"Shock Therapy" for the Russian Federation: Privatisation and Criminalisation of the Economy

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Table of Contents

List of tables

1. Introduction

A crisis of the Soviet system that developed over decades called for transformations. The monopoly of political power and economic management was in the hands of the bureaucratic elite represented by Party nomenclatura. This upper bureaucracy, that was estimated to consist of four hundred thousand officials, enjoyed four to five times higher than average salary.[1] In addition, it had privileges such as special shops and schools, private rooms in hospitals, rights to travel abroad, etc. The system, as based on bureaucratic management of the economy and monopoly of political power, was socially irrational. It just reflected nomenclatura's interests, which were mainly in the privileged access to goods and services. "The contradiction between the private interests of the bureaucracy and the economic rationality was the source of increasing waste of human and material resources… massive theft and corruption..." As a result, the number of poor people grew steadily and reached, according to some estimates, fifty million. The figures for life expectancy and infant mortality also confirmed the process of social decomposition.[2]

The USSR's reform of late eighties aimed for creation of a hybrid 'market socialism', or, in other words, transformation of the existing socialist system without transition to capitalism. The main idea behind the reform was to increase economic autonomy for enterprises and individuals on the cost of a reduced role of central planning.

The Law on Individual Labour Activity, effective May 1987, was the first law to stipulate creation of private enterprise. New private firms were to operate on five-year licenses issued by local authorities. The Law also provided the private sector with a framework of legal and other support.

The Law on State Enterprises of July 1987 gave state enterprises freedom in their investment decisions, deployment of profits, and choice of suppliers and customers. Moreover, it relaxed various restrictions on the payment of wages, premia, and bonuses. In accordance with this Law -- that went into effect on January 1, 1988 -- investment was no longer financed by the state, but rather was to come from the enterprise's own resources. However, as the practice had shown, a major portion of the enterprises' profits went to the wage and other funds and, hence, caused no productive investment. Wage increases were determined by the enterprise's capacity and management's willingness to pay and were not linked to productivity. In accordance with the Law, directors were to be elected by the workforce. But this rather gave legitimacy to the directors than instituted workers' management. The workers still had no power to impose their collective will.

The autonomy of state-owned enterprises (SOEs), which was brought about by the "transition to the market ", not only allowed enterprises to keep a major part of the profit but also exposed them to the risk of bankruptcy. It also meant the elimination of state subsidies in consumer goods, creation of supplier-customer relation in industry, and price decontrol. However, existing monopoly in certain sectors of the economy allowed the supplier to impose exaggerated prices, while existing interconnected bureaucratic cliques allowed managers to overestimate the costs of production.

Gorbachev aimed to cut price subsidies from basic goods and services, notwithstanding the fact that, traditionally, Soviet consumers and producers were heavily reliant on state subsidies. In total, subsidies represented 20-25 percent of spending.[3] For example, one kilogram of meat sold for 1.8 roubles had a state subsidy for three roubles. For a litre of milk sold for thirty kopecks, the subsidy was 25 kopecks.[4] In 1987, Gorbachev abolished housing subsidies. The elimination of housing and other subsidies reduced the buying power of the wage earner and increased the cost of living.

The Law on Co-operatives of 1988 placed co-operative ownership on a legal par with state ownership. Co-operatives, enjoying simplified procedures for registration and strengthened legal protections and tax advantages, were allowed to engage in a very broad range of activities. Moreover, co-ops with good government and management connections were profiting rapidly. The number of co-operatives grew quickly and reached 215,000 by October 1990. By then, they employed 5.2 million people.[5]

Effective January 1988,"contract" prices replaced state prices in heavy and light industries. However, in other sectors, co-ops enjoyed greater freedom in price setting than state enterprises; they could charge either state or negotiated prices. Not without reason, public opinion associated co-operatives with high prices, speculative profits, and corruption.[6] According to the Moscow News of November 22, 1987, protesters against the excessive revenues in the private sector demanded higher tax on incomes and more competition to lower prices.[7] The growing scope for negotiated "contract" prices also introduced inflation. Thus, retail price inflation moved up to 5 percent in 1990, compared with 2 percent in 1989.[8]

Especially in the construction sector, initiatives legalising black-market labour developed. Commonly, the workers used the material and equipment of the state enterprise; health and safety measures were neglected.[9]

As a result of the restructuring in the banking sector, a new system, featuring several specialised state-owned banks and the Central Bank, was created. Noteworthy, at the end of 1988, co-operatives also received the right to establish their own banks. "These were almost entirely unregulated, and substantially beyond the influence of the Central Bank."[10] Unlike the specialised state-owned banks, they were not subject to the credit controls, even though they were free to engage in the same kinds of activities (for example, to attract deposits and extend credit). As a result, "commercial banks increased rapidly in number to more than 400 by September 1990".[11]

In the external sector, the reform featured decentralisation of trading rights. On April 1, 1989, all enterprises, including state-owned, co-operatives, and joint ventures, were given the right to enter international markets. Thus, by the middle of 1990, 20 thousand firms were set up to engage in foreign trade.[12] To open up the internal market to foreign goods, enterprises were allowed, starting in 1987, to use their export profits to pay for the importing of consumer goods. Further, to attract foreign capital, special tax benefits for foreign ownership were permitted by the joint-venture legislation.[13]

In the fiscal sphere, budgetary revenues declined significantly in response to the enterprise reform that reduced the transfers of profits to the state budget and, at the same time, cut state investment expenditure. Given the fall in revenues, the state budget deficit peaked at 9.25 percent of GDP in 1988.[14] With the increased budget deficit, enterprise credit from the state banks was tightened. Despite the large number of commercial banks, their role in credit expansion was not significant. A major portion of their funds went to financial and speculative transactions. Credit to enterprises as a share of total bank credit fell from 82 percent in 1985 to 50 percent in 1989.[15]

"The external trade and payments balances deteriorated significantly, mainly due to increasing import from the convertible currency area, following the decentralisation of trade and financing", as well growing grain import prices.[16] The external deficit was financed by short term borrowing in the international capital markets, often in the form of bonds, deposits, or credit lines with foreign banks. The short-term external debt jumped from US$9 billion at the end of 1987 to US$18 billion by the end of 1989.[17] The USSR faced increasing difficulty in renewing the short-term credit lines and deposits as its credit rating was going down. In 1990, the Soviet Union even pledged future exports of diamonds and gold for new loans.[18]

"The recorded slowdown in growth affected virtually all major sectors".[19] As a result, employment declined. Moreover, there was a shift of labour from state to co-operative sectors. Aggregate output dropped by 17 percent, and the budget deficit amounted to 131 billion roubles by 1988.[20] External debt, which had been $16 billion in 1985, rose to 42.3 billion in 1988, and then to $90 billion at the end of 1991.[21] "Inflation rose from essentially zero to double digits in 1989 and to triple digits by the end of 1991".[22] The elimination of price subsidies and consequent price rises were accompanied with no compensation for the population and pushed most Soviets into poverty, anger towards perestroika, and nostalgia for the stable and predictable years. According to some estimates, up to 90 percent of the post-reform Soviet population lived in poverty.[23]

The reform "illustrated the risks of weakening the traditional command mechanisms without at the same time making rapid progress toward the creation of market-based control instruments".[24] Instead of the economy's recovery, it contributed to its disintegration and collapse.

After the fall of the Soviet Union, communist leaders still kept their control over the assets of the country. Moreover, the disintegration of the administrative-command system provided the nomenclatura with an unprecedented opportunity to turn their positions to their own advantage and take over state property. Enormous amounts of state wealth and property were transferred by Party bureaucrats abroad as well as to the private trading houses and banks created during perestroika. In June 1990, the first of many private banks were established with Party funds. Some 31 million roubles were placed as large-scale credit and investment transfers at home and abroad.[25] The nomenclatura bureaucrats who had invested in the private sector became Russia's prominent political leaders determining its future economic policy.

The first Russian president Boris Yeltsin formed his cabinet in 1991. To head the cabinet, Yeltsin named Yegor Gaidar, who in turn named Anatolii Chubais to run the State Committee on the Management of State Property.[26] This was the team that, with an appeal for Western economic assistance, implemented the largest political and economic transformation of the late twentieth century.

Like some Third World countries, the Russian Federation underwent the pressure of liberalisation, marketisation, privatisation, and internationalisation of its economy, dictated by international capital forces. A set of economic policies known as the 'Structural Adjustment Programme' was imposed by the International Monetary Fund (IMF) and the World Bank as a conditionality for granting and rescheduling loans. These policies usually involve currency devaluation, cuts in public spending, elimination of subsidies, cuts in the civil service, privatisation of state-owned industries, opening up of national economies to foreign investment, and an emphasis on export promotion in order to earn foreign currency to meet debt servicing obligations.

