Chapter Three: Rise of the Oligarchs under Yeltsin

3.0 Introduction:
Any government that comes to power or any representative government that is formed no matter which party it is elected from, the business elite are bound to form close connections. This however does not mean they will necessarily pull the strings of power that would culminate in a financial crunch or crisis for the country. The business and financial elite usually form interest groups and lobbies in order to press forward their interests especially in a democratic country. These interest groups are formed usually outside the government structures. Why Russian capitalists took the initiative to resolve the crisis of 1995-1996? How did the Russian tycoons come in direct contact with the corridors of power? Was the relation between the state and the oligarchs reciprocal or was it one-sided? How did the Russian capitalists hold their dialectics with the state? Did the Russian capitalists possess lobbies and did they form pressure groups and interest groups to register their interests or their disapproval towards public policies affecting their interests? If not, then was the relation between the state and the Russian capitalists carried on a one-to-one basis for promoting the latter’s interests?

Hence an examination of the methods employed by the capitalists to gain wealth and political clout during Yeltsin’s presidency seems necessary. It will examine the radical economic reforms and the political institutions that the business elite capitalized to catapult them to becoming the top echelons of the society. Therefore, the hypothesis that is being examined is that the Russian capitalists utilized their financial resources to become a part of the ruling elite during the second term of President Yeltsin.

3.1 Yeltsin’s Alternative to Gorbachevian Reforms:
The reasons for opting for an alternative and the subsequent radical economic reforms hold the key to the rise of the business elite, particularly the oligarchs. It must not be mistaken that the reforms undertaken were solely for their emergence. The drive for privatization was partly a reason to create class of entrepreneurs and partly for making a successful transition to a market
economy. When Gorbachev introduced the elements of market forces they were very much within the command framework retaining economic planning with decentralization. He promoted a "mixed economy" by legally enforcing the creation of small-scale individual and cooperative enterprises since 1986, to exist along with state enterprises. Eventually joint-stock enterprises were started. The debate involved conflicting groups within the CPSU—reformists supporting Gorbachev, the Conservatives and pro-market reformist supporting Yeltsin. However, in the 1990, the debate favored privatization over statization (Kotz and Weir, 2007) or nationalization.

Prior to the dissolution of the Soviet Union, Boris Yeltsin had been elected President of Russia in June 1991 in the first direct presidential election in Russian history. The end of the Cold War 1989 and the reforms of Gorbachev led to these dissenting groups and divisions within CPSU. This led to a crisis of power, and the failure of reforms ultimately led to disintegration of USSR. Due to the failure economic reforms, Gorbachev lost his political legitimacy. Yeltsin gained legitimacy within Russia for making a systemic change to market economy and liberalization because it was not simply a change but a complete alternative unlike the change envisaged by Gorbachev.

However, in October 1991, as Russia was on the verge of independence, Yeltsin announced that Russia would proceed with radical market-oriented reform known as "shock therapy". Liberalization, stabilization and privatization became the motto behind these radical reforms. Boris Yeltsin (1991) as the President of Russia, in his speech proclaimed to the Congress of Russia SFSR People's Deputies on the future of Russia that, 'Under conditions of political freedom, we must provide economic freedom, lift all barriers to the freedom of enterprises and entrepreneurship, and give people the opportunity to work and to receive as much as they can earn, casting off bureaucratic constraints'.

Yeltsin (1991), through this speech, was giving a blue print for carrying radical reforms in all spheres, which did not connote socialism. A gist of this speech would be as follows. Russia would proceed as per the norms of the international law. World prices would determine its economic relation with other countries. In area of economy economic stabilization would take precedence through tough monetary, financial and credit policy, tax reform and strengthening of
the ruble. Prices would be freed to accommodate privatization based on mixed economy with a powerful private sector. Towards this effect, Russia would seek the help of the international monetary organizations for drawing the economic reforms.

Privatization of small and medium sized enterprises in the spheres of services and trade, in industry and transport would be followed by the privatization of the large-scale enterprises. The latter would be gradually privatized, in the meanwhile be transformed into joint-stock companies with shares being distributed between the state and the labor collective. It would be followed by the sale of the state’s portion of the shares to all those who wish to buy at market prices. Bank reforms would aim to create a real reserve banking system with hard currency. Re-organization of the taxation system, land, and agrarian reforms would be carried on simultaneously. Social protection of the population would accompany the freeing of the prices by reforming the pension system; provide social assistance to the vulnerable strata of the society, increase of pays, raise in minimum wages, increase in pensions and stipends.

Yeltsin’s alternative as market economy for Russia Republic was greatly supported by a ‘pro-capitalist coalition’ (Kotz and Weir, 2007: 121-25) comprising of intellectuals, economists, private business people from non-elite backgrounds (including shadow economy operators though they did not openly endorse), and the party-state elite. Groups like Interregional Group of Deputies and Democratic Russia rallied their support to Yeltsin. The Russian public had different views as to what kind of economy and society it foresaw. In one of the public opinion survey, in European part of the Russia conducted in May 1991, interviewees were questioned on their political and social views and type of social system they wanted in particular. 36% opted for a more democratic type of socialism; 23% for a modified form of capitalism as found in Sweden; 17% for a free market form of capitalism as found in US or Germany; 14% had no opinion; and 10% for a socialist society along the lines we have had in the past (Kotz and Weir, 2007: 133)\(^{23}\). This shows that the public was divided on this issue and lacked clarity. The Russian state became the successor of the former USSR in both national and in international matters with its breakaway from USSR.

