Chapter One: Introduction

1.0 Introduction:

The Russian Federation, which under the erstwhile USSR had for 74 years professed and practiced communist dictatorship and followed a centrally planned economy, lacked the institutional support for liberal democratic institutions and free market economy. After its emergence in 1991 Russia has been able to bring in a systemic change by adopting a multiparty democracy and re-structuring into a capitalist system based on markets and private property. Its adaption into a capitalist system not only brought changes on the political and economic front but also led to a series of changes in terms of society, culture, and social structure. The reforms introduced during the Gorbachev period, under perestroika, prepared the ground for new class divisions, within the former republics of the erstwhile USSR. Out of the class divisions that emerged within the Russian Federation, after the disintegration of the Soviet Union, the capitalist class is examined. The rise of the capitalist class had its origin in the shadow economy and within the institutions created during perestroika. In this context, the hypothesis tested is that, the Russian capitalist class emerged from the sub-elite of the Soviet nomenklatura (i.e., the komsomol) due to their informal linkages and control over state property.

The introductory chapter will delineate the topic for research, clearly explain the rationale for the study and thereon its scope, lay down the research questions and give an outline to the structure of the thesis. The contextual framework will explain historically the antecedents for the emergence of the capitalist class in Russia. The objective is to examine the historical legacy that has internally influenced the economic and political conditions in Russia and the external factors. It will briefly examine the Czarist period up to the end of NEP (New Economic Policy) period where Russia tried to adopt the institutions of market economy. Thereon it will examine the stagnation period since the 1970s in USSR, which gave rise to the shadow economy, culminating in the perestroika period under Gorbachev to reform socialism. Here on the chapter will analyze
as to how an economic elite emerged during perestroika out of the monolithic structure of the Soviet power structure.

1.1 Rationale for the Study and its Scope, Research Problem or Questions:
The reforms carried under Gorbachev through perestroika and the emergence of Russia as a market-based economy changed the class composition within Russia giving rise to different classes. It is difficult to visualize the emerging class structure due to the changing economic conditions of the people brought about by hasty economic reforms under President Yeltsin. The Russian capitalist class cannot be solely understood in terms of the Western debate as they did not give birth to new technologies or enterprises like America’s Andrew Carnegie, Henry Ford, Bill Gates, or John D. Rockefeller. The tycoons in the West have relied on both the government and private capital. The activities of the Russian capitalists relatively led very less to the creation of new productive entities. They had primarily expropriated the state property. In the shortest period, Russia saw the accumulation of capital, an oligarchic financial capital (Kryshtanovskaya, 1996).

The road to capitalism in Russia was marred by several distortions in the form of the financial crisis, crime and the mafia, rise of financial oligarchy, which was parasitic in nature, corruption, delays in payment of wages, salaries, pensions etc. Moreover, the institutions that would strengthen capitalism were non-existent or weak. The shock therapy and the privatization were carried on these shaky grounds. Therefore, the kind of capitalism that has emerged in Russia has been termed in different ways—'nomenclature capitalism', 'criminal capitalism', or 'oligarchic capitalism'. These different variants pose a challenging question as to who are the real capitalists in the true sense. In addition, is Russia developing capitalism, and a capitalist class of its own kind?

The existing literature has led to a semantic confusion in labeling the entrepreneurs (Stanislav, 2006). Since the transition of the Russian Federation, the capitalist class that was formed was the first of its kind in Russia. The mechanisms for corporate governance were set gradually in the late 1990s. Hence, due to the lack of laws and regulatory institutions to monitor and direct the activities of the capitalists, the directors and mangers of the industries under the state and the
small employers, the type of capitalism that emerged has been termed in different ways. Hence the study would also include an investigation as to what kind of capitalist system that has been formed in general (although very briefly) and most importantly on one of the units of class i.e., capitalist class in detail. In order to conceptualize the capitalist class in the Russian context, a prior examination of class as such needs to be done and then its unit, the capitalist class.

The scope of the study is to understand the capitalist class in Russia as a process as per the term ‘class’ is being explained and not to limit the study to ownership of property, power, consciousness etc. The research would also study the understudied or ignored aspect of this study i.e., the attitudes, the networks and actions of the business elite or capitalists and their contemporary relevance both within the Russian political system and the global economy at large. In short, their role is being examined within the state and their contribution to the world economic system. The chapters that follow consist of all these contending issues. These chapters deal with the crucial research questions with regard to the topic that is being researched:

1. Who can be termed as the capitalist class in Russia?
2. What are the methods through which these capitalists acquired the initial capital and converted their wealth to establish huge financial-industrial holdings? In addition, how strong was the hand of the state in abetting?
3. Once their position was secured, did the capitalist class move away from the patronage of the state and establish their own identity and interests? What is the level of autonomy enjoyed by them under the tenure of Yeltsin and Putin respectively?
4. Is there consistency in consensus building amongst the Russian capitalists? Or is their coming together to build consensus something to do with protecting interests when threatened by factors like hostile opposition from people, from any ideology, parties or leadership at the government level?
5. Which are the business organizations within Russia and how effective are they in maintaining the interests of the capitalists and their businesses? What is their participation in the differentiated political structures- political parties, pressure groups, lobbies, and means of communication/media- like? How effective is the Chamber of
Commerce and Industry of the Russian Federation in promoting interaction within entrepreneurs and with the government?

6. Do the capitalists bargain collectively or individually with the state, and what are the reasons for doing so? Do they behave as a class for itself?

7. Are the institutions and regulations in place for a smooth transition to capitalism in the contemporary sense? Can Russia firmly embed the market institutions with the kind of private entrepreneurial class that has emerged, which is hostile towards foreign investors, and towards equal competition in the free economic space provided for other members of the Russian society?

The economic and political institutions that have evolved over time within any social system define the kind of economy and polity established in that particular society. The institutions of the Western countries, whose economies are determined by the market and the polity governed through liberal democracy, did not evolve over a brief period. It has taken centuries for these various institutions to take form. The case with Russia is a unique one within the Euro-Asian space. The Czarist Russia was more feudalistic and authoritarian, lacking strong democratic or market institutions. Moreover, the revolution of 1917 completely changed the entire social system. Before analyzing the capitalist class within the Russian Federation, it is important to examine the Czarist and the Soviet period in order to understand the historical antecedents in which the present business elite emerged.

This part of the chapter will briefly look into the economy of the Czarist Russia because industrialization and finance capital were taking form and strengthening during the 1890s. Was there a capitalist class when the Czarist Russia embarked on industrialization at the dawn of the twentieth century? If there was any such class, how did it thrive and most importantly how did it survive in the post-1917 Russia in the initial stages under socialism? How did the economy under the Soviet system perform? What conditions—both economic and political—gave rise to a massive restructuring under the leadership of Gorbachev? As the topic of research deals with the capitalist class in the present Russia since 1991, we need to look into the important research question that is: since the Russian Federation was the legal inheritor of the Soviet Union, did the elite, especially the business elite carry on from the elite that existed under the Soviet regime? If
so, what were the conditions that led to this continuation and what were the means and methods they employed to do so? What was the role of the state in this regard?

1.2 The Nascent Capitalist Class in Russia under the Tsars—Economic and Political Conditions:
Prior to 1917 revolution in Russia, the type of government was monarchic and therefore the Romanov Tsars initiated the industrialization process. Tsar Peter the Great and his successors until the beginning of the 20th century undertook initiatives to establish new factories and not the private entrepreneurs (Goldman, 2003). While the Western countries were on the threshold of advanced capitalism, Russia lagged in this sphere. There are many reasons as to why the economy under the Tsars could not turn to a full-fledged capitalism like its Western counterparts. The Tsarist economy was more feudal in character and the masses comprised primarily of the peasants. Business as a vocation was not held in high esteem. Moreover, lack of state and institutional support is to be accounted for the slow growth in industrialization. Hence, capitalism and industrialization made a very late entry within Tsarist Russia.

Although the Russian corporate law had remained vague since the reign of Tsar Peter the Great (1682-1725), the repressive and comprehensive corporate law of 6 December 1836, exerted a strong and lasting influence on the subsequent history of capitalist institutions in Russia. Owen (1991) explains that the major provisions of the law of 1836 are understood only in terms of its pursuit of two essentially contradictory principles: the encouragement of corporate capitalism on the current West European model and bureaucratic regulation in the traditional Russian style.