Yeltsin and his cabinet of 1991 turned to the Bretton Woods institutions for financial and political support for the reforms and reformers. The proposals were outlined in "Memorandum on the Economic Policy of the Russian Federation" of 1992 and formed the basis of Russia's Letter of Intent to the IMF. This policy document, which incorporated the elements of structural adjustment and served as a condition for lending, was developed with the assistance of Jeffrey Sachs, Professor of International Trade at Harvard University. The restructuring of the economy has been popularly referred to as a 'shock-therapy' programme.

The cornerstone of the reform programme was the privatisation of state enterprises, which was based on the 1991 Privatisation Law. Russian privatisation was rapid, extensive, and unprecedented in World history. Almost 90 percent of industrial output and 80 percent of industrial enterprises went into private hands.[27] State ownership in 60 percent of the firms covered by a 1996 Russian National Survey was nil. Following the collapse of the Soviet Union and pro-IMF marketisation, no more than a quarter of privatised enterprises were clear winners, that is financially sound firms.[28]

The IMF's intent is to enforce debt-servicing obligations and enlarge Russia's debt and dependency on external credit. Russia received a new, $6,800 million stand-by loan in 1995. In March 1996, the IMF granted a three-year $10,200 million loan, subject to periodic reviews of Russia's performance in implementing reforms.[29]

2. Macroeconomic Reform Package -- 1992

2.1. Negotiations with the IMF

The IMF granted the status of associated member to the USSR and its constituent republics in October 1991. But the new Russian government that came to office in November 1991 was intent on applying for full membership for Russia. Moreover, even before its formal membership, Russia began serious discussions with the IMF on economic policy issues. These discussions eventually resulted in negotiations on the Economic Policy Memorandum, which was signed by Deputy Prime Minister Yegor Gaidar and Central Bank Chairman Georgii Matyukin and sent to the Fund in February 1992.[30]

Russia applied for full membership in the Fund on January 3, 1992. The positive resolution on Russian membership was announced by the Board of Governors of the IMF on April 24, 1992. Finally, on June 1, 1992, less than five months after the application, the Articles of Agreement were signed by the authorised representative of the Russian government, and Russia became a full member of the IMF.[31]

It is revealing to see what conditionalities were imposed by the IMF and how they were followed up by the Russian government.[32]

With regard to pricing policy and inflation:

-- all regulated prices should be liberalised by the end of March 1992 except for housing rents, public utilities, and public transportation fares;

-- by April 20, 1992 energy prices would be liberalised and new export taxes for energy products should be introduced.

With regard to the social safety net:

-- housing rents, public utilities and public transportation fares should be increased in the line with rising costs;

-- the payments of pensions and social security benefits should be limited by the financial resources of the Pension Fund and Social Security Fund;

-- a new system of unemployment compensation should be introduced by June 1, 1992.

With regard to fiscal policy:

-- the deficit of the consolidated budget in the first quarter of 1992 should be within one percent of the GDP;

-- the full 28 percent VAT rates should be reimposed for all products in the budget for the second quarter;

-- the number of tax concessions and exemptions should be reduced;

-- additional taxation of energy production and consumption should be introduced together with the liberalisation of energy prices on April 20, 1992.

With regard to monetary policy:

-- the Central Bank of Russia (CBR) should introduce positive real interest rates as soon as possible;

-- the Government should introduce a more realistic interest rate on its internal debt by April 1, 1992;

-- the ceiling for CBR lending to commercial banks in the first quarter of 1992 should be 15 percent of financing;

-- CBR lending to the government should be no more than two percent of the GDP.

With regard to external policy:

-- the multiple exchange rate system should be abolished and a uniform exchange rate system should be introduced by April 20, 1992;

-- a new law on foreign exchange regulation and control, providing for the development of the foreign exchange market, should be in effect by April 1, 1992.

2.2 Implementation of the Reform Programme

The Russian government followed the IMF's recipe consistently. The reform programme involved the immediate liberalisation of approximately 90 percent of all retail prices and 80 percent of wholesale prices on January 2, 1992. Virtually all of the remaining controlled prices were sharply increased. In particular, energy prices, which were still controlled by the state, were raised five-fold.[33] More prices were deregulated or further increased later in the first half of 1992. Most consumer prices not previously liberalised, except for vodka, were liberalised by the Presidential Decree of March 7, 1992. The price of vodka, however, was liberalised soon thereafter. By the end of March 1992, price controls remained for twelve basic staple foodstuffs, rents, public services, public transportation.[34] However, between February and June 1992 housing rents, public utilities, and public transportation fares were increased a number of times.[35]

According to official statistics, industrial output fell by 13 percent in the first quarter of 1992, while national income fell by 14 percent. In the same quarter, retail prices grew sixfold, according to official sources.[36] Housing prices became three times higher than a year earlier, public transport between five and eight times higher and certain health charges rose tenfold. Retail sales fell by 51 percent in real terms in the first quarter of 1992 compared with the corresponding period of 1991.[37] More seriously, food production fell by 28 percent, partly because of supply difficulties, but also indicating that the impact of price increases on household incomes and savings had led to an excessive reduction in demand for food and consumer goods.

In the course of trade liberalisation, all import duties were abolished and the number of goods for which import licenses were needed was reduced. Russian exporters were required to surrender 40 percent of their hard currency revenues to the government at a special low exchange rate, and to sell an additional 10 percent at a market rate.[38] At the same time, the government reduced the number of goods for which export quotas or licenses were required. These measures were encouraging unregulated export of natural resources; foreign goods and services were imported without any protection of the domestic sectors.

At the beginning of 1992, Russian enterprises faced an interest rate increase of from 6 to 20 points per year. For instance, the CBR refinance rate was increased from 20 percent to 50 percent in April and to 80 percent in May. The amount of credits to commercial banks was also limited. Moreover, the CBR phased in a 20 percent reserve requirements for short-term commercial bank deposits.[39]

The centrepiece of the reform in revenue collection was the introduction of a 28 percent value added tax (VAT), which destroyed internal producers and encouraged import. Moreover, the emerging non-payments crisis contributed to slow collections. The federal budget deficit began to balloon:

Table 1. Russian Budget Deficit, 1992-94

	1992	1993	1994
Budget deficit, billion roubles	-642	-8283	-60781
Budget deficit, as % of GDP	-3.5	-5.1	-9.6

Source: Ernst M., Alexeev M., Marer P. (1996).Transforming the Core. Boulder:Westview Press. p.221

2.3 Macroeconomic Consequences

As a result of the reform, producers of investment goods were hit by the collapse of investment, consumer goods producers—by the collapse of incomes and the inflationary erosion of savings, agriculture and food processing—by a "scissors crisis", as prices of fuel and producer goods rose more sharply than did those of consumer goods. The tight monetary policy contributed to the contraction of the whole national production:

Table 2. Major Macroeconomic Indicators, 1990-1994
(constant prices, % over previous period)

	1990	1991	1992	1993	1994
GDP	98.4	91.0	80.8	88.1	85.0
Industry	99.9	92.0	84.4	83.6	79.0
Agriculture	96.0	95.0	90.6	96.0	91.0
Investments	100.1	84.5	60.3	84.0	75.0
Inflation, %	106.0	160.0	2509.0	840.0	220.0

Source: Ernst M., Alexeev M., Marer P. (1996). Transforming the Core. Boulder: Westview Press. p.230

Even the official macroeconomic indicators (which are believed to be biased – manipulated or falsified) presented in this table reflect sharply falling output and investment and persistently high inflation. However, the rates of decline are argued to be even greater. Ruslan Khasbulatov, the speaker for the Russian parliament, contended that the decline in agricultural and industrial output had been estimated by independent research centres to be as high as 23-28 percent in the first quarter of 1992 compared with official estimates of 15-18 percent, leading to the real danger of complete economic collapse, and that prices had actually risen by 8-12 fold in the first quarter, compared with initial predictions of increases in the order of 3.5 times.[40] This indicated that hyperinflation had already arrived and that the economic forecasts on which parliamentary support to the programme had been based had not been realised. He blamed this situation on the liberalisation of prices before the creation of proper competitive market conditions. "A balanced budget could not be achieved under these circumstances without causing multiplied damage to output, as the slump in budget revenues would enforce cuts in expenditure and finance, which would lead to further cuts in output, which in turn would lead to further cuts in revenue".[41]

The deindustrialization of Russia was evident not only from the lesser role of industry as a whole in the economy but also from the reduced importance of manufacturing, especially processing, as distinct from the extraction industry. The structural changes within industry included the rising importance of the energy sector and non-ferrous metals, and the declining role of the machine building sector.