The mechanism for Russia's independence and transition to a new system was initiated 'from above' (Hahn, 2002; Kotz and Weir, 2007), i.e., carried by the ruling elite group, not by the people. Nevertheless, the important question is why did Russia change to a new system? One of the reasons is that the Western model of market economy was a blueprint to follow—one of the most modernizing ones. The other Welfarist state-model with socialist leanings like Finland, Sweden had to be abandoned because USSR had tried to reform socialism and the final straw was the Gorbachevian reforms. Secondly, change towards this model is due to the international order. USSR could not live in isolation and had to establish contacts with other economies. Most of the countries had to open their economies as per WTO prescriptions due to their financial situations.

Robert Kuttner (2000: pp. 149-150) explains the hegemonic worldview in complement to global corporations of the twenty-first century. He says that it is believed for the efficient allocation of goods and services all barriers are to be dismantled for the free commerce and free flows of financial capital. To the extent that there is a remnant regulatory role, that it is to protect property, both tangible and intellectual; to assure open, non-discriminatory access; to allow any investor to purchase or sell any asset or repatriate any profit anywhere in the world; to remove and prevent subsidies and other distortions of the \textit{laissez-faire} pricing system; to dismantle what remains of the government industry alliances.

Most of the International Monetary Fund-World Bank (IMF-WB) prescriptions like structural adjustments and the reform packages aim exactly to create the above scenario as explained by Robert Kuttner. Most of the third world countries like India and the former socialist countries like Russia were required by these international monetary institutions to carry radical reforms in order to apply and procure financial aid and loans to finance the budgets and boost the economies. This was to expedite transition to market economy and hence integrate into the world economic system. President Yeltsin, unlike Gorbachev, made a public commitment to bring in radical changes to the economy and therefore accepted the terms and conditions of the IMF-WB. Russia's move into the market economy also meant that it was to compete with the rest of the market economies, both the older (i.e., of the core countries following capitalist form of economic organization) and the new states that had embraced it. This also meant that it had to
‘keep pace with knowledge/ideas, modern security systems, new production techniques and shifting finance structures’ (Marshall, 2006: 95).

In order to carry on the radical economic reforms, on 2 November 1991 the Congress of Russian SFSR People’s Deputies voted in favor of special powers to broaden the executive powers for a year up to December 1, 1992. According to this, the President had the right to reorganize the structures of the supreme bodies of executive power, to ban referendums and all elections and the right to suspend the Union and republic acts that hinder the implementation of the reform. The proposals helped Yeltsin to get the support of the masses as well as that of the political elite unlike Gorbachev.

Yeltsin also saw to it that the appointments made to various posts were not only persons supporting his radical policies but also for preserving his own personal power (Medvedev, 2000). He appointed, in November 1991, Gennady Eduardovich Burbulis as the first deputy premier of new Russia and Yegor Gaidar to form and implement the “reform” program. The ‘shock-therapy’ program was headed by a team of young group consisting of Aleksandr Shokin, Andrei Nechaev, Maxim Boyko and Aleksei Ulyukaev. They were aided by the Western advisers Andrei Schleifer, Jonathan Hay, Anders Aslund, Jeffrey Sachs and Laurence Summers. The standard recommendations of IMF, WB and IBRD (International Bank for Reconstruction and Development) became the basis for the implementation of the reform package.

On two counts, Yeltsin scored over Gorbachev in terms of his success. One was that he neutralized the opposition to these reforms from the Supreme Soviet. Second, he gave an alternative which was in no way a palliative.

**A. Tug of War between Yeltsin and the Parliament:**

The independent Russia was plunged into deep reforms, which were radical in nature. The people of Russia could not familiarize with the institutions of liberal democracy and more importantly market economy. For much part of the command-economy was devoid of ownership of private property or access to capital. Russia did not have administrators and policy-makers who had any inkling of the market economy.
On January 2, 1992, a decree on "liberalization of prices" went into effect. The Russian economy was thrown into the anarchy of the market system with its hands tied. There was no debate on 'shock therapy, as its adoption be it political, public or academic because the reforms were initiated from 'above' and not initiated, and motivated from 'below' (Chenoy, 1998). A special decree announced unrestricted freedom of trade, which meant that it was no longer against the law to engage in speculation. Restrictions on foreign trade were also lifted. Within four months of liberalizing the prices, Russia faced its first financial crisis. Many of the Russians lost their savings in February 1992 because of the twenty six-fold inflation, which hit Russia in the initial months of 'shock-therapy' by the deliberate devaluing of the internal debt. Most of these Russians were above fifty who had saved as security against old age, illness, for their children, for purchasing maybe house or car. Weakened control over foreign trade and unjustifiably low exchange rate of the ruble accompanied by an outflow of raw materials and energy resources became detrimental to the economy (Medvedev, 2000).

On January 2, 1992, Yeltsin—acting as his own prime minister—enacted the most wrenching components of economic reform by decree, thereby circumventing the Supreme Soviet and Congress of People's Deputies, which had been elected in June 1991 before the dissolution of the USSR. This was done in order to do away with all the remnants of the Soviet system from the picture of New Russia. Hence, privatization came first and the late entry of actual building of legal institutions to regulate the same led to the enhancement of the rise of a group of speculators who were later called as the 'oligarchs'. The radical reforms brought about by 'shock-therapy' and the accompanying privatization program created the new and the rich who had the valuable assets to take from; this theft on a massive scale is termed as 'piratization' by Marshall I. Goldman (2003).