A close examination of the Tsarist corporate law shows that the regime just could not relinquish its legislative and administrative control, and tolerate a genuinely free market (Owen, 1991: 15-18). Left with no chances of carrying independently their private activities, the business community heavily depended on state patronage. Social and ethnic restrictions hindered the move towards market economy. Since business was relegated to foreigners or minority groups like Poles, Germans, Jews, Armenians, or Georgians, the traditional prejudice and contempt only enhanced the contempt Russians had for business (Goldman, 2003). Arbitrary laws were designed to strengthen the economic position of ethnic Russians against encroachment by Jews and the Poles (Owen, 1991). The xenophobia of foreign contact and of foreign investors
affected, in the end the Russian business practices, commercial codes, and operating mores. Hence, Russians could not familiarize with the forms of capitalism that took roots in the West Europe.

Peter Lyashchenko (1949: 489), while tracing the history of national economy of Russia prior to the 1917 revolution, explains that the factors for higher rate of industrial development were largely non-existent. They were large capital resources, improved technical methods, skilled labor, a capitalist organization of distribution in the form of a developed network of railroads, commercial banks, credit, and organizational experience in the construction of such new industries as petroleum and coal. Moreover, the new industrial Russia was on the shaky foundations because of the free-trade tariff of 1857, higher quality, and low price of the foreign products, importing of small products like screw, bolts, and other items, exporting the raw materials at cheap rates, and the opposition of the regime to the capitalist principles.

Despite the restrictions, a look into the fledgling capitalism that developed in Tsarist Russia shows that though it was a late entrant it had made some form of headway. Prior to the 1861 Reform, there were 78 joint-stock companies in Russia with a capital of 72 million rubles. The flow of foreign capital into the Russian industry in 1860 was 9.7 million rubles. Between 1861 and 1873 there were 357 stock companies with a capital of 1,116,00 rubles. In addition, the foreign capital amounted to a total of 97.7 million rubles. Hence, a major share of investment came from the Russian capital. Out of the 357 corporations, banks and railroad companies were high in number along with 163 various types of industrial companies. Steamship companies and commercial enterprises had approximately numbered to 15. With the emergence of independent banks and their mergers, finance capital was linked with industrial capital. (Lyashchenko, 1949: 489-490)

Banking system developed fairly well post-1861 with the aid of foreign capital. The old credit institutions had been liquidated by 1861 (the Bank of Issue, the Loan Bank, and the personal loan institutions), and the old Commercial Bank was re-organized into the State Bank which was set up in 1860. Therefore, the State Bank stood at the head of the banking system. The period between 1900 and 1914 was a crucial one in the history of Russian banking system in terms of
concentration. Many independent small banks merged into a small number of giant banks. For example, the Azov Don Bank, United Bank, Russo-Asiatic Bank etc. On an average each of the banks situated in Petersburg owned 42 million rubles of its own capital whereas those in Moscow were 19 million per bank (See Table 1.1), whereas in the post-Soviet Russia the reverse was to happen where Moscow became the hub of financial-industrial groups.

**Table 1.1 Banks in Czarist Russia, 1900-14**

<table>
<thead>
<tr>
<th>Groups of Banks with a Capital of</th>
<th>Number of Banks</th>
<th>Their Capital in % to Total Capital of All Banks</th>
</tr>
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<tbody>
<tr>
<td></td>
<td>1900</td>
<td>1914</td>
</tr>
<tr>
<td>Up to 9.9 million rubles</td>
<td>30</td>
<td>24</td>
</tr>
<tr>
<td>From 10 to 19.9 million rubles</td>
<td>6</td>
<td>11</td>
</tr>
<tr>
<td>From 20 to 29.9 million rubles</td>
<td>2</td>
<td>4</td>
</tr>
<tr>
<td>From 30 million rubles up</td>
<td>-</td>
<td>7</td>
</tr>
</tbody>
</table>

*Source: Lyashchenko (1949: 704).*

Due to these mergers, seven large banks (hitherto absent in 1900) of Petersburg owned more than half of all the capital by 1914. Table 1.1 not only displays the number of banks with the capital slabs but also shows how these mergers led to the decline of the total capital of all the small banks from one-half to one-tenth. In the meanwhile, the seven banks became the owners of more than 50% of all the capital by 1914. This implies the possibility that, though Russia was a late entrant into the Western form of capitalism, it was on the first stages of taking off towards being a capitalist economy, more in the lines of the monopolistic capitalism that developed before the Great Depression in America.

Despite the bureaucratic regulation of the economy, ironically, a tiny group of capitalist entrepreneurs did exist. The number of companies founded in the Russian empire before the Bolshevik revolution in October 1917 scarcely surpassed 6000 that included approximately 1500 founded during the World War I (Owen, 1991: xi). The establishment of new banks, the expansion of bank credit, and the intensified construction of new railway lines resulted in the
rapid growth of all branches of capitalist industry, especially in ferrous metallurgy and machine building. Peter I. Lyashchenko (1949: 696) detects the emergence of a 'financial oligarchy' because of coalescing of industry and banking capital in the Tsarist period of late 1890s. This kind of 'financial oligarchy'\(^1\) was to raise its head again with the independence of Russia (though the present financial oligarchy has no connection to its Czarist equivalent) by the end of 1995 (Chapter 3).

The concentration of banking capital resulted in the emergence of a conspicuous "financial oligarchy": the seven Petersburg banks disposed of more than one-half of all capital resources for the financing of all Russian industry (Lyashchenko, 1949: 704). The leadership of Russian banks, corporations, and industrial enterprises was in the hands of this small circle of persons. They were the captains of industry and finance, while at the same time the board chairpersons of several banks, directors, and board members of numerous syndicates and corporations associated with these banks, and large shareholders in these companies. Another important aspect, in common with the present Russian financial oligarchy, was their association with the ranks of the upper bureaucracy, particularly with ministries for finance, industry, and trade. They exerted their influence by resorting to bribery, a "lucky" play at the stock exchange on behalf of the officials of the ministries, stock subscriptions on privileged terms, and by attracting the upper officialdom to highly paid positions in the management of banks and corporations (Lyashchenko, 1949: 706). Therefore, the beneficiaries were also the Tsarist bureaucrats.

How did finance-capital arise within an imperialist system and how did the coalescence take place between banking capital and industry? The Russian banks were prohibited by their charters to exceed their purely intermediary, credit functions, and engage in the financing of industry, this injunction had long become a dead letter (Lyashchenko, 1949: 708). The banks were not only creditors of many industrial enterprises but also their founders, cashiers, directors of their current accounts, the managers, and owners of their shares and their basic capital. The banks financed the industrial enterprises and with time, the debts of these enterprises increased tremendously. Hence, over the years when the enterprises failed to pay back the debts, the collateral which was

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\(^1\) Sociologist Olga Kryshtanovskaya was the first to identify a group of financial–industrial oligarchs within Russia since its independence in 1996. See Kryshtanovskaya, Olga (1996), The Financial Oligarchy in Russia, of the Post-soviet Izvestia, Jan. 10, p.5 or The current Digest Press Vol. 48 (4) Feb. 21, 1996 titled “Post-Soviet Elites: Parlaying Power into Property” pp. 1-5.
in the form of shares of the various industrial enterprises turned in to stock for these banks. History was to repeat similarly in the Russia Federation, especially in 1995. The oligarchs in 1995 through the 'loans for shares' scheme under the Presidentship of Boris Yeltsin, changed from a financial oligarchy to an industrial one (Chapter 3).

One such example\(^2\) will exemplify as to how the banks came to be the complete masters of the enterprises: in 1895, the Russian Commercial-Industrial Bank financed many enterprises out of which the Nikopol-Mariupol Company and the Hartman Plant deserve special mention. This bank owned 13,735 shares of the Nikopol-Mariupol and 11,836 shares of the Hartman Company. This made the Russian Commercial-Industrial Bank the complete master of the two corporations owning a majority of their stock and debentures when they failed to pay back the debts.

Another method, which these banks used to gain dominant influence in the affairs of the corporations, was through the "financial reorganizations" of the enterprises and "cleansing" (Lyashchenko, 1949: 710). The industrial crisis struck Russia in 1900. The banks, to which the enterprises were indebted, in order to avoid the collapse of these enterprises were forced to resort to "financial reorganization"- the total amount of losses involved were "written off" the basic capital of the company. After this "cleansing", the bank undertook to issue new stock to secure an influx of new capital. It served no longer as merely the intermediary in the issuance of the new stock but simply took all the new stock into its own holdings to become in reality the owner of a substantial part of the company's stock capital.