Table 3. GDP and Employment by Sector, 1991-1994 (percentage of total)

	GDP		Employment	
	1991	1994	1991	1994
Industry	42.9	36.7	30.3	27.7
Construction	10.7	11.1	12.0	10.2
Agriculture	13.9	8.2	12.9	14.9
Transportation and communications	5.0	15.0	7.7	7.6
Other services	27.5	29.0	37.1	39.6

Source: Investment Guide for the Russian Federation (1995). Paris: The Centre for Co-operation with the Economies in Transition. p.36

Table 4. Structure of Industrial Output, 1991-1994 (percentage of total)

	1991	1992	1993	1994
Electric energy	4.0	6.4	9.2	13.1
Fuel	7.3	18.5	17.2	17.3
Metallurgy	11.2	16.7	17.1	16.2
Chemistry	6.5	8.0	7.2	7.3
Machine building	24.9	20.1	20.0	18.5
Timber, pulp and paper industry	5.8	4.8	3.9	4.0
Construction materials	3.7	3.3	3.3	3.9
Light industry	16.2	7.1	5.2	3.0
Food industry	14.4	10.3	12.4	12.2
Other	5.9	4.9	4.6	4.4
Total	100.0	100.0	100.0	100.0

Source: Investment Guide for the Russian Federation (1995). Paris: The Centre for Co-operation with the Economies in Transition. p.36

The decline was especially large in productive investment -- that is, investment aimed directly at enhancing the production potential of the economy. The share of such investment declined, according to official numbers, from 65% in 1992 to less than 60% in 1994.[42] Particularly steep was the decrease in investment in the agro-industrial complex, equipment manufacturing, electronics, chemical and petrochemical industries. Only investment in oil and gas, car manufacturing, and communications increased. Most foreign investment went to such sectors as fuel and energy.[43]

Naturally, declining output was accompanied by declining employment. Moreover, the general reduction of employment was accompanied by a continuing shift of labour from industry and science to consumer services, the share of which in employment reached, according to some estimates[44], 40 percent as compared to only 35 percent at the beginning of 1992. Only during the first half of 1994, industrial employment fell by almost 10 percent with the greatest reductions taking place in machine building and metal working, wood processing, and light industries.[45] Moreover, this shift of output and employment to services could be seriously underestimated because the statistical coverage of the service sector in Russia is less adequate than that of the other sectors. Besides, these data do not take into account the underground economy, which is mainly concentrated in the service sector.

The government attempted to keep the growth of wages below that of prices by means of a progressive tax levied on any growth of the total wage fund of state enterprises above a government-determined norm. Wages were slow to follow suit, and the first and most obvious effect of this policy was a marked increase in poverty throughout the country. This change was evident both in the growing numbers of poor people in the streets and in official figures, which placed more than 80 percent of the population below the poverty line.[46] Only in January 1992, following price liberalisation, real incomes fell by 40 percent.[47] The Ministry of Labour and Employment estimated the minimum income necessary for subsistence for an adult worker to be 900 roubles in April 1992. By this measure, over nine million workers (11 percent of the total population) failed to earn a subsistence wage and a third of the population (50 million people) lived below the subsistence level.[48] Moreover, other government estimates considered that already in February 1992 the minimum consumption basket cost from 1300-1500 roubles per head.[49]

Further, the productive economy was demonetised, and enterprises could not make payments for deliveries and wages. In the face the government's tight monetary policy, enterprises were enforced to issue interest-free credits to each other. The Russian Central Bank estimated that inter-enterprise credit had reached a gross figure of over 1.4 trillion roubles (the equivalent of three month's GDP) by the end of April 1992.[50] Inter-enterprise credit largely resulted from the inability of enterprises to pay their suppliers. Enterprises had serious difficulties obtaining cash from the banks even for wage payments unless they could demonstrate their solvency. Establishing solvency, however, did not require any adjustment for the quality of their accounts receivable. As a result, by the beginning of the second quarter of 1992 enterprises began to introduce a shortened working day or send employees on vacations. The value of wages and pensions unpaid or whose payment was several months in arrears totalled 40 billion roubles in March 1992.[51]

The emerging non-payment of taxes undermined the government's attempt to bring the budget under control. The state itself was becoming a major debtor of enterprises. As of the end of the first quarter of 1994, the government owed enterprises over 11 trillion roubles. At that time the total overdue accounts of all Russian enterprises amounted to 35.2 trillion roubles. And it was estimated that at least three quarters of all debt in arrears was accumulated due to the Ministry of Finance nonpayments.[52]

"For all its liberal rhetoric, the government was actually doing nothing but issuing more and more bits of paper while investment collapsed. . .".[53] The estimated $30 billion of Russian-owned capital "flying" abroad by the end of 1993 was four times the value of the 500 top first-stage privatised enterprises and 10 times the sum of second-stage privatised enterprises.[54] Further, capital flight severely reduced investment funds, cut the taxable base, limited the ability to service internal and external debt. This situation, together with the continuing domestic inflation, ensured that the rouble's exchange rate with Western currencies fell steeply.

Table 5. Average Exchange Rate, 1991-1995 (roubles per $US)

1991	1.67
1992	222.1
1993	992
1994	2,191
1995	4,559

Source: Eastern Europe and the CIS (1997) London: Europa Publications Limited. p.636.

By late 1995 an estimated $50 billion had been deposited off shore by Russian residents, both firms and individuals.[55] Current estimates for the aggregate of funds held externally by residents of the CIS are in the range of $50 to $60 billion, but can not by their nature be accurately identified.[56] It was estimated, however, that about 40 percent of Russian investment abroad is illegally exported capital, mostly held in cash, securities, and real estate.[57]

3. Privatisation Programme

Given the combination of declining output and large labour force retrenchment, industrial restructuring was among the most difficult parts of the reform programme. The enterprise reform process was driven by privatisation, whose spontaneous forms shaped as early as in 1988.

3.1 Spontaneous Privatisation (1988-1992)

A legal ground for divestiture of state enterprises and spontaneous privatisation was provided when Mikhail Gorbachev signed the USSR Law on Co-operatives in May 1988. Until then illegally, but henceforth legally, the enterprise administration developed its control over the assets of the enterprise for the private benefit of the management. Typically, only better enterprises were involved in spontaneous privatisation, while loss-making enterprises remained in state hands and were not restructured. The straighforward plundering of public assets took the form of private appropriation of the property and financial assets by former Party officials. They could enrich themselves not only by establishing their own private commercial and financial companies to siphon off resources and accumulating substantial shareholdings, but also by exploiting their positions and taking "commissions".

Initially, spontaneous privatisation took the form of managers simply diverting the profits from their enterprises. Thereafter, it generated into the transfer of state assets to new private firms and co-operatives in the form of leasing or buying state assets at negligible prices. Within the enterprise the co-operative form of organisation was attractive to managers since it was used to establish the managers as owners of the co-operative, which gave them greater scope for self-enrichment. Typically, a state enterprise would assign the productive assets to a co-operative, would sell to the co-operative at the state prices and the co-op would sell on the open market. Moreover, a co-op had tax advantages, since it enjoyed an initial tax holiday.

Enterprise managers could also take over the profitable parts of the enterprise as subsidiaries, then abandon the unprofitable shell of the state enterprise and set themselves up as independent private capitalists. This form of spontaneous privatisation could be accompanied with or replaced by siphoning off the profits from state enterprises through private commercial and financial intermediaries, which formed the basis of most private fortunes.[58]

Another form of spontaneous privatisation was management buyouts at the book values of assets, which were likely much less than their market values. These deals were usually accompanied by the "purchase" of approval from local governments and sometimes the central government ministries. A number of documents were signed by Mikhail Gorbachev that party property around the country be transferred to new "private" owners.[59] "In one case, senior bureaucrats at Gossnab, the Ministry of State Supply, arranged to buy 142 government-owned dachas outside Moscow for the equivalent of about 75 thousand dollars, at prevailing rates, in 1990. A year later, the buildings as well as the land had an estimated value of more than four million dollars."[60] Thus, spontaneous privatisation partially recognised the ownership rights of the ministries and the local governments, while transferring wealth from the state into the hands of managers.