The financial crisis undermined the blind faith of the Russians on the market. Therefore, Yeltsin removed Burbulis as the first deputy premier in May 1992. However, Yeltsin could not hold on to his legitimacy for long after the independence of Russia in 1991. Scholars like Graeme Gill
and Roger Marvick, in "Russia's Stillborn Democracy? From Gorbachev to Yeltsin" (2000) 24, argue that an initial but fragile elite unity, which was probably based more in a negative consensus about the Soviet past than on a common view of the post-Soviet future, was shattered by the Yeltsin government's 'shock-therapy' economic policies during 1992 and early 1993. This program was executed through the presidential decrees as the Duma was opposed it. Therefore, first, he had to fight against the Duma for enhancing his role of presidency to carry on with the radical economic reforms. First, he allowed the regional governors to have as much power as they want so as not to have any opposition from that camp and by altering the Constitution by presenting his own version of the same.

The members of the Duma were elected in 1990 during the Gorbachev reforms. A newly independent Russia witnessed the struggle for power between the parliament and the president for power. The cause of disagreement was the radical reforms implemented by the Yeltsin-Gaidar team. Their policies could not get the legal backing from the parliament, for which they heavily relied on the presidential decrees. The economic reforms were executed through the presidential decrees as the Duma was opposed it. The crisis of power was between the President and the Duma. When the resistance of the parliament reached a crescendo in September, it was simply besieged and sacked by the military acting on the orders of president Yeltsin in October 1993. Moreover, the Constitution drafted by the President Yeltsin's team was passed in December 1993. Moreover the referendum of 25 April 1993, gave Yeltsin a political mandate for the carrying on with the economic reforms.

Thus, he saw to it that the Constitution was altered not only to give more powers to the presidency but also to legitimize him. The Constitution tipped the balance of power by laying it with the President. Secondly, he legitimized himself completely by his second presidential election which was laced with controversies. The conflict between and as to the supremacy of the parliament (form of government) and that of president (hegemony) was resolved through the 1993 events (Higley et al. 2003).

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B. On the Quick Road to Market Economy:
The former Soviet Union republics and other socialist countries like Poland, Hungary, etc moved their economies towards the Western model of market-oriented economy. Their economic transformation policies were outlined and prescribed by the multilateral institutions based in Washington. The IMF and World Bank were behind the Structural Adjustment Programs (SAPs) of the late 1980s-what came to be called the ‘Washington Consensus’ in the early 1990s. The third group was the US government, especially the Treasury Department (Stiglitz: 2002) who was the main string-puller.

In the West, two schools of thought (Stiglitz, 2000) emerged regarding how Russia should make a transition to a market economy. The gradualist, like Kenneth Arrow, J. Stiglitz, and others who had expertise on the region, gave importance to establish institutional infrastructure for a market economy like legal structures, regulatory structures, to foster competition rather than just privatizing state-owned industries. Thus, they aimed at gradual transition to a market economy.

The other school that won over the IMF and US to their side consisted largely of macroeconomists who knowledge on the history or details of the Russian economy was sparse. They strongly insisted on shock therapy for transition to a market economy, which was endorsed by the IMF and the US Treasury Department. Their views were accepted without any open debate and these officials who ‘applied Washington Consensus policies failed to appreciate the social context of the transition economies’ (Stiglitz, 2002: 160). Their prescriptions for economic transformation comprised of four main policies: 1.) Market liberalization, 2.) Stabilization, 3.) Privatization of state-owned firms, and 4.) Globalization. By globalization, it meant the full integration of transition economies into the global economy. Priority was given for macroeconomic stabilization (Goldman, 2004 and Stiglitz: 2002) of Russia.

At the beginning of the post-communist reforms, these countries thus lacked the investment banks and other financial institutions and regulations needed by the market. The reforms thus meant the need to establish a proper system of banks and other necessary institutions, and the legal and regulatory frameworks required for functioning markets. In addition, firms were to be financially transparent and operate within approved rules of corporate governance.
The most important components of radical reform strategy in Russia were the ‘Shock Therapy’ involving three major characteristics: liberalization, stabilization, and privatization of state property. The objective of adopting the policy of ‘Shock Therapy’ was two-fold: first, to make a dramatic shift in the economy in one go i.e. in the shortest possible time and secondly, to make the economic transition to market economy irreversible.

As part of liberalization process, prices were freed overnight. The result of the liberalizing of prices was hyperinflation. This was because shortages of goods and excess demand unleashed high inflation (Äslund, 2007: 104). In January 1992, prices rose by 250% which went up to 2,500% at the end of the year and 900% in 1993. Important prices, those for natural resources etc was kept low. Instead of bringing in currency reforms, Gaidar retained controls on a few priority prices such as petroleum. Goldman (2003: 71) asserts that, it would have allowed avoiding those energy price controls since there would have been less temptation to divert so much petroleum to foreign markets where the price was sometimes as much as 10 times higher than prices at home. In turn, Gaidar would have avoided much of the corruption that ensued when those with petroleum fought to win export permits. This was a strong cause for arbitrage and transfer pricing (dealt later) methods used by the state enterprise managers and the private entrepreneurs to siphon money. This shows how the state aided them to become the business elite of the Russian society.

Hyperinflation was only worsened when the Central Bank, an organ under parliament, which was skeptical of Yeltsin’s reforms, was short of revenue and printed money to finance its debt. The banks under the Soviet period carried out payments and distributed credits or subsidies to the state enterprises. Reforms under the Russian federation did not involve sound banking policy which suited the needs of a new economic system. The Russian banks, both private and state, were subject to rudimentary regulation (Äslund, 2007: 121). The then Chairman of the Central Bank of Russia (CBR), Victor Gerashchenko, issued more money in the absence of bank reforms and non-accountability to the parliament. On the negative side this led to high inflation and collapse of the national currency. The same could not be said for the capitalists who were

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25 Inflation at double-digit rates per month.