However, despite this, the Russian financial capital was dependent on the foreign capital, which infiltrated in the period 1900-1914 in both the industry and banking. In this way even, the industries were supported through foreign capital. The foreign capital increased much faster than the internal accumulation. During 1900-1913 it increased by 85.5% and Russian capital by 59.3%. Lyashchenko (1949: 717, 719) says that in terms of the absolute size, Russian capital was far more important than foreign capital in the capitalist system of Russia. However, the system as a whole was more and more under the influence of foreign capital, thus acquiring a semi-colonial

character. This again was one of the reasons for the lack of development in private entrepreneurship within Tsarist Russia.

The Czarist regime was riddled with apprehensions to shift from an agricultural economy to an industrial foundation and contradiction between initiation of industrialization and opposition to capitalist principles. Owen (1991: 217) says that the systemic conflict that existed between the autocratic state and the capitalist elite resulted in the contradicting laws and policies towards corporation by the regime, which had deep economic impact so much so that it stifled the entrepreneurial freedom in particular, and the embedding of capitalism in general. The financial backwardness of Russia perpetuated its dependence on foreign capital and its semi-colonial character. Hence, Russia’s system of capitalism could not become an independent national system (Lyashchenko, 1949: 719). The imperialist Russia remained a military-feudal system.

With the rise of socialism in Russia, capitalism was abandoned for another seventy years or so. The nascent capitalist system that was beginning to emerge in the period economic boom of 1909-1914 was wiped away by war and the Bolshevik coup.

1.3 The Soviet Period

A. The New Economic Policy Period-a change in the Bolshevik Policy towards Capitalism:

In the conflict between the Provisional Government and the Bolsheviks after the fall of the Romanov dynasty, the latter through the October Revolution of 1917 won. However, the Bolsheviks had to fight the all non-Bolshevik factions to emerge victorious in the civil war that had ensued right after the October Revolution. The period 1918 to 1920 of “War Communism” put the Russian economy in ruins. In 1920, the peasant disturbances had become widespread. In the beginning of 1921, the country was plunged into disastrous fuel, transport and food crisis, and this unrest spread even amongst the industrial workers. It was under these conditions that the Communist Party of the Bolsheviks decided to bring in new economic policies. This shows a change in their policy towards capitalism. The New Economic Policy (NEP) during the period of 1921-28 briefly accommodated capitalism within the Soviet socialism.

At the 10th Congress of the Russian Communist Party (Bolsheviks) of March 1921, the decree on mass nationalization of small and cottage industries was repealed. In its place, a new decree (of
July 7, 1921) was established, permitting any citizen of Soviet Russia to open a cottage industry or industrial (one craftsman with a motor-driven machine) production facility, with no more than one per owner. No authorization was required for this; one could hire up to 10 workers (with a motor-driven machine) or up to 20 (without a motor-driven machine). In March 1923, a selective census by the Central Statistical Administration registered 165,781 industrial, and cottage-industry enterprises in European Russia, of which 88% belonged to private craftsmen, 3% to cooperative workers and 7% to the state; the rest belonged to foreign concessions (Sirotkin, 1989: 11).

The other changes were that it introduced hard, convertible monetary unit with strong gold-backed ruble. A system of taxes, loans, and credit operations through banks and saving banks was instituted. A most important aspect of NEP was the economic reform based on decentralization and broad autonomy for enterprises that had been switched to economic accountability (within the framework of the state budget and stable prices) and business accountability (obtaining of a profit at contract and market prices). Moreover, Lenin introduced the principle of separating Party leadership (policy) from administrative leadership (the economy and the market) which was strictly practiced up to 1929. The Politburo appointed only the top economic managers, and very often from among non-Party specialists.

Trade was resumed on a national scale, with more retail trade in private ownership. This was a retreat towards capitalism. The large-scale industries remained with the state and small factories either rented or sold by the state to individual owners. Foreign investors were allowed entry into Russia. Private business ventured into trade, services, and industry (Kotz and Weir, 2007: 20). The central feature of NEP was the right of individual peasants to sell their products freely, locally or nationally, to private traders, direct to other individuals, or to state agencies. The kind of freedom enjoyed by the peasants during this period is nothing compared to the Czarist period. They had complete right over their produce, to determine what to sow, when to reap, what to sell and at what price etc. The New Economic Policy improved the lives of the peasants tremendously where some of them turned wealthy. Unlike the war communism period, they experienced self-sufficiency and profits from their produce. They did not want to give up their
ownership of land or their individual authority of running farms. When they resisted Stalin's collectivization, they were called as 'kulaks'.

The success of NEP was short lived. Though Stalin was instrumental in eliminating NEP in any form, even within the Party, it had opposition. Party members like Leon Trotsky, G. Zinoviev, L. Kamenev, etc favored rapid industrialization and collectivization of agriculture whereas the faction led by Nikolai Bukharin supported a gradual course. Essentially NEP divided the Party leadership into doctrinaires and pragmatists. The main struggle on the theoretical level developed between Trotsky and Bukharin: Where is NEP leading--to restoration of capitalism in the USSR or to a world revolution? Bukharin tried in vain to save NEP as “the universal path to socialism” and the thesis on the intensification of the class struggle as a method of speeding up the world revolution in the Comintern’s Program for World Revolution. The fabricated trial of the “specialist-wreckers,” the so-called Shakhty Affair where the accused (which included foreign engineers) submissively confessed to using NEP as a screen for sabotage and liaisons with foreign intelligence agencies in the West brought in the decline for NEP as a economic policy. The Shakhty affair followed by the Industrial Party trial led to a nationwide campaign against specialists and technicians.

One of the most serious negative aspects of NEP was unemployment, and Stalin took credit for its elimination (along with the elimination of NEP) after 1929. Stalin eliminated all kinds of ownership-land, property, productive resources, unearned incomes, or rents. Stalin defeated all kinds of factions within the party, which enhanced his personal power and embarked on rapid industrialization and collectivization of agriculture. With Stalin’s rise to power and the introduction of the first Five-Year Plan (1928-1932), private trade, private ownership or any forms and traces of capitalism was eliminated. Stalin aimed at complete state ownership by asserting a need for ‘growth which will ensure a systematic preponderance of the socialist sector of the economy over the capitalist sector.’ (Davies et al, 1994: 137) Hence, the authorities put an end to the unofficial NEP. However, the changes Stalin forcibly initiated within USSR were to

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define the ‘Soviet System’ for years to come with very few changes or scope to reform the system. His long tenure aided the system to be embedded unlike the one that Lenin planned to install.

B. Economic and Political Conditions in the Soviet Union and the External Influences:
The USSR managed the production and distribution of goods and services through its centrally planned economy. In short, the state machinery controlled the economy. This implies that there was no possibility of having an alternative economy or a mixed economy. The Marxist-Leninist ideology, which was to guide the Soviet Union and bring in democratic-socialism, was replaced by authoritarianism under Stalin’s rule.

The Soviet Union perceived the West as a threat and vice versa. Therefore, the Soviet was anti to the ideology of Western capitalism. It condemned the Western principles of individualism, private ownership, freedom of choices, freedom of enterprise, market competition, self-interest etc. This is one of the reasons for the failure of USSR to embrace new technologies and innovative methods after its stupendous performance up to the 1960s in the economic sector. The rate of technological innovation slowed down around the 1970s. The Soviet Union failed to bring in new technologies associated with communication and information-processing brought by electronics and computers.

C. Attempts to Reform Socialism in USSR:
Once the Socialist system was in place, the Soviet leaders failed to reform it parallel to the global changes or even create alternatives. However, in the mid-1950s the Soviet leadership attempt to bring in efficiency within the economic system, without radically changing it. Nikita Khrushchev (1954-63) was the first General Secretary to attempt to reform the Soviet system. He could not be more successful because he did not gain the support from the CPSU (Communist Party of the Soviet Union). Aleksei Kosygin (1965-67), prime minister in the Brezhnev government, introduced radical elements from the market economy. The enterprise performance had to be evaluated by two major indicators: profitability and by the volume of sales. At that time, it was not clear to Soviet economic policy makers that market criteria would not have any beneficial
impact and would lose all its economic meaning in the conditions of absolute state property ownership, state control over prices, central allocation of supplies and the dominant role of the CPSU (Polonsky and Polonsky, 2000).