The final step in the destatisation[61] of enterprises was the freeing of the enterprises themselves through their conversion to the form of joint-stock and limited companies that was provided for by the 1990 Law on Property, implemented by a decree of June 1990. By August 1st 1991, 347 joint-stock companies and 793 limited liability companies had been registered.[62]

3.2 Privatisation Techniques (1992-)

The framework for privatization in Russia was outlined in a law enacted by the Supreme Soviet in July 1991, "On the Privatization of State and Municipal Enterprises in the Russian Federation" (the 1991 Privatization Law). It contained the general principles of privatization and authorized the establishment of implementing agencies. Four agencies were involved in privatization: the State Committee for the Management of State Property (GKI), the regional or municipal Committees for the Management of State Property (MKI), the Property Funds, and the Privatization Commissions.[63]

Privatization Agencies.

The GKI was responsible for the organization of privatization. It developed the implementing legislation for privatization, including the State Privatization Program. In addition, it organized and supervised the implementation of the Program: formed Privatization Commissions, was responsible for the "corporatisation" of enterprises, the production and distribution of vouchers, the promotion of investment funds and holding companies, and the delineation of initial ownership of state property among levels of government and localities.[64]

In each locality, however, the responsibility for privatizing federal, republican, and municipal enterprises fell to the Local Committee for the Management of State Property (MKI). These Committees were operationally largely autonomous, but their programs had to be approved by the local Congress of People's Deputies, and then submitted to the Russian Federation GKI. The latter coordinated the activities of the MKIs.

Property Funds were being set up at all levels to perform the ownership function (and therefore be the sellers) of enterprises in the interim period between corporatization and privatization. The Property Funds were legally subordinated to the legislative branch at various levels.

The Law also provided for the creation of Privatization Commissions. These bodies were set up by the GKI and local Committees to prepare the enterprise privatization plan.[65]

The Government's 1992 Privatization Programme was detailed in a document called "The State Programme of Privatization of State and Municipal Enterprises of the Russian Federation for 1992".[66] It specified the objectives, principles, methods to be used, and the sectors to be privatized.

Objectives. The fundamental objective was stated to be ''creation of private owners that would facilitate the development of a market economy". Other objectives were "to contribute to the financial stabilization of the economy, to promote competition, and to ensure the development of a safety net and social infrastructure".[67]

Overall strategy. The Programme followed three separate tracks for privatization, depending on the size and nature of the enterprise. For small enterprises, the responsibility for privatization was with the local Committees; they were sold through competitive auctions. Some medium-sized and most large enterprises were converted into joint-stock companies ("corporatization") and their shares sold to bidders in competitive auctions or tender. Any remaining shares were to be sold by public offering on the securities markets. Once corporatized, the enterprise was given from 12-18 months to prepare privatization plans and complete the privatization process.[68] The Programme also stated that some very large enterprises and those with special characteristics were to be privatized only upon approval of the Russian Government.

Methods. The Programme specified a number of methods that could be used:

a) sale of shares of open joint-stock companies;
b) sale of entire enterprises that were not joint-stock companies at competitive auctions;
c) sale of entire enterprises that were not joint-stock companies at auctions where conditions were placed on the operation of the enterprise after the sale (for example, requirements concerning employment, business activities, or future investment), these were related to as "commercial competitions";
d) sale of entire enterprises in competitions where the primary criterion for selecting the winning bid was the proposed future investment in the enterprise ("investment tenders");
e) sale of property or assets on enterprises that were being liquidated; and
f) buyout of leased assets.[69]

Small-scale privatization

Authority to implement the privatization of small enterprises and shops was delegated to the local level. Small enterprises were considered those engaged in wholesale and retail trade, construction, agriculture, food, and trucking with 200 employees or fewer and a book value of fixed capital of less than one million rubles. [70] These were privatized through competitive auctions carried out by local Committees for the Management of State Property (MKI). Such enterprises were generally not converted into joint-stock companies. Standard procedures and documentation for use by MKIs were derived from experience of the International Finance Corporation (IFC) and European Bank for Reconstruction and Development (EBRD) pilot privatisation programmes in St.Petersburg and Nizhnii Novgorod. The legal and technical steps undertaken in these cities served as a guide to most other local governments.

Mass privatization programme

The Government began implementation of its mass privatization scheme before the end of 1992. This was a very quick start to such a huge campaign, but the intention was to quickly privatize a large number of firms. Mass privatization was not driven, as in many countries, by the government's desire to raise revenue by selling state firms, but rather by a desire to move as many firms as possible into private hands before politics could reverse the process. Given the various constituencies in the country opposed to privatization, the programme emphasized speedy implementation and the inclusion of all medium-sized and large state enterprises with few exceptions. It was widely claimed by the authorities that such a decision would build political support for the programme, contribute to the small number of private enterprises in Russia, which were dominated by state owned enterprises (SOEs), and give liquidity to an illiquid population.

The Mass Privatization Programme formed a major component of the overall Privatization Programme. This programme provided for privatisation of most large and medium-sized enterprises (excluding those with fewer than 200 employees and enterprises in a few sectors) on a voucher scheme.[71] Although mass privatization schemes and vouchers (privatisation cheques) were not inevitably linked, they were generally associated with each other. The programme allowed vouchers to be applied to privatization of up to 35 percent of the shares in each enterprise.

Vouchers were certificates distributed to the population that could be converted into shares in state owned enterprises (SOEs). They were denominated in rubles, each with a face value of 10,000 rubles. Starting in the fourth quarter of 1992, vouchers were distributed to Russian citizens on the basis of *propiska* (certificate of residence) records and were immediately tradable. To facilitate trading, investment funds were licensed by GKI and authorized to trade vouchers. Of the 147 million vouchers issued, 44 percent were by the end of the first stage in investment funds. [72]

Voucher auctions began in Moscow in December 1992. By mid-1993 already seventy regions were involved in auctions. By March 1994, about 9,500 enterprises, employing 10.8 million workers, had sold shares in the voucher auctions.[73] By the close of the mass privatization programme in July 1994, about 16,000 enterprises had been privatized, employing nearly 22 million workers.[74]

3.3 Nature of Privatisation: Undervalued, Inequitable, Hyperinflationary

"Privatisation was a seed that fell on a hard, dry ground."[75]

For the sake of speed, privatisation was implemented by valuing enterprises at book value – without allowance for later inflation. The book value of the 14,000 privatised enterprises was calculated once, in January 1992, and have not been changed since, even though prices have risen by 10,500% in the intervening period.[76] Moreover, this book value, which was based on the depreciated value of an enterprise's capital stock, took no account of property or intangible assets. This implied that the valuation of enterprises both in roubles and dollars for the purpose of privatisation was much below a realistic market valuation.

For example, KamAZ, one of the largest enterprises in Russia, was capitalised at 4.7 billion roubles, while only in its first full year of operation as an independent enterprise it made a declared profit of 2 billion roubles.[77] A list of the five hundred biggest privatised enterprises issued by the State Property Fund valued those firms at $7.3 billion in aggregate, which meant at under $1,000 per employee, compared to about $100,000 per employee in the United States.[78] A market capitalisation for Russia's 14,000 largest companies was estimated to be around $12 billion – only slightly more than Kellogg, the American cereal firm. According to another estimate, the top 200 firms (excluding Gazprom) were capitalised at less than $40 billion – roughly equal to the capitalisation of Motorola or Gillette.[79] The estimates vary but they consistently show a distinct undervaluation of privatised assets in Russia.

Table 6. Indicative Enterprise Valuations* of Russian Companies, March 1994 ($US)

	Unit	N.America	W.Europe	Russia
Telecommunications	access line	1,637	848	69.97
Electricity	Megawatt	372,000	650,000	2,260
Oil	barrel of proven reserves	7.06	3.58	0.17
Cement	Ton	144	162	1.92

*Valuation per unit of production = market capitalisation of leading companies in sector divided by volume of production.
Source: Sale of the Century. The Economist, May 14 1994 p.67. London.

A greater divergence opened due to a significant increase in the rouble-dollar exchange rate, encouraging appropriation of Russian assets by foreign capital. In the first quarter of 1994, when $317 million was recorded as direct foreign investment and $47 million as portfolio, almost half-- $132 million -- went to the fuel industry (above all, oil and gas); trade and catering with $35 million; timber and paper were third, with $22 million; and engineering was fourth, with $21 million.[80] In 1995, half of Russia's foreign investment went to the energy sector, which accounts for less than 6 percent of all employment.[81] Foreign purchases were not subject to any restriction; no local authority was allowed to impose its own restrictions on foreign owners.

