to claim property from the criminal state, restored it, and made it work for themselves and millions of others. These oligarchs, following in the footsteps of the dissidents of the 1970s and 1980s, challenged the omnipotence of the KGB and the bureaucracy, created the first mass media truly independent of the state in Russian history, established the first private charities, and supported the cause of political and economic freedom. Gusinsky and Khodorkovsky fought anti-Semitism, supported the cause of Chechen independence, and opposed the restoration of the KGB tyranny in Russia. Yet Goldman, with the rigor of a trustbuster or Putin's prosecutor, traces the biographies of Berezovsky, Gusinsky, and Khodorkovsky for presumed tax evasion and other "economic crimes." The oligarchs, however, have already lost everything and are either in exile or in jail. Stripped of their mass-media assets, exiled to the West, continuously harassed in the government-controlled press, they have lost their political weight and are now losing control over the economy and Russian natural resources. Putin is passing this control to his KGB cronies. The recent sentencing of Khodorkovsky and his associates to ten years of imprisonment is an obvious indication that Putin and his almighty organization are eager to destroy anyone who would dare to oppose its monopoly on power in present-day Russia.

Western leaders today are willingly playing into Putin's hands in the same way that Franklin D. Roosevelt sold out the Poles, Balts, and other eastern Europeans to Uncle Joe during World War II. Western executives in Moscow are humbly following the Kremlin's directives. Dmitry Slobodanuk wrote in *Pravda* on November 6, 2003:

> Bill Browder, CEO of Moscow-based Hermitage Capital said in an interview to the Financial Times that a well-governed authoritarian regime is better than the oligarchic mafia regime. Hermitage Capital has been working for more than ten years in Russia. The company prefers to cooperate with the state-owned Gazprom and Sberbank. One shall assume, Western businessmen are expecting the complete destruction of the class of Russian oligarchs. The destruction will definitely take place—one may not have any doubts about it. First, the repressive mechanism to redistribute the national wealth has been launched and it is dangerous to stop it. Secondly, if the process is suspended, the present Russian government will be dramatically defeated; it will lose its followers too. (my translation)

The title of Slobodanuk's article—"Russian Oligarchs to Be Liquidated: The Process Has Been Launched and It Cannot Be Stopped"—calls to mind Stalin's 1937 directives on the "cleansing of society of capitalist sleaze and mold." Such popular feelings toward oligarchs and private property in general are deeply ingrained in Russian society.

Goldman recognizes that seventy years of central state planning and ownership destroyed all market infrastructure and resulted in an absence not only of formal market-supporting institutions, such as impartial courts and commonly applied commercial laws, but also of market-supporting informal norms and conventions: "none of these institutions and norms were in place when Russia began its reforms" (p. 74). He acknowledges that Russia's culture would have defeated any sound privatization plan.

The experiences of political and economic transitions in the formerly socialist states indicate unequivocally that certain cultural conditions are necessary for a successful transition to a market economy. Goldman quotes Alan Greenspan's 1997 lecture about Russia, in which

> Greenspan pinpointed the reasons why the Russians have had so much difficulty with privatization. To Greenspan the major problem was the difference in "culture," a word, as we saw, other economists sometimes have trouble pronouncing in public. In his words: "Much of what we took for granted in our free market system and assumed as human nature was not nature at all, but culture. . . . The dismantling of the central planning function in an economy does not, as some supposed, automatically establish a free-market entrepreneurial system. . . . Black markets by definition are not supported by the rule of law. There are no rights to own and dispose of property protected by the enforcement power of the state. There are no laws of contract or bankruptcy or judicial review and determination, again enforced by the state. The essential infrastructure of the market economy is missing. (p. 29–30)

The last sentence, writes Goldman, is significant for much of his story.

Goldman critically assesses the approach to economic reform the Russian government took after the Soviet Union's collapse. He contends that the reforms Gaidar and his American advisors Sachs and Schleifer introduced only made the situation worse, producing a few oligarchs amid an impoverished population, instead of a strong and prosperous middle class. Moreover, he argues, real alternatives existed—Poland serves as his best example. Now, however, the momentum has been lost; "it is probably too late to adopt the Polish model" (p. 238). Thus, *The Piratization of Russia* provides us with more evidence that private-property rights are indispensable to the functioning of a free and prosperous society. Without such rights, economic growth and human progress are impossible. The linkage between human effort, the resulting product of that effort, and well-being must be secure and stable for economic activity to flourish. To establish such a linkage for the majority of Russians, "the underlying culture must also be changed" (p. 238).