During Leonid Brezhnev’s (1964-82) second part of leadership as General Secretary of the CPSU in the seventies, stagnation set in and the GDP reached a stagnation point from which it did not recover. With regard to retail-distribution, there was acute shortage of ordinary goods. Moreover, consumer services were in a dismal state. It was during this time there began the acute shortages of commodities, long queues, unemployment, etc. On the diplomatic front, the relations with the West soured. The seventies and the eighties were the decades of stagnation of the economy and shortages of commodities. However, a second economy or secretive alternate economy, famously called as “shadow economy” existed alongside the Five Year Plans. The shadow economy thrived in industry, retail trade, black markets, and everywhere (Kosals, 1999 and Ryvkina, 1998). This was so because there was a great need for basic goods.

When Yuri Andropov (1882-84) became the General Secretary, he argued for a process of reform. In fact, he is the first to use in his speeches the terms ‘change’ and ‘restructuring’. He wanted to reform the system by rooting out corruption; by increasing discipline and efficiency; and by encouraging relatively an open debate on economic problems concerning the system. During his tenure, experimentation with new economic methods to improve work incentives and technological innovation was authorized. No change was introduced, formally, due to his untimely death. Konstantin Chernenko (1984-1985) who was in the same mould of Brezhnev replaced Andropov. He did not see any need to reform the system and hence maintained status quo. Hence, two underground institutions that plagued the Soviet Union, and later the Russian Federation were (i) the shadow economy and (ii) organized crime and mafia.

(i) Shortages and the Shadow Economy: Before we proceed any further into Gorbachev’s leadership and the changes, he brought in to reform the Soviet system, it is vital to understand the system of shadow economy. Shadow activity had become an element of socio-economic system in the 1970s and the 1980s, and turned into an economic institution of the Soviet society. As an economic institution, the shadow economy possessed a relatively stable social structure within the framework of which people had a certain status and played specific social roles-
“expediters,” market traders, and apartment brokers among others (Kosals, 1999). It amounted to 3 to 4 percent of the GDP (Kosals, 1999) in the USSR in 1973-less than in developed countries with market economies.

The activities that were a part of the shadow economy were: barter exchanges; unsanctioned dual job-holding (moonlighting); the delivery of products to “unaffiliated” consumers; unplanned construction; the output of products not accounted for, aside from planned targets; putting into commercial circulation the material resources economized above and beyond the official norms for the consumption of raw materials and others; the activity of the illicit dealers; offering services for a fee or “under the table” that were supposed to be free; bribes for admission to higher educational institutions or for any other decisions; currency operations, etc. (Kosals 1999: 8).

Shadow economy by definition lies beyond state control. This system arose within the USSR due to the shortages that was experienced by both the enterprises that faced in terms of inputs and the people through the non-availability or scarcity of necessary goods and services. Kosals (1999: 10) explains the two important functions that the shadow economy performed. First, it compensated for the shortcomings in the functioning of the official Soviet economy. Secondly, it provided a social niche for enterprising people who yearned to own property of their own and to earn suitable remuneration for their labor. Along with this kind of a second economy, the mafia too grew strong.

János Kornai, the well-known Hungarian economist, explains the basic reason for shortages. He described five stages in the economic relationship between state and micro-organization (a firm, nonprofit institution or household). Out of the five stages ‘Degree 4: Grants in kind-passive acceptance’ stage offers an important insight to understand the cause for the shortages in the Soviet Union. This stage involves a high degree of paternalism from the state towards enterprises (Kornai, 1980: 563). By “paternalism”, Kornai means absolute protection and safety. The most important link between the two sets phenomena i.e., paternalism and shortage is the soft budget constraint. Here the state intervenes when there is a financial imbalance. He says if this softening occurs, it will entail several phenomena connected with shortage: the almost-insatiable demand
for labor and the tendency to hoard it, the almost-insatiable hunger for investment, and so on (Kornai, 1980: 568)."

(ii) Organized Crime and Mafia: In the Soviet Union, the organized crime functioned parallel to shadow economy. The shadow markets became the breeding ground for the members of the organized crime to exploit the black market entrepreneurs. The criminal groups extorted money from the revenue of the shadow market operators (Shelley, 2006). Traditionally these criminals during the Soviet period rejected the legitimate world. However, in the post 1980 they got involved in politics and economy. Perestroika enabled these groups to profit more as the rules and laws had become lax. During this time new groups, other than the earlier ethnic groups, emerged namely from professional athletic background, Afghan veterans, juvenile delinquents etc. The groups that famously operated within Russia were Tambov mafia in St. Petersburg, the Solntsevo group in Moscow and the Uralmash crime group in Ekaterinburg (Shelley, 2006).

The Soviet mafia was the chief player in the organized crime. They were the agents or the suppliers of a much sought after commodity-protection or 'krysha'-in an environment devoid of trust where property rights remain crude and undefined (Rawlinson, 1997: 28). Along with the growth of shadow economy, the mafia or the organized crime evolved steadily and infiltrated the Soviet social structure, especially the economic structure. Gradually, the masses relied on the black market for goods and services that the state failed to provide. The enterprise directors relied on the tolkatch (fixer, a wheeler and dealer who negotiated the exchange of necessary goods or equipment, which would enable firms to meet their official quotas) and krysha for the goods and the services which they failed to procure from the state to meet their production targets. This type of second economy growing parallel to organized crime was to have its repercussions within the liberalized state of Russian Federation. Most of the members of the organized crime in Russia have been identified with the order of the ‘Thieves Under the Code’

4 For more on this see Criminal Tumor- ‘Thieves Under the Code’ on the Movie Screen and in Real Life. Current Digest of the Soviet Press 1989. April 12, 1989, 41 (12), pp. 5-6. Interview conducted by Yury Slavich with Aleksandr Ivanovich Gurov, deputy head of a department of the USSR Ministry of Internal Affairs’ All Union Research Institute, who says, “‘Thieves Under the Code’ are a caste of professional criminals that included various ‘specialists’-thieves, robbers, swindlers [who] existed in pre-revolutionary Russia....Persons entering the grouping were not supposed to work, serve in the Army, be witnesses in court, read newspapers, and so on...live only by crime, and not to violate the resolutions of the “assemblies”. Only a recidivist who had earned “credit” with the
or also called as ‘thieves-in-laws’ (Shelley, 2006). They existed in the pre-revolutionary Russia and continued in one form or the other through the Soviet period. They flourished when Russia became independent in 1991, as the laws were lax and incoherent, and the borders were porous during the transitional period led to their establishment within the social system.

Authors like Gustafson (1999) and Medvedev (2000) point out that it is difficult to clearly define ties of the “new Russians” or the capitalists to the world of mafia, illegal business, the shadow economy, and the black market. The shadow economy that existed in Soviet Russia for decades took on impressive dimensions in the years of stagnation. The legalization of private entrepreneurship let these elements out in the open and gave them an opportunity to legalize their trade activities. Medvedev (2000) says the continuity between those who were active in the shadow economy in the seventies and the “new Russians” of the nineties is more the exception than the rule.

1.4 Gorbachev and the Period of Great Change:
A. Restructuring:
When Mikhail Gorbachev became the General Secretary of the CPSU, he was well aware of the decaying Soviet system. In order to save it from the collapse he devised grand schemes for reforming the system through Perestroika (‘restructuring’) and Glasnost (‘openness or transparency’). The April 1985 plenary session and the 27th Party Congress adopted the reforms towards restructuring of the Soviet system. The objective of perestroika was uskorenie meaning ‘acceleration’ of the economy. The objective of these measures was a type of hybrid market socialism with increased economic autonomy for enterprises and individuals without losing state ownership. Gorbachev began with the policy of glasnost, or openness before he fully embarked on the radical economic reforms. Glasnost facilitated the public and the mass media to

thieves could become a “thief under the code”. He went through a three-year probationary period and was then approved by an “assembly”. Unlike political prisoners, criminals in Stalin’s time quickly got their bearings and even started helping camp administrations in some ways. But this was not a system. More often than not, they had the camp administration under their thumb. It controlled the prisoners in exchange for certain privileges. After Stalin’s death, the CPSU Central Committee and the USSR Council of Ministers adopted a resolution on improving the struggle against crime. The struggle against the ‘thieves Under the Code’ also went on outside places of deprivation of freedom, and by 1960s their grouping had been dealt a serious blow. In the late 1960s and early 1970s, when organized crime began to appear, they made their presence. In mid-1980s they had turned into small-time Mafiosi, from whom organizers of criminal activity began to develop.’
openly criticize the Soviet society and the leadership. In 1988, a year after Gorbachev introduced the economic plans, the democratization of Soviet political institutions was initiated. *Glasnost*, radical economic reform, and democratization of political institutions are the three elements collectively called as 'perestroika' meaning 'reconstruction'.