Vouchers were calculated on the same value scale. The government planned to issue about 1.5 trillion roubles worth of vouchers by November 1992, while the total privatisation valuation of the productive assets of the whole of the USSR in 1991 was less than 2 trillion roubles. The total privatisation receipts anticipated for 1992-94 were 892 billion roubles. Against this, outstanding inter-enterprise debt at the end of June 1992 amounted to between three and four trillion roubles, and unpaid wages amounted to a further 400 billion.[82] A voucher, which was nominally worth around one month's wages at the time of issue, was worth not more than a couple of days' wages by the summer of

1993. Even though one of the primary goals of privatisation was to cover the budget deficit and to meet external obligations, privatisation receipts for the first quarter of 1993 amounted to less than 300 million roubles, against the target of 3 billion, which was not even enough to cover the administrative costs.[83]

The government desperately tried to boost the demand for vouchers, announcing that vouchers would be redeemable for apartments or land, could be used in municipal privatisation, and that 30% of payments at auctions must be in vouchers, a measure that only encouraged the concentration of vouchers in the hands of fraudsters. Privatisation was taking place when employee shareholders had little funds of their own to finance restructuring, needed because no government put significant money in before privatisation. Inflation following the price decontrol destroyed savings. Many Russians were virtually compelled to sell their vouchers, including those ill paid, owed wages, and those who realised that dividends would be slow in coming.

Thus, the implementation of the massive privatisation gave birth to a secondary redistribution of property. The market forms of this redistribution included the sale of the State-owned blocks of shares at money sales. The blocks were most often purchased by the entities themselves, or by groups of persons from the management. But most commonly, secondary redistribution took non-market forms. At many entities, "initiative groups" purchasing shares of stock from employed persons, retired persons, and third parties were formed. In addition to the purchase, the mechanisms of transfer of the shares of stock, in and outside the collective, for the trust management to the administration, mainly the director, were usual. Already in the middle of 1995, cases were frequent when groups of 10-20 persons owning up to 50-60% of the shares of stock formed in enterprises.[84] The privatization processes and the first steps of the property redistribution showed that the management of industrial enterprises succeeded in controlling them and took active parts in them.

Most existing managers were able to retain command because of their own right to buy equity, their purchase of the shares of the staff, and their place within the local nomenclatura. At prices significantly below those that reflected their true value, state property was transferred to the hands of the 'nomenclatura' (including managers and former party officials with inside knowledge), as well as to the business mafia. One of the major beneficiaries of the government's privatisation programme were also the KGB and senior military officials. It was confirmed that the KGB nomenclatura invested three billion roubles in six hundred newly established commercial firms and banks around the country.[85]

The nomenclatura and mafia funds were used at auctions to supplement voucher bids for the prospective purchases. The money went to the government in order to serve internal and external debts and did not bring any fresh investment to the enterprise. Moreover, knocking-down the prices at which enterprises were valued for privatisation made acquisition far more profitable than new investment. Thus, in 1993, 60 percent of newly privatised enterprises laid off workers.[86] The third biggest repository of vouchers, Alfa-Capital, would call firms in target industries to inquire about any unused or imported plant or equipment that can be sold in case of liquidation.[87] "Decumulation of capital was the rule rather than the exception".[88]

"Fraught with the possibility of social exposure" -- that was the nature of the privatisation, according to Yevgeny Yasin, head of the Expert Institute of Volski's

Russian Union of Industrialists and Entrepreneurs.[89] "Privatisation equals mafia ownership", claimed Ruslan Khazbulatov, former Speaker of the Russian Parliament.[90]

4. Political Developments and Organised Crime Since 1993

4.1 Opposition to the Gaidar Programme (1993-94)

In October 1993 a group of parliamentary deputies occupied the "White House", the legislative and administrative centre of the Russian Federation. "...Army tanks shelled the White House, symbol of democratic resistance to the 1991 coup, and over the course of the two-day confrontation at least 144 people died and 878 were wounded".[91] The parliamentary revolt was mainly against the increasingly corrupt and authoritarian government of the reformers.

The impact of price liberalisation on the national economy and on living standards led to severe criticism of the reform programme. Opposition to Yeltsin's reforms came from two main groups. The "red-browns", the coalition of neo-communists and Russian nationalists, claimed that Yeltsin was capitulating to the West, allowing economic policy to be dictated by the IMF and the World Bank. They fiercely accused the Government of humiliating Russia in every way, and blamed it for the collapse of the Soviet Union. These critics demanded that Russia rely on its own resources and return to the social guarantees and state planning of the Soviet period. The second group, known as the Civic Union, headed by Arkadii Volsky, represented a constructive centre opposition. It supported the general shift towards a market economy, but advocated national capitalism with a strong role for the state.

Ruslan Khasbulatov, the speaker for the Russian parliament and a leading opponent of the government programme, argued that there was "no alternative to a profound transformation" of the economy, but that existing policies were based upon over-optimistic assessments of their impact on the level of output and the standard of living and of people's tolerance to these measures and underestimated the possibility of a major political reversal if the reforms did not command greater popular support.[92] Khasbulatov was proposing to halt the slump in output, introduce price and wage controls, abandon the target of a balanced or no-deficit budget, strengthen the regulatory controls of the state bank over the commercial banks, establish state priorities for industrial restructuring, as well as improve social benefits such as health and education.[93] These proposals implied the primary necessity for more constructive measures to change enterprise behaviour.

Aleksandr Rutskoi, the Russian Vice-President, who was elected as Yeltsin's colleague in the presidential election, argued that his opposition to the then-ruling Communist Party did not imply his support of the policies dictated by the IMF and the World Bank. He defined Yeltsin's privatisation programme as a "swindle", which was intended to impoverish the country, and demanded harsh measures against organised crime. Thus, government intervention to halt the disastrous decline in industrial production and broad social guarantees constituted the base for this constructive opposition.

By October 1993 the tension between the legislative and the executive branches of power had turned into a serious confrontation. In spite of the suspension of power supplies to the parliament building, the White House, some 180 parliamentary deputies remained inside the parliament building, including Rutskoi and Khasbulatov. On 4 October Yeltsin ordered the military to bring tanks right up to the White House and bombard the building. Over 100 people were reported to have died in the conflict.[94] Rutskoi and Khasbulatov were arrested and imprisoned. As studies have shown, "the conditionalities were set by the IMF in such a way that they could be met only by suspending parliament altogether... [The IMF] credit was immediately tightened and interest rates raised, measures were adopted to increase the pace of privatisation and trade liberalisation... The storming of the White House by elite troops was thus largely intent on getting rid of individuals opposing IMF-style reform..."[95]

The tension developed after the October events. A decree of 24 December 1993 on the second, mass stage of privatisation failed five times to secure a majority in the Duma. The opposition in the Duma was based on the following objections:

--The Federal Insolvency Agency was imposing over-strict rules for indebted enterprises, which would in consequence be sold off on the disposal value of their property; bankruptcies should be dealt with only by the courts on application by creditors.

-- The State Committee on Privatisation was a monopoly and might undervalue assets to secure quick sales.

-- Foreign buyers were unrestricted and could purchase assets too cheaply.

However, on 22 July 1994, President Yeltsin took advantage of the Duma's recess to issue a new decree and introduced it as a formal law.[96] Provincial governor Vladimir Polevanov replaced the Minister for Privatisation and soon revealed that privatisation was endangering Russian security by the foreign ownership of shares in companies in the defence industry and in the production of strategic metals and that the government should "change its economic line and increase the state management of enterprises".[97]

Eventually, Polevanov was dismissed, and Chubais was explicitly set in charge of the agencies administering privatisation. As a result of ministerial changes in November 1994, Anatolii Chubais, who had run privatisation from the start, became the First Deputy Chairman in charge of the entire economy.