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enriched due to his generous credits (Åslund, 2007: 120). In 1992, Russia hit by 26-fold inflation wiped people's savings, mostly the middle classes. The radical reforms changed the structure of the Russian society where the middle class was reduced to either being below poverty line or near its borders. This became the cause for the polarization within the societal structure. The second round of shock therapy was to bring down inflation, which resulted in tightening monetary policy i.e., raising interest rates (Stiglitz, 2002).

With inflation at double-digit rates per month as a result of instantaneous price liberalization, macroeconomic stabilization was enacted to curb this trend. Stabilization, also called structural adjustment, involves austere measures (tight monetary policy and fiscal policy) for the economy in which the government seeks to control inflation. In order to bring in price stability or financial stabilization, national currencies had to be established; fiscal policy had to be tightened; a new tax policy needed to be in place; strict monetary policy had to be pursued; and exchange rate had to be unified and devalued to be competitive (Åslund, 2007: 104).

Under the stabilization program, the government let most prices float, raised interest rates to record highs, raised heavy new taxes, sharply cut back on government subsidies on industry and construction, and made massive cuts in state welfare spending. These policies caused widespread hardship as many state enterprises found themselves without orders or financing. When 'tight money policy' was adopted, as a part of the stabilization program, it affected industrial enterprises most of which were state owned. Without necessary cash or credit, most of them were unable to run the enterprises. Moreover, the large-scale industries were not privatized; they were mere joint stock companies with the Red Directors\(^\text{26}\) having control of some shares and of the management.

Russia was able to rein in inflation below 40%, from 1994 to 1996 through serious stabilization efforts. However, these efforts did not vouch against inflation and financial crisis that was to hit it with force in 1998. It was burdened by huge budget deficits, debts, lack of proper tax policy to bring in incomes especially from the private entrepreneurs, unsound credit policies, etc. High

\(^{26}\) They were called so as they were the heads of large state enterprises in the Soviet era and who continued to do so after the collapse of USSR. They emerged as the new propertied class.
inflation that hit Russia in 1992, 1994 and 1998 led to demonetization. This also eroded people’s confidence in the ruble and was one of the key reasons for conversion to dollars.

C. Privatization:
Privatization\(^{27}\) was adopted parallel to the radical reforms, styled more on Czechoslovakia. This further caused anarchy in the market reforms and confusion amongst the ignorant masses. The various laws that created the cooperatives and joint stock companies under the economic reforms of \textit{perestroika} led to the mushrooming of enterprise associations, concerns, and corporations between 1989 and 1991. By the end of 1991, there were 3, 076 associations, 227 concerns, and 123 consortia (Åslund, 1995: 226). This was termed as \textit{nomenklatura} privatization (Åslund, 1995; Kryshtanovskaya, 1996 and Medushevskii, 1997).

Under the Russian Soviet Federated Socialist Republic (RSFSR) small enterprises were transferred to municipalities in 1991 either to be sold through competitive bidding or lease buy-out. This \textit{small privatization} was in the area of wholesale and retail trade, public catering, consumer services, construction firms, construction materials, state agricultural enterprises other than \textit{sovkhozy}, firms in the agro-industrial sector, food and light industrial enterprises, enterprises operating at a loss, factories that were still standing, and unfinished construction projects (Åslund, 1995: 242).

Russia even before its break-up from the USSR moved to adopting the provisional program, “Basic Provisions of the Privatization Program” in December 1991. A presidential decree of 29 January 1992, “On Acceleration of the Privatization of State and Municipal Enterprises” introduced the necessary regulations to keep the privatization process moving and aiming at full-fledged privatization program. It was finally adopted on 11 June 1992. Anatoly B. Chubais was appointed minister of privatization and chairman of the State Committee for Management of State Property (\textit{Goskominushchestvo} or GKI). He was in June 1992, promoted to deputy PM, while retaining the earlier portfolio.

\textbf{(i) Corporatization:} The first step under the privatization program was corporatization, i.e., the mass creation of joint stock companies as per the presidential decree of July 1992. There were

\(^{27}\) Housing privatization and land reforms are not dealt here.
about 25,000 large and medium size industrial enterprises. Large enterprises were those with 1,000 employees and fixed assets of more than 50 million rubles and those with 200 to 1000 employees and fixed assets of more than 1 billion but less than 50 billion rubles were considered medium size. Large enterprises were to be converted into open joint-stock companies. Medium-size enterprises were free to choose either the direct sale or the corporatization method (Naray, 2001). Though they were to be converted by 1 November 1992, however by April 1994, about 80% of the 20,000 large and medium size industrial enterprises had been converted into joint stock companies. (Åslund, 1995: 253).

For corporatization to be carried out, a general meeting of a workers’ collective was held to select one of the three privatization options. Privatization plans were to be submitted by the enterprises themselves in which one of the three privatization options, approved by two thirds of the work collective, had to be indicated. Enterprise assets were sold in three stages: first, a closed subscription for employees to buy shares under the conditions of the option chosen and second, the sale of a certain amounts of shares in public voucher actions, and third, the sale of remaining shares against cash at public auctions (Naray, 2001)

(ii) Closed Subscription for Insiders: After corporatization, privatization commissions were formed for each enterprise to be privatized. They organized closed subscriptions among employees to allocate shares in accordance with the chosen privatization option. Under Option One the workers obtained 25% of the company capital for free as preferential shares of the enterprises. In addition, employees could buy 10% more of an enterprise’s statutory capital as voting shares at 70% of the (very low) book price. The management could then buy 5% of the shares at the book price. During this initial phase of privatization, the directors and the branch managers fought for more shares over the shares of the work collectives for holding on to power and control. Others to join in this scramble were the regional authorities, new entrepreneurs, the general public, and the state itself (Åslund, 1995: 233). The public did not gain much from the privatization process though. This option did not give the work collectives the required control of the enterprise because of the preferential shares.