While presenting a report at the Plenary session of the CPSU Central committee, on Jan. 27, 1987, “On Restructuring and the Party’s Personnel Policy” Gorbachev explained the meaning of the concept restructuring in the Soviet context. It meant, ‘resolutely overcoming the processes of stagnation, scrapping the mechanism of retardation,...to combine the achievements of the scientific and technological revolution with a planned economy,... the expansion of openness, criticism and self-criticism in all spheres of the life of society; it means respect, raised on high, for the value and worth of the individual....renouncing the peremptory issuing of orders and administrative fiat, ensuring the changeover of all elements of the economy to the principles of full economic accountability and to new forms of the organization of labor and production, and encouraging innovation.... the fullest possible disclosure of the humanistic nature of our system in all its decisive aspects-economic, social, political and moral....” (Gorbachev, 1987: 6).

The first significant changes after Gorbachev took power were not economic in nature but were in the realm of culture and individuals’ right to freedom of thought. He initiated the policy known as glasnost, which entailed lifting the stifling controls on public debate and individual expression of opinion, in the beginning of 1986. It should be noted here that for the first time within USSR, individualism was securing a place of its own with the reforms carried under glasnost and perestroika. Individuals’ right to freedom of thought were given importance for the first time. Glasnost lifted the stifling controls on public debate and individual expression of opinion in the beginning of 1986. Earlier USSR believed in an egalitarian society, which entailed wage leveling. This was a method utilized to eliminate the class system. Again, the Soviet Union wanted to recognize individuality and personal interests of the people to improve the quality of work and output, to bring in motivation and enhance competition amongst the workers in the enterprises.
Since the practice of wage leveling had become a part of the economic system, it was one of the causes for the decline in the economic growth especially in the industry. Within an enterprise, the worker who toiled and the worker who loafed were given their due share of the salary. Secondly, this killed the motivational spirit of the workers, as the output of the industry did not affect their personal interests. Thirdly, an increase or decrease in the output growth did not threaten the job-security of workers. In order to bring in initiative and motivation, Gorbachev introduced the idea of wage differentiation. Gorbachev (1988: 9) in his speech defended this stance to ensure a direct connection between income and final results, so that any improvement in the quality of a collective’s work is rewarded by an increase in income. The factors that brought in new social stratification within Russia lay in the reforms of Gorbachev. The differentiation of wages was one of the first factors in the new social stratum.

Gorbachev wanted to bring in a change to the system that had become authoritarian. He wanted to reinstate the Marxist-Leninist model, i.e., to reform the system and not to change the system. One of the answers to the question why Gorbachev, unlike Yeltsin, refused to have a systemic change towards capitalism with private ownership of property and land or radical change like a revolution is found in his self-authored book, ‘On My Country and the World’. Here he says that he renounced revolution as a means of solving problems: ‘although our country was ripe for change to such a profound extent that it was truly in need of a revolution. My concern was that a new revolution might cause destructive upheavals as in the past-or worse, since this is the atomic age’ (Gorbachev, 2000: 11).

The perestroika package within the economic sphere contained new laws, decrees, and resolutions in practically all spheres of the Soviet economy – enterprise management, prices, finance, taxation, foreign trade, agriculture, etc. Important ones were:

- Law on Individual Labor Activity (November, 1986)
- Law on State-owned Enterprises (Associations), (1987)
- Law on Cooperatives in the USSR, (May, 1988)
- Cooperative and Other Public Enterprises, Associations, and Organizations, (1988)
- On the Lease system (Foundations of legislation of the USSR and the Union Republics)
A wide-ranging debate on economic reform was encouraged in 1986 as part of glasnost, and this led to the first serious economic reform efforts in the summer of 1987. Decree Authorizing Private and Co-operative Trading were passed by the Supreme Soviet on November 19, 1986 and became effective as of May 1, 1987. These decrees along with komsomol economy led to a flood of private entrepreneurs in the Soviet Russia. A meeting of the central committee in late June 1987 approved a document called “Basic Provisions for the Radical Restructuring of Economic Management.” A few days later the Supreme Soviet adopted a series of decrees designed to carry out the new policy and adopted the Law on State Enterprises the latter to take effect on 1 January 1988. Gorbachev took two fundamental and far-reaching steps that began to unwind the socialist experiment. The Law on the Enterprise (1987) was one and the Law on Cooperatives (1988) is of importance here because these primarily laid the foundation for the class of ‘New Russians’- the new class who acquired wealth legally due to these laws. Moreover, the former gave greatly expanded autonomy to the enterprises and the latter to the individuals.

Gorbachev brought in political reforms, which were relatively successful. These political reforms need brief examining because they led to a split within the Soviet elite to becoming political and economic elite. In 1987, Gorbachev abolished the economic and industrial sections in the Party Committees. This meant a drastic weakening of the CPSU’s control over the economy, yet no other administrative mechanism was proposed. Article VI of USSR Constitution (1977), declaring the position of the CPSU, as ‘the leading and the guiding force’ of the Soviet society and the ‘nucleus’ of its political system and of the state and social organizations, was deleted from the Constitution. These political reforms contributed to the weakening of the power structures within the Soviet system especially the CPSU Party. It gave the power to the Republics, led to the growth of a multi-party system and elections. This undermined the prestige of the nomenklatura and therefore, in order to retain its privileges the members adapted to the changes under perestroika to become the beneficiaries in terms of making profit under the Law of Enterprises and the komsomol under the Law of Cooperatives.

B. Attempts at Economic Reforms: Unlike his predecessors, Gorbachev succeeded in carrying on these comprehensive reforms. However, the policies of perestroika and glasnost did not
succeed. This was because whenever any of the policies backfired Gorbachev abandoned it altogether. He neither created alternatives nor tried to remedy the situation. Gorbachev advocated a ‘socialist oriented market economy’ but could not evolve a method to achieve it (Chenoy, 2001). Most of the economists that drew the plans for reforming the economy advocated free markets in place and private ownership in place of state or worker ownership (Kotz and Weir, 2007).

In order to bring in radical reforms or introduce the market techniques to accelerate the economy, Gorbachev first approved the Abalkin Plan. Leonid Abalkin, director of the Economics Institute, held to the position of reforming socialism rather than opting for capitalism. In July 1989, Gorbachev named him to the post of deputy prime minister in charge of economic reform. Abalkin envisioned a significant role for market forces in the Soviet economy, but he criticized the idea of free market. He used the term “socialist market” by stressing the need to develop markets gradually and did not link markets with any need for privatization. He wanted market relations to play a significant economic role but within a framework of economic planning, and with large enterprises to remain in state hands.

The economic problems of 1988-89 evidently persuaded Gorbachev that another round of economic reform was need, and in March 1990, he declared that perestroika needed to be radicalized and economic reform to move faster. He set Abalkin to work, with a team of 60 economists and lawyers, to devise a new economic plan. They came up with recommendations for speeding up the transition to a market economy. Their plan included gradual freeing of most prices; denationalization of small companies and turning large companies into joint-stock corporations; and replacement of job guarantees with a system of unemployment compensation. However, some key sectors, including fuel, metals, and transportation, were to remain state owned and with controlled prices. Although Abalkin had been opposed to a headlong rush to the market in1989, his proposal of March 1990 was a big step in that direction. Despite his call for radicalizing perestroika in March 1990, in mid-April Gorbachev refused to accept the recommendations of Abalkin’s team terming it too radical.
In May 1990, the government adopted a plan for a gradual five-year transition to a “regulate market economy” prepared under Prime Minister Ryzhkov’s direction, with centralized economic controls to remain in force during the transition. Gorbachev appeared to approve it initially. In August 1990, Gorbachev and Boris Yeltsin, by then the Chairman of the Supreme Soviet of the Russian Republic, jointly named a team of economists to come up with a new economic reform plan. Gorbachev’s advisor Stanislav Shatalin, with Yeltsin’s advisor Grigory Yavlinsky also playing a lead role, headed it.

Stanislav Shatalin headed the task force, which produced the famous 500-Day Plan in September 1990, which called for a drastic transformation of the Soviet economy within this period—that is about 17 months. Though the plan was never implemented, it played a key role in the transition from the stage of reforming socialism to the dismantling of socialist institutions. They argued that the government should intervene in the market only to improve macroeconomic stability, to avoid excessive inequality of incomes, and promote more even development of different regions. They called for denationalizing and privatizing at least 70% of industrial enterprises within 500 days by turning them into joint stock corporations and with large foreign investments. Finally, they called for creating a financial system based on private commercial banks and securities markets.