4.2 Redistribution and Concentration of Economic Power (1994-). Formation of Financial Syndicates

Results in the voting for election to the State Duma on 12 December 1993 amounted to a serious indictment of Yeltsin's policies and the attack on the White House -- only 15.4 percent voted for Russia's Choice, the coalition of radical reformers led by Yegor Gaidar.[98] Therefore, Gaidar's Russia's Choice had to move into opposition. The Communist Party advocated state intervention in support of domestic industries and farming in the form of subsidies and import tariffs. It also proposed increased spending on the poor and disadvantaged, an end to privatisation of state industries, and harsh measures against organised crime. The Communist Party received 22.73 percent of the popular vote in parliamentary elections in December 1995 for a new State Duma.[99]

In the six months between the legislative and the presidential elections, looking for a greater popularity among voters, Yeltsin surrounded himself by the centrists, including his friend and chief bodyguard Aleksandr Korzhakov. The president dismissed the remaining reformists in his administration (foreign minister Andrei Kozarev, First Deputy Prime Minister with responsibility for the economy, the father of privatisation, Anatolii Chubais, and presidential chief-of-staff Sergei Filatov) and replaced them with conservatives (respectively, Yevgenii Primakov, Vladimir Kadannikov, and Nikolai

Yegorov). Chubais was dismissed from his post of deputy Prime Minister chiefly because of the unpopularity of "his" privatisation with voters. The unpopularity of the voucher privatisation among Russian voters caused Yeltsin to issue a statement that Chubais was not a member of the government and would not become one.[100]

These measures, as well as the alliance with another candidate, retired Lt-General Aleksandr Lebed, an Afgan war veteran, helped Yeltsin to win the second round of the presidential elections on 3 July 1996. However, the new "January-1996" course of the President turned out to be no more than an entourage that had no direct bearing on practical politics. The populist statements of President Yeltsin and his personnel decisions (Anatoly Chubais' resignation and strengthening of the positions of Oleg Soskovets and Nikolai Yegorov) just gave the illusion of a drastic change in economic policy. A special agreement was signed with the IMF with regard to giving Russia a three-year extended credit, which set parameters for the work of the Russian Government.[101]

To comply with the agreement, the President had already dismissed the most anti-reformist members of his administration, including the defence minister, Pavel Grachev, and Aleksandr Korzhakov, by the time of Yeltsin's inauguration on August 9, 1996. Pavel Grachev was alleged to be "mired in corruption".[102] The aim behind the allegation was to discredit a number of contenders to the post of Russian Defence Minister and to imply that it was Igor Rodionov [a candidate for the new Defence Minister post] who could save the military from corruption and should be appointed Defence Minister. "On the one hand, it is the cleaning out of people who have been too close to Grachev; on the other, it is an indication to society that the administration is living up to its promises to clean up corruption."[103]

Moreover, some pro-western economists, like Anatolii Chubais, reappeared in office. This turned Russia back on the road of reforms because it again gave an enormous amount of Chubais influence over the President. There was little doubt that he would be determining the economic policy of the Russian Federation. "This position [deputy Prime Minister] is very close to Yeltsin, and Chubais will use this position . . . to become an economic tsar. . ."[104]

In fact, Chubais returned to work for Yeltsin already during the re-election. He stayed in office even after Korzhakov's men detained his aides leaving the White House with US$500,000 in cash in their pockets.[105] And he will be able to retain overall control after his recent dismissal from the post of Finance Minister and keep his main job as deputy Prime Minister because, according to Yeltsin, "the world knows about him. . . we became members of the Paris and London clubs".[106]

Chubais's removal from his ministerial post in November 1997, as requested by Duma, was caused by the bribes paid by Uneximbank to Chubais and his allies. The payment came as a book royalty from a publishing house controlled by the bank, which recently won highly contested state property sell-offs overseen by Chubais. "In 1995, via auctions controlled by Chubais, Uneximbank received large stakes in the enormous metals combine Norilsk Nickel and in the oil company Sidanko. Uneximbank's chief, Vladimir Potanin, admitted last week what had long been obvious, that the auctions had been rigged. . . Privatisation chief Alfred Kokh resigned soon after . . . [He] has also received a $100,000 book advance for yet another academic monograph about Russian privatisation, and this too came from a Swiss company controlled by Uneximbank . . . Nemtsov [mayor of Nizhnii Novgorod] was paid a $90,000 advance for the book by Vagrius Publishers, a company controlled by advertising mogul Sergei Lisovsky. Some 25,000 copies of Nemtsov's book were published; they retail for less than $1."[107]

Linked to Chubais were other institutions and persons. Among those named are Potanin's colleagues, particularly Boris Berezovsky of LogoVAZ, Vladimir Gusinsky of Most-Bank, former Mayor of Nizhnii Novgorod and now First Deputy Prime Minister Boris Nemtsov, Yegor Gaidar, as well as officials of Bank Menatep and the George Soros-Uneximbank consortium.[108] "I am a product of privatisation. That is why I am so close to Chubais' mentality," says Boris Berezovsky.[109]

Boris Berezovsky, top financier and head of the President's Security Council, "whose appointment to the security Council has caused surprise and anger"[110], says that "the alliance of seven powerful Russian financiers that helped re-elect Boris Yeltsin is now the driving force behind Kremlin policy."[111] "This Yeltsin's group of bankers", aside from Berezovsky, include Uneximbank boss and first deputy Prime Minister Vladimir Potanin; Mikhail Khodorovsky, head of the Rosprom and Menatep financial empire; Vladimir Gusinsky, head of Most banking and media group and a "personal friend" of Yury Lushkov, mayor of Moscow; Aleksandr Smolensky, president of Stolichnuuy Bank of Savings; Pyotr Aven, former foreign trade minister with the government of Yegor Gaidar, and Mikhail Friedman, the two of Alfa Bank and Alfa group." According to Berezovsky, they make most of the decisions in Russia and control 50 percent of the Russian economy.

"These are conglomerates in which finance and industry participate and where the government plays an important role."[112] "Berezovsky has earned his wealth not thanks to capitalism, but thanks to the existence of bureaucrats who sign the documents he needed."[113] As former Komsomol and Communist Party members, the Big Seven secured well-established influence in the state and combined it with commercial gain. They transformed their government connections into highly controversial privatisation deals, partly through auctions and investment tenders; monopolies selling cars and airplane tickets; tax exemptions and other government aid under presidential decrees; special government contracts and oil export rights; execution of many state programs; the buy-out of the Russian Public Television (ORT). Berezovsky made his first fortune when his company was allowed to buy Ladas at very low export prices from the state car maker and then resell them at a much higher price on the domestic market. Later, he received a 51 percent stake in the flagship national broadcaster in a shady privatisation deal.[114]

Such a political and business success often followed together with strong ties with the mafia. Berezovsky made fortunes thanks to not only privileges from the corruptive government members in connection with the privatisation process but also close links with the Chechen mafia. He was mysteriously appointed as director of ORT, taking the place left vacant by Vladislav Lystiev, a popular journalist and TV host, who had just been murdered. Lystiev was killed shortly after he was named to take over ORT and promised to impose a moratorium on advertising until an ethical system could be introduced. Thus, a corruptive-criminal capitalist class has emerged from the existing nomenclatura by the rude methods of theft capital accumulation.

There is little doubt that Russia will stay on the road of reforms. On March 23 1998, "to give economic reform more energy and efficiency", Boris Yeltsin fired the government and its Prime Minister Chernomyrdin and appointed as acting Prime Minister a 35-year-old junior minister and former oil executive, Sergei Kirienko. The acting Prime Minister is a man who has won the respect of the reformist team clustered around Anatolii Chubais; "the Chubais team fully supports Kirienko".[115] Moreover, the dismissal of Chernomyrdin is believed to brighten Berezovsky's prospects for the presidential elections scheduled for 2000…[116]

4.3 Organised Economic Crime

4.3.1.) An overview

In the Soviet society, criminality and corruption were stimulated by the malfunctioning of the bureaucratic management of the economy. According to Simis (1982), "the Soviet Union [was] infected from top to bottom with corruption – from the worker who gives the foreman a bottle of vodka to get the best job, to Politburo candidate Mzhavanadzer who takes hundreds of thousands of roubles for protecting underground millionaires; from the street prostitute, who pays the policeman ten roubles so that he will not prevent her from soliciting clients, to the former member of the Politburo Ekaterina Furtseva, who built a luxurious suburban villa at the government's expense – each and everyone is affected with corruption." [117] In addition, poverty, demoralisation and depolitisation of the working class facilitated the growth in alcoholism, crime, and use of drugs.

The privatisation and marketisation processes brought about an even higher degree of criminality. The disintegration of state industries and banking sector, lack of regulations, divestiture and privatisation of state enterprises, and corruption in state bureaucracy and law enforcement provided a fertile ground for criminals. The pressure to reduce government expenditure for a lower budget deficit and the attraction of work in the private sector reduced the effectiveness of policing and the criminal justice system. Experienced detectives left the service because their salaries were several times below the level of income available in the private sector.

Taking advantage of the absence of state power, the Russian mafias followed a path taken by organised crime throughout the world. But unlike many Western criminal groups, the Russian mafias are highly engaged in business and politics. Already since the Soviet times, corrupt bureaucrats and mafias have merged into a criminal state's power class that combines the former's distributive authorities with the latter's funds and enforcement. In fact, there are no boundaries between crime, politics, and business in Russia. Business syndicates are involved in legal, as well as illegal activities (such as narco-business, financial fraud, tax evasion and money laundering), while criminal gangs are engaged in extracting money from legal businesses.