A second option was adopted to give more control of the enterprise to the work collectives by managers and workers. Under this, all employees of a privatized enterprise would be granted the
right to buy voting shares representing 51% of the authorized capital at 1.7 times the book price, leaving insiders with a majority of the votes. This also gave the managers quite leverage over the enterprise ownership and control which was earlier exercised by the directors. The third option was limited to the privatization of the medium-size companies. It entitled a group of managers to buy 20% of the voting shares of an enterprise at book value if two-thirds of the employees agreed. Later on, the management could purchase an additional 20% of the shares at a discount of 30% of their nominal value. Option 1 was chosen by 25% of the enterprises with 25% of the shares being given free to employees, while 73% chose Option 2 with 51% of their shares bought cheaply by insiders and, only 2% were in favor of Option 3 with management buyout (Åslund, 1995; Earle and Estrin, 2001; and Naray, 2001).

(iii) Voucher Auctions: In April 1992, voucher privatization was announced by President Yeltsin through a decree. Each Russian citizen (only adults were eligible) was entitled to receive a voucher with a nominal value of 10,000 rubles for free. These were to be collected by the end of 1992, but were extended up to 31 January 1993. These vouchers were fully transferable and tradable, but could not be used for payment. The people could participate in voucher auctions or (according to option 2) by using vouchers for buying out a share of the enterprise, where they worked, through closed subscription. They could also invest them in investment or voucher funds or simply sell them. Voucher funds were not allowed to possess more than 10% of the share in any enterprise. 146.4 million Russian or almost 97% eligible Russians collected their vouchers.

When initial privatization did not aim at the general populace, the privatization program through voucher auction was held, known as ‘mass privatization’. Anyone could participate in a voucher auction-employees, locals, voucher funds, outsiders, and even foreigners-but only vouchers were allowed as payment. Although 35% of the shares were supposed to be sold for vouchers, an average of about 20% was put up for auction (Åslund, 1995). A presidential decree on the rights of Russian citizens to participate in privatization was issued in May 1993. It established that not less than 29% of all shares should be sold at voucher auctions within three months after an enterprise had been corporatized. However, the share stayed at around 20%, because enterprises continued to resist voucher privatization, preferring to keep the stocks for their employees.
(notably, oil companies released less than 10% of their shares for voucher auctions) (Åslund, 1995).

When the value of the ruble had fallen from hundreds to thousands in 1992-93, the value of the vouchers also decreased. It is not surprising that vouchers were bought up by investment funds which were set up with official support, and which belonged to future oligarchs. The vouchers were in turn exchanged for shares in privatized enterprises (Hoffman, 2000 and Kagarlitsky, 2002). This form of privatization was completed by 30 June 1994. From 18 enterprises sold through voucher auctions held in December 1992, the numbers peaked to about 14,000 by 30 June 1994 (Åslund, 1995: 255-6). By 30 June 1994, 144 million out of 148 million Russians (97%) had invested their vouchers. This involved the people in the privatization program in a meaningful, although not in an economically beneficial way.

During this period of privatization, though foreign investors were allowed to participate, they owned less that 2% of the stock (Naray, 2001). The insiders’ i.e, the workers and the management and the Russian investors were wary of foreign ownership. The Russian government undertook, at a later stage in 1995, the third method known as ‘cash privatization’ or what popularly came to be called as the ‘loans for shares’. The stated objective in this type of privatization was to mobilize resources for the Federal budget by selling some portion of state assets. The third phase of privatization is more important to the research as it deals with the large enterprises. This is also because of the manner in which the privatization was conducted and the group of persons who were able to make the best use of this process.

3.2 Privileged Privatization—‘Loans for Shares’:

The oil industry was considered to be of strategic importance by the Russian government. During the disintegration of the Soviet Union, the oil industry was under the Ministry of Fuel and Energy. All its enterprises were completely owned by the state. The Law on State Enterprises of 1988 and 1990 transferred the power from the ministries to the directors and managers over the enterprises. As per the Presidential Decree No. 1403 of 17 November 1992, prior to the

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28 This was regarded as the official founding document for the reform of the oil industry. Its main features were: (1) reorganization of all enterprises involved in oil production, refining, and marketing into joint stock companies; (2) establishment of the first three VIOCs—LUKoil, Surgut Holding, and Yukos; (3) establishment of the state enterprise Rosneft to manage in trust for a period of three years the majority of shares of oil enterprises which were
privatization process, the oil industry's 40 extracting companies and 28 refineries were divided between a dozen legally independent holding companies (Rutland, 1997). As per the decree they were organized as vertically integrated oil companies (VIOCs) comprising of holding and subsidiary (operating) companies. From this issued the independent holding companies (the leading role was played by Vagit Alekperov) like LUKoil, Surgut Holding and Yukos. Sidanco, Slavneft, VNK (Eastern Oil Company), and ONACO were to follow this pattern in 1994 and Sibneft, Rosneft and TNK in 1995. This was done with the aim of avoiding a 'unified national oil company' (Moser and Oppenheimer, 2001: 304).

However, by 1995 most of the oil-producing associations and refineries were converted into 10 joint-stock companies-combining state and private ownership; four autonomous republic companies; and one state-owned holding company (Moser and Oppenheimer, 2001). Hence, it retained 38% of ordinary shares, giving its 51% of voting shares of the subsidiaries of the oil industry, during the initial privatization in 1992-3 (Earle and Estrin, 2001). These were either bought by the management or by the banks through loans-shares scheme. The Russian government undertook, in 1995, the third method known as 'cash privatization'. 29 firms were chosen for this scheme. It was here that the government sold off its entire shareholdings, especially in Yukos, Sidanco, Sibneft, and Surgut.