Gorbachev complained that some opponents called the 500-Day Plan program leading towards capitalism. He did not want private property to play a substantial role. He, thus, emphasized a continuing role for state enterprises, cooperatives, and other collective form of property, insisting that the plan was consistent with socialism. A month later Gorbachev backed away from the 500-Day Plan and Yeltsin obtained its approval by the parliament of the Russian Republic.

In June 1991, Grigory Yavlinsky teamed up with a group of Harvard University economists to propose another plan for speeding the transition to free markets and private business. Its salient features were rapid mass privatization through sales, fiscal stabilization through higher state revenues, and a swift yet gradual price liberalization. It was termed too radical by President Gorbachev, and in October 1990, he buried it forever (Aslund, 2002). It was tagged as “the Grand Bargain” by the media because it called on the West to provide $100 billion in economic
aid to the Soviet Union if the plan was adopted. PM Valentin Pavlov, who had replaced Ryzhkov, in December 1990, counter-posed a more cautious plan.

Once again, Gorbachev combined the two into a compromise plan to bring to the upcoming meeting of the G-7 of leading industrial countries. In October 1990, Gorbachev submitted a compromise plan to the Soviet parliament, which passed it on 19 October, known as the “Presidential Plan,” retained the goals and broad features of the 500-Day Plan, such as the eventual phasing out of most price controls, the privatization of industry, and the creation of a market-type financial system. It eliminated the 500-day timetable, calling for a more gradual transition. Boris Yeltsin seized the opportunity by completely severing ties with the CPSU to embark on an alternative economy i.e., the market economy within a liberal democratic Russia. Gorbachev failed because he wanted to bring in market mechanisms without giving up the Party, though he had weakened the powers of the CPSU and Socialism as an ideology. However a look into the komsomol economy, the Law on Cooperatives and the privileges shows that it gave rise to a new class who could make money and own property at the expense of the state.

1.5 Formation of Seed Capital during the Perestroika Period:
The seed capital for the private ventures of most of the business elite of present Russia was procured through the komsomol economy, Law on Individual Labor Activity (November, 1986), the Law on Cooperatives (1988), Enterprise Law of 1990 and lastly through the privileged position and power wielded by the nomenklatura. (A) Institutions and (B) Methods were employed to accumulate the seed capital:

A. Institutions:
The laws that were implemented as part of the reforms turned the Cooperatives, Komsomol, and the Nomenklatura system into profit-making and commercial institutions.

(i) Creation of the Cooperatives: As early as 1985, the new leadership began to take limited steps to allow private business activity by Soviet citizens in the form of individual labor or cooperatives. This was expanded with the Law on Individual Labor Activity in November 1986 and finally the Law on cooperatives in May 1988. In 1986, Gorbachev drew the attention to the cooperatives, a type of quasi-private business that had its roots in the NEP of the 1920s. They
became the first private businesses in the Soviet Union. It took shape in 1987 within the narrow sections of the economy like baking, recycling, laundry services and other consumer goods. Before the cooperatives assumed a legal stature, many of the cooperatives had turned into proper businesses. This was the time when komsomol economy took roots and branched into many youth cooperatives. The Law on Co-operatives of 1988 modified to cover ‘other public organizations’ which enabled the new youth centers to broaden the basis of their activity. It not only increased the sphere of activity of the komsomol economy but also led many of the youths individually to begin their own private concerns. Cooperatives were entitled to engage in any kind of activity save those prohibited under USSR and union republic law.

Article 3.2 of the Law (USSR Supreme Soviet, Law on Cooperatives, 1988) stated that the Cooperatives ‘are created and operated for the production, procurement, processing, and sale of agricultural output and technical production commodities; the manufacture of consumer goods; the collection and processing of secondary raw materials and usable production waste; the repair and servicing of equipment; the provision of services to production, highway, and housing construction, the retail trade, public catering, and consumer services; the organization of cultural leisure and medical aid; and the provision of legal, transport, forwarding, scientific research, planning, design, consultancy, sports and fitness, and other services, and also in the spheres of fishing, fish farming, production of fish products, timber procurement, extraction of minerals and other natural resources, and other spheres of economic activity.’

The Law had a clause, which allowed the formation of financial or credit businesses as cooperatives. This enabled the komsomol units, which carried on quasi-private services to turn into cooperatives. Moreover if the concerned members of the komsomol registered as a cooperative it could free of cost use the state property and space and also be protected by the party officials so as to keep the KGB and other authorities at bay from enquiring into their activities. The members holding positions within the industries, the research institutes, komsomol, etc used their positions to create financial structures and funds for themselves. The new youth centers indulged in businesses like tourism, show business, buying and reselling of video recorders, computers, and other forms of techno gadgets at inflated prices that was against
the law. There was no action taken against the inflated prices because the system had accelerated at its own accord with 17,000 youth co-operatives in operation by 1990.

(ii) The Komsomol\(^5\) economy: The first beneficiaries of the economic changes were the komsomol members. All the Soviet elite had to be members of CPSU. So initially, they had to join the komsomol. Ann Baum (1987: 1) says that established political systems often use socializing techniques to transfer values to younger generations to inculcate the youth the basic principles of the society. Organizations are hence, created with specially designed programs to produce future leaders and adherents to these principles in order to maintain the political status quo within acceptable parameters. In this similar manner, the komsomol expanded beyond the socialization process and acquired a place for itself.

The Communist party officially established the komsomol in August 1918, receiving official recognition from the Bolshevik Party in March 1919. The CPSU imparted its ideals to the youth by utilizing the socialization techniques through the komsomol. The komsomol became the youth counterpart of the CPSU. So invariably if one had to climb the hierarchy within the Soviet administration one had to be a member of this youth organization.

The komsomol played an important and an enthusiastic role during War Communism. However, the compromising period of NEP and its policies watered down their efforts to establish socialism over capitalism (Baum, 1987: 14-16). Most of the komsomol members had enthusiastically supported War Communism measures during the civil war, and subsequently resented the contrasting compromises of NEP. It is ironic that Gorbachev brought in reforms through the Co-ordinating Council of Centers for Scientific and Technical Creativity (TsNTTM), Youth Housing Cooperatives (MZK) and Youth Centres operating on the basis of cost accounting which was entrusted in the hands of the komsomol. These were the first structures of commercial activity, which later turned many of the komsomol members into private entrepreneurs. The komsomol that evolved within a traditional military orientation (Baum, 1987) during perestroika became commercially oriented towards the end of the Soviet period.

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\(^5\) Komsomol is an acronym for Communist Youth League (Kommunisticheskii Soiuz Molodezhi). Lazar Shatskin, a presiding officer, arrived at the name ‘Communist League of Youth’, the first Russian syllables of which formed the name Komsomol.
When Gorbachev had come to power, the West in particular had already made great advances in the fields of information technology, computers, etc. Being aware of all this Gorbachev wanted the Soviet Union to follow the same. Secondly, this was one of the alternative forms created by Gorbachev to reclaim the control over the economy that the Central committee of CPSU had lost (Kryshtanovskaya, 1995). The *komsomol* experiment was the brainchild of Konstantin Zatulin, appointed aide to Mironenko, the first secretary of the *komsomol*. His first job was to draft a letter to the Politburo, suggesting new business directions for the *komsomol*. He suggested creating a series of “Centers for Scientific-Technical Creativity of Youth,” which, in theory, would use young scientists to help Soviet industry solve technical problems and this idea suited Gorbachev’s need. Zatulin had no idea that he approved a springboard to capitalism (Hoffman, 2002). Hence, the *komsomol* members, especially the scientists, were entrusted with the task of operating these centers.

To implement this, the CPSU Central Committee adopted a resolution on 25 July 1986 in which it approved a proposal from the *komsomol* to establish a network of scientific and technical centers. The new centers, established in 1987, were supposed to operate on a commercial basis, basing themselves on agreements with enterprises and providing services that were not otherwise available. The scope of the new centers increased tremendously in 1988. These were staffed by the *komsomol* officials, with a network of centers attached to every district party committee in Moscow. Therefore, these became the first commercial structures and the first wave of new Russian entrepreneurs became established (Kryshtanovskaya, 1995). The dissolution of the *komsomol* in 1990 did not damage the *komsomol* economy. By then it was able to get along without the organization’s tutelage. Besides, it became possible to put some of the property formerly belonging to the komsomol into profitable circulation (Medvedev, 2000).