With the macroeconomic reforms, rapid development of technology and communications, and the explosive increase in financial interactions, economic crime has become a highly diversified and fast-growing industry. On the whole, according to official statistics, "total revenue from economic crime in 1994 amounted to at least 38.4 trillion roubles ($17.4 billion at the average annual dollar-rouble exchange rate) or 6.1 percent of GDP, which is almost as much as the 6.3 percent share of agriculture in GDP and more than the value added tax collected by the federal budget (6 percent of GDP in 1994)".[118] In 1994, government officials were involved in 25 percent of all recorded bribery cases. In 1995, law enforcement officers were implicated in 10.9 percent of all recorded cases of office crime (7.6 percent were involved in 1994)."[119]

4.3.2.) Criminal business

4.3.2.1.) financial fraud

Today, the speedy and mainly unregulated development of the banking and insurance sectors and lack of control over financial flows parallels the rapid growth of financial fraud. Moscow, Russia's financial capital, records annually about 13.3 crimes committed in the financial sector per 100,000 Muscovites, almost twice the country's average of 7.6 per 100,000 people.[120] "A breakdown of fraud by sector in 1994 (the latest year this data set has been available) indicates that most cases of fraud—24 percent—were committed in the financial sector, followed by commerce and catering (13 percent) – sectors promoted by the reforms, and only nine percent in industry, and seven percent in agriculture. Two major cities, Moscow and St. Petersburg, accounted for 28 percent of all fraud cases.

Of the 38.4 trillion roubles in illegal revenues, yields from pyramids and other "investment" projects accounted for 20 trillion roubles in 1994. The financial sector generated 53 percent of all criminal income (12 trillion roubles, or $5.4 billion). Two-thirds of this amount came from falsified credit and other payment operations and one-third from pyramid frauds . . .

Russia's MMM

In 1994, particularly, the Russian public discovered how much damage could be done by investment fraud and pyramids. Since the collapse of the Soviet Union, new regulations, including the opportunity to establish limited liability companies, have opened a wide gate for fraud and other "market type" economic, white-collar crimes.

"Every night, millions turn on their television sets to watch the latest 30 second episode in the lives of Lyonya and his wife. When the commercials began several months ago, Lyonya was worrying about how to make ends meet; his job looking after an escalator in the Moscow Metro paid miserably. On a whim, he bought a share in MMM, a then little-known investment company. Within a week, he could afford to buy his wife a pair of winter boots. Next came a new suit for Lyonya and a fur coat for his spouse. By mid-summer, the couple were nonchalantly scanning the financial pages of newspapers and pondering going on a trip to France -- all thanks to profits from trading in MMM shares. Millions evidently believed that MMM could make their dreams come true too. The slick advertising campaign has turned MMM into the biggest investment company in Russia. It has 60 offices in Moscow, another 76 in 49 cities spread across Russia and claims to have 10 million shareholders.

As in any classic pyramid financing scheme, MMM used money from selling new shares to buy back shares from those at the top of the pyramid who wanted to get out. Those left at the bottom when the pyramid collapses will be ruined. The price of MMM shares, which were for a time the most actively traded in Russia, rose from 1,600 roubles in February (then worth US$1), to 105,000 roubles (US$51) on July 25. On August 3 the share price was 1,275 roubles."[121]

The investment fund crashed twice and the board members ended up in jail on charges of failing to pay taxes. Only MMM director Sergey Mavrodi got out in October 1994. Afterwards he successfully campaigned to get himself elected into the Duma, the parliament, where as a delegate he enjoys immunity . . .

Many investment funds and even municipalities followed the path taken by MMM.[122] "The St. Petersburg municipal bond issue was obviously a pyramid scheme. The city was on the verge of bankruptcy". Following the collapse of Russia's MMM, Mr. Victor Chernomyrdin, the Prime Minister, admitted that the government was at fault.[123]

4.3.2.2.) Tax evasion and money laundering.

"We pretend to vote and the government pretends to govern. It is the mafia that runs everything . . .[124] A government official told us that we had free rein to break the tax law: "You can figure out ways to get around the system."[125]

High taxes made it virtually impossible to conduct business legally; the legitimate economy has been submerged by the black market. Russia's tax police in the first half of 1996 uncovered about 12,000 cases of evasion resulting in 3,100 criminal cases, raising 13 trillion rubles for state coffers, and lodged penalties that will bring in another 9.3 trillion rubles.[126] Despite the high tax rates, Russia has one of the lowest rates of overall tax collections. As only about 17 percent of firms pay taxes regularly and in full, while at least a third publish no accounts and make no tax payments at all, the federal tax system now collects only 9 percent of GDP in taxes.[127]

As a result, nine out of ten Russian securities transactions are settled offshore. One of the sharpest paradoxes is that, with more than fifty stock exchanges and over

2,000 banks, virtually all stock trading is nonetheless done over-the-counter and offshore.[128]

The unregulated access to offshore transactions makes laundering money almost as easy as conducting regular business. Moreover, privatisation enabled the transfer of large amounts of cash into assets. The Russian economy is itself becoming cash-oriented. Thus, about 40 percent of the working capital used in the economy in 1993 was estimated to be in cash (an increase from 20 percent in 1992).[129] Proceeds from illegal domestic transactions that are laundered through offshore banks constitute about half of all foreign investment in Russia, according to Russian financial experts.[130]

4.3.2.3.) Narco-business

"We estimate that 40 percent of the movement of capital in Russia is now linked with narcotics. Organised criminals abroad have discovered how easy it is to launder drug profits through business and banks here...The disintegration of the central banking system made it easy for drug traffickers to find safe havens for their money. The movement of capital in and out of the country was insufficiently regulated by the Government, and new commercial banks were able to launder huge amounts of criminal profits. Until 1994, any Russian with one hundred thousand dollars could open a banking institution. The required starting capital was later raised to about 1.2 million dollars, but by then drug profits provided enough funds to get around this obstacle."[131] Thus, the lack of effective bank regulations made Russia a good location for criminals.

In accordance with one police estimate, "every rouble invested in narco-busness earned a profit of one thousand roubles. In early 1993, the income from production and sale of opium, hashish, and synthetic drugs was estimated at more than sixty billion roubles (about 120 million dollars) a year, and several hundred thousand people were employed at every step of the drug chain, from the cultivation and processing of narcotics to its transportation and distribution."[132]

Russia, with its borders with many former-Soviet republics, serves as a major transit route for drugs from Asia to the West. The post-Soviet highway, air, and rail grid that connects nearly every corner of the Eurasian continent gives Russian traffickers a sophisticated transportation network.[133] Moreover, the Russian mafia is becoming a valuable player in Latino-American drug dealing. "The Colombians would never have shipped their cocaine to St. Petersburg unless they were confident that a strong Russian network was there to assist them."[134]

Furthermore, the former Soviet Union is "an extraordinary rich source of raw materials for the drug trade. An estimated one million hectares of cannabis grow wild in Russia along. Central Asia and parts of Trans-Caucasia are home to enormous fields of opium poppies. There are reports that hemp is being cultivated as far north as Yakutia, which stretches into the Arctic Circle, and in the lands of the Russian far East . . . Opium grown in remote, fertile river valleys on the borders of Kazakhstan and Kyrgyzstan is sent to laboratories in Baku for processing and then shipped thousands of miles north to dealers in Russian cities. From Moscow the produce is transported to Riga and other Baltic ports to be shipped onward to Scandinavia and Germany. Khimka, a hemp product cultivated in the Maritime and Khabarovsk regions crosses the continent by air and rail to Siberia and Central Russia, or is shipped out to Japan and Australia."[135]

The cultivation of narcotics may be believed by someone to save the economy from collapse. But the focus on drug profits in connection with government revenues ignores the fact that drug dealing is linked to corruption. "The post-Soviet drug industry could never have reached its remarkable level of profit so quickly without the close involvement of "civilians". Corrupt bureaucrats, law enforcement authorities, and customs officials ensure that the drug network remain largely free of interference.[136]

As a result, in 1992, some 1.5 million Russians admitted taking narcotics at least once a month compared to only 130,000 drug users three years earlier. 70 percent of those in 1992 were under thirty and 9 percent were under eighteen. 54 percent were unemployed...[137]

4.3.3.) Racketeers and gangs

The Russian MVD (Ministry of Internal Affairs) currently estimates that more than 3,000 criminal groups control over 40,000 businesses, including more than 400 banks, nearly 50 stock exchanges, and almost 1,500 enterprises in the government sector of the economy.[138] The lowest levels in these criminal groups "consist of the runners and lackeys who depend on mafia connections for security and debt collection. For this they pay a significant portion of their profits. The second class makes all the headlines. These are racketeers who guarantee that money is paid on time, troublemakers disappear, and competitors are eliminated. At the top are the chiefs. Some of them have emerged from the government bureaucracy, others from the godfathers of mafia syndicates. They combine the power of old-time Party connections, government access to resources, and the strength of mafia enforcement. "The government has been a crucial part of these developments . . . The main structures remain untouched. And the connections between the mafia and governments are already very settled, because for work to be profitable you are dependent on good government connections. The interesting thing is that it was always the government people who took the initiative to form the clans."[139]

5. Conclusions

The IMF and the World Bank declare that the goal behind a structural adjustment programme is to ensure that the indebted country will maintain a viable balance of payments position. However, in Russia, as in many other countries undergoing structural adjustment, the macroeconomic objectives of growth and balance of payments stability have not been achieved.