In 1995, Vladimir Potanin masterminded this scheme to self-serve their interest at the expense of the state: the financially strapped Russian government would mortgage the state's most valuable industrial assets to a few politically connected insiders for far less than fair value. Under the 1995-96 'loans for shares' program, banks competed to offer loans to the government in exchange for blocks of shares of large state-owned companies. The stated objective in this type of privatization was to mobilize resources for the Federal budget by selling some portion of state assets. In the "loans for Shares" auctions, the leading Russian banks lent the government less than 1 billion US dollars in return for big equity stakes in the best industrial companies. The shares served as collateral on the condition that if the government failed to pay back the loans,
the banks could keep the shares. Under the terms of the deals, if the federal government did not repay the loans by September 1996, the lender acquired title to the stock and could then resell it or take an equity position in the enterprise. In exchange for the loans, Yeltsin handed the shares of these enterprises whose market value was worth many times as much.

It found adherents in the Chernomyrdin, the then Prime Minister, deputy Prime Minister Oleg Soskovets, and Anatoly Chubais who was in charge of the privatization in Russia. This scheme was turned into law on 31 August 1995. The method was that when the government defaulted on repayment of loans to the banks, the shares of the state enterprises would be auctioned. Here mostly the banks participated in the bids. Due to irregularities and corruption, the program was very controversial. The participating banks ensured that outsiders and the foreigners were dissuaded from competition. The irony was that the bank that organized the auction also won the bid (Peter Naray, 2001) for low prices.

Beneficiaries like Alexander Smolensky, Mikhail Khodorkovsky, Boris Berezovsky, Vladimir Gusinsky, Vladimir Potanin, Mikhail Fridman, Vladimir Vinogradov, Roman Abramovich, Vladimir Bogdanov, Rem Vyakhirev, Vagit Alekperov, Viktor Chernomyrdin, Victor Vekselberg, etc emerged as Russia's most powerful and prominent oligarchs. In this way the small group of oligarchs came own large amount of the state property during the 1995 privatization. Under the scheme, the Yeltsin regime auctioned off substantial packages of stock shares in some of its most desirable enterprises, such as energy, telecommunications, and metallurgical firms, as collateral for bank loans. ONEK SIM bank, acquired packets of shares in Sidanko Oil (51 percent), Norilsk Nickel (38 percent) and Novolipetsk Metallurgical Combine (15 percent); Menatep, which won control of 45 percent of the Yukos oil; and LogoVAZ, which acquired 51 percent of Sibneft oil. After the auctions, ONEK SIM Bank, Menatep, and LogoVAZ markedly increased their shareholdings in these companies through additional purchases via their subsidiaries or holding companies (Johnson, 1997: 352).

Where could the industrialist and the entrepreneurs obtain the initial capital to buy the state enterprises? First, they made their capital due to the difference between state prices and the prices on commodities and raw-material exchanges. The second option was the difference
between world and domestic prices. Third was from the imports. The exchange rate quoted for
the dollar went from 18 to 50 rubles, and the State Bank’s “affection” and personal liking played
a role in specific cases. Andrei Neshchadin (1994: 5), member of the Russian Union of
Industrialists and Entrepreneurs’ Expert Appraisal Institute, asserts that “this system had its great
flourishing between mid-1991 and mid-1992. For a specific fee, bureaucrats gave specific
favorable attention to authorizing participation in foreign-economic activity and issuing licenses
and quotas at all levels.” Yeltsin (2000: 93) defends the Russian capitalists (especially the
oligarchs) in his autobiography, that the capital to buy state enterprises came in the ‘form of
loans that Russian entrepreneurs could obtain on the Western financial market. That is, once
again it was western money’.

The examination of the ‘loans for shares’ becomes more important than the other two
privatizations. The auctions themselves were riddled with allegations of fraud. This scheme was
more controversial because the state allowed banks both to organize and to bid in the share
auctions (see Table 3.1). For example, the Surgut Holding and LUKoil managements themselves
won the auction. Whereas Menatep used proxy companies like Laguna and Monblan (Table 3.1)
as bidding vehicles (Moser and Oppenheimer, 2001: 309). Berezovsky who denied his
connection with the oil industry used proxies like NFK, FNK, Sins and Rifle Oil. Secondly, only
a few persons were involved and the foreign investors were kept out. This is because the firms
received special terms and restrictions which made it difficult for foreign bidders and outsiders
without close connections to the companies to participate (Moser and Oppenheimer, 2001). This
proves that the capitalists who were involved in the ‘loan for shares’ ensured the participation of
very few persons which, lacked equal opportunities for all (Kryshtanovskaya and White, 1998).
Thirdly, it involved the privatization of sectors involving energy resources on which primarily
the GDP of Russia depends on. Fourth, the winners of the shares auctions offered only slightly
above the minimum price (Table 3.1). Russia’s Norilsk Nickel29 plant, which was worth several
billion dollars, was sold for a paltry sum of 236.18 million ECUs i.e. $283 million (Kommersant-
Daily, 6 August 1997). In most contentious case, ONEKSIM bank won control over Norilsk
Nickel despite Rossiyskiy Credit’s higher bid for the shares.