*(iii) Nomenklatura Capitalism:* Kotz and Weir (2007) define the practice of party control over appointments to important positions as the “nomenklatura” system. T. H. Rigby (1988: 523-24) says that a clear allocation of jurisdiction among the various authorities involved within the system of personnel management was what was meant by the Soviet term ‘nomenklturnaya sistema’ when it was originally introduced. All official bodies in the Soviet Union involved in
personnel administration operated according to a listing or schedule (Russian ‘nomenklatura’) of the posts they are responsible for staffing. Rigby names three aspects that makes this system in the USSR qualitatively new and unique among modern societies: the concentration of important positions in all official and ‘voluntary’ organizations in the nomenklatura of party committees; the inclusion of elective positions; and the comprehensiveness of the system, which omits no position of any significance in the society, and thereby, incidentally converts the occupants of nomenklatura positions into a distinct social category.

The top party bodies in the nomenklatura system, that is the politburo and central committee, determined who would occupy all top posts in the government, the military, the security agencies, the mass media, trade unions, professional organizations, and so forth. Lower-level party bodies named individuals to lower-level positions in state and non-state organizations. Within the party, the highest-level bodies in Moscow controlled appointments to lower-level party bodies and to top party positions in the republics, provinces, and major cities.

Formerly the privileges of the nomenklatura had largely been in kind, reflected in the granting of state property for private use, or in money and special services. However, during the reforms under Gorbachev they began to acquire an increasingly ‘monetary’ character (Kryshtanovskaya and White, 1998). The members were allowed to do things that were prohibited to others and to extract profit for them; the paramount privilege became, in general, permission to obtain profit. The members of the nomenklatura along with the members of the komsomol especially benefited more due to the reforms spearheaded by Gorbachev. The creation of laws legalized and widened their scope for private entrepreneurship.

Under perestroika the Law on Individual Labor Activity (November, 1986), the Law on Cooperatives in the USSR, (May, 1988), and the USSR Enterprise Law of 1990, gave rise to the elements of market socialism and especially private enterprise. The republics took the initiative to start private enterprise as per these laws. Towards this end, Russian Republic adopted the Law on Enterprises and Entrepreneurial Activity in 25 December 1990. This allowed all kinds of enterprises. Though the shares of joint stock companies were prohibited from public trading, it
gave rise to insider privatization (Åslund, 1995). Moreover, as part of the political reforms, in 1987, Gorbachev abolished the economic and industrial sections in the Party Committees, which weakened CPSU’s control over the economy. The deletion of article VI of USSR Constitution (1977) which declared the supreme position within the Soviet Union weakened the power structures and undermined the prestige of the nomenklatura. Therefore, in order to retain its privileges the members adapted to the changes under perestroika to become the beneficiaries in terms of making profit under the Law of Enterprises and the komsomol under the Law of Cooperatives.

This Enterprise Law of 1990 introduced the concept of workers’ self-management, labor collectives, and enterprise councils of elected members. It gave more powers to the directors and managers, which hitherto rested with the branch ministries, who directly became the head of the enterprises. These state enterprise managers and the directors became powerful and virtually owners of the enterprises even before Yeltsin could fully launch the radical reforms in Russia because of which it came to be called as “nomenklatura capitalism” (Åslund, 1995; Kryshtanovskaya, 1996 and Medushevskii, 1997), i.e, state capitalism. It characterized the perestroika period up to the adoption of the shock therapy program in 1992. That is why only the second and third rank of the nomenklatura made it to the top elite (Kryshtanovskaya, 1995: 26) of the Yeltsin’s government (continued in Chapter 3). Only 5% made it to the business elite from the top nomenklatura, whereas 61% were from the sub-elites of the nomenklatura (see Table 1.2). This proves the hypothetical statement that the Russian capitalist class emerged from the sub-elite of the Soviet nomenklatura (i.e., the komsomol) due to their informal linkages and control over state property. Unlike the general population, they had linkages with the apparatchiki (bureaucracy), and due to their positions in the political and more in the economic spheres, they were the first to join the new class of entrepreneurs. The methods that are dealt below and Table 1.3 give us further proof of their emergence from the ranks of the nomenklatura, especially the sub-elites.
Table 1.2 Recruitment of Yeltsin Cohort from the Top Stratum of the Old Nomenklatura

<table>
<thead>
<tr>
<th>Recruitment of Yeltsin Cohort from the Top Stratum of the Old Nomenklatura (%)</th>
<th>Total from nomenklatura</th>
<th>Including: from top nomenklatura</th>
</tr>
</thead>
<tbody>
<tr>
<td>Top leadership</td>
<td>Party elite</td>
<td>Regional elite</td>
</tr>
<tr>
<td>75.0</td>
<td>57.1</td>
<td>82.3</td>
</tr>
<tr>
<td>24.2</td>
<td>35.0</td>
<td>8.9</td>
</tr>
</tbody>
</table>

Source: Kryshtanovskaya (1995: 26)

During the reforms in the late 1980s, they protected their position mostly through the privileged access to the market. Hence, they played an important role in the economic system during perestroika to retain their power. Many of those who belong to the financial-industrial groups, the current economic elite (i.e., the managers and directors of the large state enterprises) have a nomenklatura origin.

The reforms under perestroika brought changes within the economic and political system that was undermining the role of the CPSU Party that directly affected the nomenklatura. Therefore, they due to their advantageous positions were able to reap in the benefits before the completely wiping out of the institutions of a single party system and the nomenklatura. Men linked to the Soviet power structure used their privileged position to seize state assets at a conjuncture of state weakness. The abuse of constitutional mechanisms and support from the political elite aided this process. Before the privatization of the Russian Federation, they used their privileges to make profit during the perestroika period. Nomenklatura capitalism ended with the privatization of the Russian state. However, those members of nomenklatura who made it to the elite group of Yeltsin’s cohort continued to strip state assets and property for their own benefit.

Kryshtanovskaya (1995) is the first Sociologist to enumerate the methods as to how the nomenklatura, before the privatization of the state, used their privileges to make profit during the perestroika period. This helps us in understanding the riddle that, despite no person owning land or resources, how groups of individuals became rich and were able to invest their capital when
the Russian Federation legalized and formalized privatization under a market economy. The people in the USSR lived in state apartments. The enterprises were owned by the state and the land was collectivized. Therefore, no one owned any property. The methods employed during the perestroika period by the nomenklatura were due to their advantageous positions and institutional privileges that aided them to make profit. She calls this as the ‘exchange of power for property’ (Kryshtanovskaya, 1995: 192 and 1996: 3) by the nomenklatura. They utilized many methods to convert this property.

B. Methods of Profit Making within USSR:
It must be noted that along with the nomenklatura even the members of komsomol also utilized some of these methods. Again, individuals who were from a non-nomenklatura background also became the first beneficiaries due to their closeness to the bureaucracy. Following are some of the methods through which the economic-cum-business elite made their first fast cash and started their fledgling private concerns in the perestroika years:

(i) Conversion of paper credits into cash: TsNTTM had the privilege of converting its “nominal assets” (beznalichnye) or non-cash “dead” (dereviannye) money into “cash” (nalichnye). Once it had received this privilege, the TsNTTM extracted a profit of 18-30 percent (5% went to the CPSU) for its mediation between an organization and private individuals.

(ii) Preferential Credits and Currency Speculation: Again being a member of nomenklatura or having connections with high officials, would ensure one credit at low rate of interest in foreign currency. The state exchange rate remained constant at 65 kopecks against the US dollar while the commercial and tourist exchange rates increased.6 (Kryshtanovskaya, 1995).

(iii) Property Deals: The firms created the first commercial structures and to create office space, the nomenklatura sold the state property at preferential prices to itself.

6 There were three exchange rates during the perestroika period: the state, the commercial, and the special tourist rate of exchanges.
(iv) **Import-export operations:** The nomenklatura created special firms to serve intermediaries between the domestic producers and the western buyers. It was easy for them to pocket the profits. Again the goods were imported at state prices wherein the commercial bodies were created to sell the same at retail prices. The owners of these commercial bodies pocketed the profit due to the difference in prices, known as 'arbitrage'. The opportunities to make a lot of money in private business improved greatly after a decree was passed by the Council of Ministers in December 1988 called “On the Foreign Trade Activity of State. Cooperative and Other enterprises.” The decree on the foreign trade of 1988 opened an important means to get rich. The low controlled prices of the Soviet Union made many Soviet goods, particularly oil and metals, potentially lucrative export items for anyone who could get hold of them. This decree opened up foreign trade to private firms; import-export companies were formed, in the legal form of cooperatives, which soon began to conduct partly legal and partly illegal and very profitable export trade.