Instead, the reforms negated the possibility of national accumulation and social progress. The failure of the central motor of a development strategy, the leading role of the state, led to increased poverty, inequality, and denationalisation of the economy. The human costs are in loss of public services and subsidies, in loss of jobs, and in loss of savings through currency devaluations.

Privatisation, which was implemented as a precondition for imposing financial constraints on national industry, proved to be hyperinflatory and inequitable. Privatisation and the arrival of a national capitalist class would be welcomed by workers only if they were accompanied by new investment, higher wages, and improved working conditions – all that did not happen in Russia. Rather, instead of a two-class system formerly comprised of proletarians and Party members, Russian society today encompasses a mafia hierarchy.

"The country has entered the age of the seven bankers where crime is not just organised, it is institutionalised. The "reform" turned out to be no reform at all; it was just a bald hand-over of the Russian economy to the seven guys who were fastest with a rubber chequebook. The end result is nothing at all like a competitive market economy.

There is no "market" involved in this, no competition, no improvement in efficiency. The economy crashed drastically, and the rouble hyperinflated. Vast hordes of Russians were flung out of work or, worse yet, found themselves working and not being paid for it, for months on end".[140]

In a country like Russia, where the markets have been highly bureaucratised and power and influence monopolised, government officials in charge of property redistribution and company managers with the necessary connections could hardly resist the available opportunities to enrich themselves. The privatisation process turned out to be fraught with charges of corruption, favouritism, and unfair power of the former elites. It led to a battle, often criminal, for redistribution and control over property, resources, and allocation channels. As a result, the legal business—in practically every part of the Russian economy—is taken over by organised and highly structured alliances of criminals and corrupt government officials.

The growth in recognised crime and corruption represents a significant challenge to national development in Russia and increases people's perceptions of injustice and unfairness. Connections between nomenclatura capitalists and criminal groups are developing at all government levels; mafia habits and corruption reflect the criminal nature of the state and remain the norms of social relations. State criminals exploit social institutions and political structures to take over the economy and society.

[1] Mandel, 1991:33.
[2] Mandel, 1991:12,14.
[3] Mandel, 1991:63.
[4] Ibid.
[5] A Study..., 1991:30.
[6] A Study..., 1991:30.
[7] Mandel, 1991:63.
[8] A Study..., 1991:41.
[9] Mandel, 1991:66.
[10] A Study..., 1991:31.
[11] Ibid.
[12] A Study..., 1991:32.
[13] Ibid.
[14] A Study..., 1991:34.
[15] A Study..., 1991:34.
[16] Ibid.
[17] A Study..., 1991:40.
[18] Ibid.
[19] A Study..., 1991:38.
[20] Moskoff, 1993:16.
[21] Moskoff, 1993:17.
[22] Moskoff, 1993:18.
[23] Moskoff, 1993 :110.
[24] A Study..., 1991:61.
[25] Handelman, 1995:102.
[26] Boyko, 1995:1.
[27] Blasi et all, 1996:187.
[28] Blasi et all, 1996:190.
[29] Eastern Europe and the CIS, 1997:621.
[30] Moshin, 1993:63.
[31] Moshin, 1993:65.
[32] Moshin, 1993:70.
[33] Ernst et al., 1996:221.
[34] Smith, 1993:167.
[35] Moshin, 1993:66-67.
[36] Ekonomika I Zhizn, 1992, no.17, qtd. in Smith 1993:176.
[37] Smith, 1993:167.
[38] Moshin, 1993:68.
[39] Ernst et al., 1996:220.
[40] BBC Summary of World Broadcasts, 4 April 1992, qtd. in Smith, 1993:195.
[41] ibid.
[42] Ernst et al., 1996:231.
[43] ibid.
[44] Ibid.
[45] ibid.
[46] Eastern Europe and the CIS, 1997:610.
[47] Izvestiia 21 February 1992, qtd. in Smith, 1993:190.
[48] Ekonomika i Zhizn 1992, no.17, qtd. in Smith, 1993:210.
[49] Ekonomika i Zhizn 1992, no.4, qtd. in Smith, 1993: 215.
[50] Smith, 1993:163.
[51] Smith, 1993:178.
[52] ibid.

[53] Clarke, 1993:227.
[54] Kaser, 1995:192.
[55] Eastern Europe and the CIS, 1997:625.
[56] Kaser, 1995:193.
[57] Kisunko,1997:3.
[58] This is often termed as divestiture of state enterprises.
[59] Handelman, 1995:103.
[60] " Komsomolskaya Pravda", July 5, 1991, cited in Handelman, 1995:103.
[61] The "destatisation" of property refers to the differentiation and distribution of state property into discrete and independent units which can act as juridical subjects.
[62] Johnson and Kroll, 1991:290, qtd. in Clarke 1993:210.
[63] Nellis, 1995:86.
[64] ibid.
[65] Nellis, 1995:87.
[66] ibid.
[67] ibid.
[68] ibid.
[69] Nellis, 1995:89.
[70] Nellis, 1995:88.
[71] ibid.
[72] Nellis, 1995:91.
[73] Lieberman, 1995:16.
[74] Lieberman, 1995:17.
[75] Blasi et all, 1996:19.
[76] Sale of the century, The Economist 1994:67.
[77] Clarke, 1993:229.
[78] ibid.
[79] Summers, 1997:1.
[80] Samoilova, Kommersant, 8 November 1994, Business Central Europe, June 1994:20; qtd. in Kaser, 1995:143.
[81] Blasi et all, 1996:190.
[82] Clarke, 1993:230.
[83] Clarke, 1993:226.
[84] Dolgopiatova, 1996:1.
[85] Handelman, 1995:108.
[86] Kaser, 1995:141.
[87] Business Central Europe, July/August 1993, p.57. qtd. in Kaser, 1995:186.
[88] Cohen, 1994:260.
[89] Clarke, 1993:227.
[90] Lieberman et al., 1995:128.
[91] Handelman, 1995:6.
[92] Eastern Europe and the CIS, 1997:618.
[93] ibid.
[94] Eastern Europe and the CIS, 1997:620.
[95] Chossudovsky, 1997:235.
[96] Kaser, 1995:145.
[97] Izvestiia, Segodnya, 30 December 1994, qtd. in Kaser, 1995:146.
[98] Eastern Europe and the CIS, 1997:620.
[99] ibid.
[100] ibid.
[101] Mau, 1996:1.
[102] Bernstein, 1996:1.
[103] Zagorsky, qtd in Bernstein, 1996:2.
[104] Bivens, 1996:1.
[105] ibid.

[106] Yeltsin Boris, qtd. in Zaks, 1997:1.
[107] Zaks,1997:3.
[108] Zaks,1997a:1.
[109]Lukianov, 1997:1.
[110] Bernstein, 1997:1.
[111]Lukianov, 1997:1.
[112] Khodorovsky Mikhail, qtd. in Lukianov, 1997:1.
[113] Andrei Piontkowsky, qtd. in Lukianov, 1997:1.
[114] Bernstein, 1997:4.
[115] Thornhill, 1998:1.
[116] The state of Russia, 1998:21.
[117] Simis, 1982, qtd. in Dallin, 1991:678.
[118] Kisunko, 1997:3.
[119] Kisunko, 1997:4.
[120] Kisunko, 1997:3.
[121] Lawrence and Ngo, 1997:4.
[122] See, for example, Katz, 1997:1.
[123] ibid.
[124] Handelman, 1995:340.
[125] Handelman, 1995:337.
[126] Handelman, 1995:338.
[127] Summers, 1997:1.
[128] Summers, 1997:2.
[129] Kisunko,1997:3.
[130] ibid.
[131] Handelman, 1995:197.
[132] Handelman, 1995:199.
[133] Handelman, 1995:197.
[134]ibid.
[135] "Moscow News, June 25,1993, qtd. in Handelman, 1995:200.
[136] Handelman, 1995:200.
[137] General Aleksandr Sergeev, head of the MVD's Division for the Control of Drugs, qtd. in Handelman, 1995:198.
[138] Gray, 1995:1.
[139] Kreye, 1994:5.
[140] Sterling, 1998:1.

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