29 Norilsk Nickel produces 90% of all Russia’s nickel and 1/314 of the world output.
Most importantly, the scheme was tailored to mobilize resources for the Federal budget by selling some portion of state assets; the irony is that instead it only helped the some of the Russian capitalists to get the shares at a low cost because the auctions were rigged. Moreover, in February 1996, Russia had to borrow a loan of US$ 10.1 billion from the IMF’s Extended Fund Facility on the terms that it substantially reduces inflation, increase confidence in ruble, and lower the federal budget (Naray, 2001: 54). In June 1997, the Duma through a new privatization law barred the share auctions of the 1995 program. Under this new law, the oil industry privatization was to be undertaken in order to raise money to bridge the budget deficit. The state-owned shares in oil companies were to be auctioned off to the highest bidder. For instance, unlike the loan-share auctions of 1995, on 18 July 1997, Alfa Group (which had failed to win a piece of the oil industry in the first wave of auctions) was able to secure a 40% stake in the Tyumen Oil Corporation (TNK) for $810 million—a bid much larger than the starting price of $160 million (Rutland, 1997, and Moser and Oppenheimer, 2001). Table 3.1 bears testimony to the fact that the auctions and bids were rigged and the amount raised by the government through this scheme brought no positive returns to it.
Table 3.1: Russian Oil Industry and the Loans-for-Shares Scheme, 1995-7

<table>
<thead>
<tr>
<th>Oil Company</th>
<th>Size of stake under auction %</th>
<th>Loan provided by auction winner to government, 1995 ($m)</th>
<th>Bank which organized auction, 1995</th>
<th>Auction winner, 1995</th>
<th>Guarantor issuer, 1995</th>
<th>Minimum sale price, 1996-7 ($m)</th>
<th>Price paid by auction winner, 1996-7 ($m)</th>
<th>Auction winner, 1996-7</th>
<th>Amount raised by govt. in 1996-7 as a result of sales (in additon to original loans) ($m)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yukos</td>
<td>45</td>
<td>157</td>
<td>Menatep Bank</td>
<td>Laguna (Menatep affiliated)</td>
<td>Menatep, Stolichny Savings bank, Tokobank</td>
<td>160</td>
<td>160.1</td>
<td>Monblan (Menatep affiliated)</td>
<td>0.77</td>
</tr>
<tr>
<td>Surgut Holding</td>
<td>40.12</td>
<td>88.40</td>
<td>Uneximbank</td>
<td>Surgutneftegaz Pension Fund</td>
<td>Uneximbank</td>
<td>74</td>
<td>73.5</td>
<td>Surgutfond invest (linked to Surgut)</td>
<td>0</td>
</tr>
<tr>
<td>Sidanco</td>
<td>51</td>
<td>130</td>
<td>Uneximbank</td>
<td>MFK (part of Uneximbank group)</td>
<td>Uneximbank</td>
<td>129</td>
<td>129.8</td>
<td>Interros-Oil (part of Uneximbank group)</td>
<td>0</td>
</tr>
<tr>
<td>LUKoil</td>
<td>5</td>
<td>35.01</td>
<td>Imperial Bank</td>
<td>LUKoil, Imperial Bank</td>
<td>Slaviansky Bank</td>
<td>43</td>
<td>43.6</td>
<td>LUKoil Reserve-Invest (linked to LUKoil)</td>
<td>6.013</td>
</tr>
<tr>
<td>Sibneft</td>
<td>51</td>
<td>100.3</td>
<td>Menatep Bank</td>
<td>NFK, Stolichny Savings bank</td>
<td>Menatep Bank</td>
<td>101</td>
<td>110</td>
<td>FNK (an offshoot of NFK, linked to SBS-Agro)</td>
<td>6.79</td>
</tr>
</tbody>
</table>

Source: Moser and Oppenheimer (2001: 310)

Note: 1) 70% of sale profit (above value of original loan) accrued to government.
2) An additional issue of shares in 1996—an approximate 36% share capital increase—to repay the debt of the companies' subsidiaries reduced the 45% of Yukos shares pledged by the government to Menatep under the loans-for-shares scheme to 33%. Menatep purchased 80% of additional emission of shares.

Unlike the earlier methods of privatization, under the 1995 'loan for shares' privatization the banks played an important role. The shares-for-loans auctions catalyzed the banks leap in becoming the dominant financial-industrial conglomerates. The large-scale industries were in the
control of the Red Directors. A group of private financiers through their banking and trading shifted their activity to own the stock of these large enterprises. The role of the Red Directors reduced while the financial-industrial oligarchy emerged (Kotz and Weir, 2007). Future shares-for-loans schemes were officially banned in a law signed by Yeltsin on July 25, 1997.

A. Consolidation of Financial-industrial Groups (FIGs):

With ‘loans for shares scheme’ the oligarchs were able to branch out and increase their holdings and invest in subsidiaries. Therefore, their holdings were turned into financial-industrial groups (FIGs). There are basically two types of FIGs: industry-led FIGs and Bank-led FIGs (Johnson, 1997).

The Soviet Union followed a monobank system, i.e., it had one single banking institution called the Gosbank. It directed the government expenditure and assisted in tax collection. Apart from this, there were four state-owned commercial banks (spetsbanks) Vneshekonombank handled foreign trade and payments, Agroprombank dealt with agriculture, Promstroibank with industry and Zhilsotsbank with housing. This was the scenario up to the adoption of the 1988 Law on Cooperatives, which gave rise to the newly formed cooperative banks. By 1990 there were almost one thousand banks both in Moscow and at the regional level, with the numbers rising over to 2,000 commercial banks. They were the by-products (Dmitriev et al. 2001) of the privatized non-bank entities. Dmitriev et al. (2001: 215) suggest one of the reasons for the sudden growth of private banks was that the privatized non-bank entities ‘wanted to keep control of their revenue and cash flows—both to facilitate misappropriation and to protect against misappropriation by others—by setting up their own “pocket” banks to handle them.’ The participation of the major banks in the loans-for shares scheme, turned them into bank-led FIGs.