(v) **Privatization of the State by State before Privatization for People:** Kryshtanovskaya (1995: 15) explains this phenomenon as a process by which the state officials, taking advantage of their authority, privatized state structures under their control (which began in 1987 end before the official privatization for the people). Privatization of the state occurred in managing the economy, banking system, distribution system and in the most profitable enterprises. The enterprises under the state underwent a change due to the reforms. They acquired the legal status of shareholding company. Those in charge especially the ministers, deputies became the new owners, as they were the shareholders. Similar reforms of 1988-89, dismantled the unitary banking system in whose place commercial banks were formed. However all the paraphernalia, including personnel and the resources, related to banks were retained except that it functioned commercial way. The officials from the Ministry of Finance participated in this process too.

The dismantling of the structures of Gossnab (institution for the distribution of the means of production) was replaced by the first stock market structures like Russian Commodities and Raw Materials Exchange, the Moscow Commodities Exchange, the Moscow Investment Exchange
etc. They were led by the Komsomol members and Gossnab specialists. Here even the officials from the Ministry of Trade and of Foreign Trade too started commercial structures.

An association of joint enterprises was established in 1988. These joint enterprises were collaboration between the Soviet Union and the foreign enterprises. These enterprises were started with the founding capital invested by the CPSU and its members participated though its ‘authorized organizations.’ Even before the official privatization could take place the large profitable enterprises became the shareholding companies viz., BUTEK, MNTK Microsurgery Eyes, KAMAZ, AvtoVAZ etc. What we find here is that the structures of the command economy were gradually being replaced with new ones.7

(vi) Blat or Connections: The business elite were able to sell raw materials like aluminium for dollars, after purchasing it inside the USSR for rubles, then using the dollars to import computers and fax machines by having the “right connections” with the bureaucrats and the party officials or blat. These connections served as the only way to get financing as the private banks were not yet established and there was a complete absence of the private investors. (Gill, 1998; Kryshtanovskaya and White, 1998; Medvedev, 2000; Kotz and Weir, 2007.)

Arbitrage and financial speculation were the initial methods that gave rise to the much needed capital. The preferential credits and the advantage of TsNTTM to convert paper credits onto cash enabled the private commercial banks to be set up under the Cooperatives Act of 1988. These methods under the perestroika helped the would-be capitalists to procure the required seed capital, along with the capital made through underground dealings during the years of ‘shadow economy’. The accumulation of capital happened both internally and with the help of foreign capital. Internally the state funds, state institutions, state enterprises, CPSU Party funds, Party resources in the form of buildings and offices were utilized to this endeavor. Externally the foreign capital was utilized as part of the investment as Gossnab (agency to allocate resources) and Gosplan (agency for planning) were abolished by 1990. Therefore, the enterprises and firms had to rely on more capital, which they found through the external financing. The institutional

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7 The account of most of these methods was first give by Kryshtanovskaya (1995), but they were elaborated again in a joint work of Kryshtanovskaya and White (1998).
privileges created to operationalize laws like Laws on Cooperatives (1988), on Joint-Enterprises (1989) etc, and the functions assigned towards this end, expedited the nomenklatura and the komsomol their move towards a full-fledged market economy. The resistance towards reforms by the nomenklatura and the komsomol was negligible as most of them defected towards the side of market economy when their positions were compromised with the systemic change pos1-1991.

Table 1.3 enables us to understand overall all the groups like members of the komsomol, physicists, directors, bankers, the members of the nomenklatura as to their time of entry, and what kind of entrepreneurial activity they were involved.
<table>
<thead>
<tr>
<th>Group/organization/individuals</th>
<th>Social Baggage/earlier work experience</th>
<th>Time of entry into business</th>
<th>Entrepreneurial activity created under law</th>
<th>Initial activity</th>
<th>Present activity/spheres of entrepreneurial interests</th>
</tr>
</thead>
<tbody>
<tr>
<td>Komsomolers</td>
<td>In production, in scientific research institutes, in Komsomol structures.</td>
<td>1987-89</td>
<td>Centres for Scientific and Technical Creativity of Youth (TsNTTM), Youth Housing Cooperatives (MZK) and Youth Centres operating on the basis of cost accounting.</td>
<td>Cashing in of state resources, leisure-time activities &amp; video market (mostly pirated).</td>
<td>Holding companies, show businesses.</td>
</tr>
<tr>
<td>Physicists</td>
<td>In management, in scientific research institutes,</td>
<td>Late 1980s</td>
<td>TsNTTM &amp; MZK</td>
<td>Innovative industrial activity, construction, setting up new technologies &amp; programming development.</td>
<td>Stock market, holding companies, financing and investment companies &amp; new banking structures.</td>
</tr>
<tr>
<td>Managers</td>
<td>Production experience, middle level of enterprise management, middle level of ministries, managing a scientific research institute, Professional orientation towards construction or the extractive industries (oil and gas).</td>
<td>1988-92</td>
<td>Reorganization of state structures and a ‘free choice’.</td>
<td>With new economic forms-leased enterprises, joint ventures and commodity exchanges formed by group of producers.</td>
<td>Large financial and industrial groups, holding companies, commercial and industrial houses converted from stock exchanges, and dynamic commercial banks.</td>
</tr>
<tr>
<td>Bankers</td>
<td>In banking.</td>
<td>1988-91</td>
<td>Reorganization of state banks into commercial banks.</td>
<td>Heading commercial banks and also ‘sectoral’ banks formed on the basis of capital from a specific sector of the national economy.</td>
<td>Heading new commercial banks.</td>
</tr>
</tbody>
</table>
Unlike the komsomolers, the physicists had no experience working in the political structures though some had been members of the CPSU. The managers were part of the nomenklatura and most of them actively participated in the party work. Bankers like the mangers were members of the CPSU too. Another category to enter the entrepreneurial field was the elite families—diplomats, heads of trade delegations, important ministry officials, academicians etc. Due to their experience of working in komsomol structures, and in foreign trade organizations, by 1988-1992 they moved to entrepreneurial activities like joint ventures, bank, foreign trade association etc.

1.6 Conclusion:

Though the referendum on preserving the Union won 76.4% of the vote by the people, The Soviet Union could only last for nine months. Gorbachev (2000) in his memoir says he never resorted to use force to preserve the Union and he stood by his adherence to democratic methods. Many factors played into hastening the demise of the Union. The Stalin regime, suppression of people’s freedom, lack of true democratic socialism, Western pressure, opposition to the reforms under perestroika by the some if not all of the top echelons of the system, the opportunities unleashed by the perestroika and glasnost etc. The elite abandoned the Communist ideology when their power and privileges were threatened. Under the changes that perestroika brought into the economic system, one could not only manage but also own the means of production. Therefore, the members of the Soviet elite i.e., the nomenklatura, other than the ardent supporters of the Soviet ideology, shifted their allegiance from Gorbachev to Yeltsin.

The seeds that gave rise to capitalist tendencies, which were more in the speculative guise in Russia, are traced to the ‘economy of shortages’ during the Soviet times. This acuteness gave
way to 'shadow economy', which encouraged underground traders who sought profits from shortages of basic goods. Their role was enhanced by the hasty privatization during the Yeltsin’s period. However, it was the reform years, under Gorbachev, that for the first time opened up the avenues for private entrepreneurship through various decrees and laws. There was lack of new legislations to regulate the benefits accrued from the new reforms. The state exchange rate remained the same while dealing with foreign currency exchanges, the state purchase prices for imported goods remained constant, confusion over what activity is prohibited or allowed under the Cooperatives Act etc were the problems which were not supported through adequate legislations. Most importantly, the privileges and positions within the power structures enabled the nomenklatura and the komsomolers, unlike the public, to become the first ones to embrace entrepreneurial activity. The political and economic reforms by Gorbachev set up mechanisms for liberal democracy and market economy. What should have brought in ‘restructuring’ for ‘change’ brought instead a systemic change within the Soviet social system.

With the collapse of the USSR, Boris Yeltsin emerged as the leader of the new independent Russia. The economic elite and the business elite who managed to create wealth for themselves found great opportunities to carry on their private activities full-fledged and on a large scale. Not all of them could make it to the top of becoming the captains of the industry. However, with time only few would consolidate their wealth and move towards becoming the business elite i.e., the capitalists of Russia.