According to Kryshtanovskaya, (1995: 98-9 and 1996: 4) in 1990s, Russia comprised of three types of dominant holding or financial-industrial groups:

1. a group of industrial enterprises with a bank as sponsor, formed on the basis of an order from the authorities (let us call them “semiofficial FIGs”);
2. a holding company that creates banks (“holding FIGs”); and
3. a bank that creates a holding company (“empires”).
The third type of FIGs became the important players within Russia. They were Promstroibank (Industrial Construction Bank) holding company (more than 20 juristic persons); Vneshtorgbank (Foreign Trade Bank) empire; Menatep empire (about 60 juristic persons); ONEKSIM bank-MFK (United Export-Import Bank/International Financial Corporation) empire (more than 30 juristic persons); Rossiiisky kredit (Russian Credit) empire (more than 30 juristic persons); Inkombank (Bank of Foreign Commerce) empire (about 30 juristic persons); and Most empire (42 juristic persons) (Kryshtanovskaya, 1995: 99 and 1996: 4). Other than the Vneshtorgbank and Promstroibank, the rest belonged to private members.

Most of the highly profitable enterprises became a part of these bank holdings during the privatization process. The family of former Prime Minister Viktor Chernomyrdin thus became the participants in the privatization of Gazprom, while Yeltsin's family featured in the privatization of the Aeroflot company-Russian International Airlines (Kagarlitsky, 2002). The state did act at all levels to pass legislation promoting FIGs. Numerous decrees, regulations and laws spelled out in glowing terms what FIGs were what they could do for the economy and what benefits the FIG members would receive. The state promised registered FIG participants tax breaks, the transfer of state shares in member companies to the FIGs, government loan guarantees, lower reserve requirements for participating banks, privileged involvement in state investment projects and other booms (Johnson, 1997).

Governmental officials saw FIGs as a way to direct state investments, promote foreign investments in Russian industry, achieve economies of scale, and gain competitiveness on the world market. In January 1996, supporters of industry-led FIGs created a lobbying association under Soskovets leadership, the Association of Financial-Industrial Groups, which stated that its main objectives were to defend the legal rights and interests of its members, to participate in drafting new legislation on FIGs, to coordinate the FIGs' economic activities, to help establish new FIGs, and to represent the Associates' interests to the government (Johnson, 1997).

Russia by 1994, had 2,500 registered banks. Some of these had their origin in under the Soviet Law on Cooperatives (May 1988). They flourished due to the availability of cheap credits issued by the Soviet State Bank and Central Bank of Russia. During the first years of the transition,
banks had little reason to invest heavily in industry and hence focused on acquiring enterprise in consumer goods, construction, textiles, chemicals and other kind of light industries in which they could gather significant packets of shares. During this process the banks found that their evolving FIGs served many useful purposes for them, providing a bank guaranteed enterprise customers, tax havens, less uncertainty in lending, and enterprise revenue with which to carry out short-term financial dealings (Johnson, 1997). Moreover, it is the largest Russian banks that act as credit-financial institutions taking part in the FIGs (Makrushenko, 1998).

Apart from the ‘loans for shares’ program to strip state assets for pittance the following shows that the methods of creating wealth, which flourished during the perestroika period also continued under Yeltsin’s period despite the complete legalization of business.

3.3 Methods of Stripping State Assets and Capital during Yeltsin Period:
Under Gorbachev’s rule many of the speculators and would be capitalist had resorted to different methods to strip the state of its wealth and resources as dealt in Chapter 1. Yeltsin’s first term of presidency led to newer methods, with a continuation of the older ones, to siphon wealth of the state and to rob the people of their savings. Apart from the loans-for-shares program, there was no stopping the Russian capitalists and speculators in resorting to unhealthy business practices. The means through which they stripped the state assets clearly shows a comparison with the robber barons of America is not sufficient. The capital accumulated by the latter remained within the country and secondly they introduced new industries to the country. In the case of Russia, the capital did not remain within the country. They used shell companies to siphon profits, transfer-pricing, etc.

Following are a few methods through which robbing of the state assets was completed:

A. Financial Speculative Schemes:
‘Currency speculation’ was a lucrative business whereby the speculators, taking advantage of hyperinflation, dealt in dollar-ruble exchanges. Between the collapse of the Soviet Union in 1991 and the end of 1994, the ruble exchange rate against the dollar dropped 95%. Most of them made enormous profits by essentially gambling on daily fluctuations in the ruble-dollar exchange rates.
The overvalued exchange rate did not favor the small and medium entrepreneurs. However, the Russian capitalists found it favorable to deposit their profits in the form of dollars (Stiglitz, 2002).

The people having lost their faith in the ruble due to ‘shock therapy’ preferred the dollar and therefore most of them invested their savings in the financial pyramid schemes viz., MMM, Vlastelina, Khoperinvest, Tibet etc. The savings were not only wiped out when the schemes collapsed, but also investors did not receive any returns on the money they had invested. Sergei Mavrodi who engineered the MMM pyramid scheme or investment fund, was let out of the prison and made his way to being a member of the Duma (Solongo, 2001).

Many commercial banks made profits in these early 1990s by investing in cheap funds. These funds were obtained from enterprise deposits that were paid negative real interest rates (Solongo, 2001). The newly formed private banks serviced both the enterprises and the government sector. The government outlays or expenditures and taxes were channeled through the authorized commercial banks. Many banks delayed the financial transfers to the recipients for weeks and months. While this resulted in a profit for the banks, it led to the ‘phenomenon of payment arrears’ (Dmitriev et al., 2001: 220).

B. Capital Flight:
According to the Oxford Dictionary of Economics ([1997] 2002: 48, OUP, Indian edition) capital flight involves large-scale and sudden movements of capital from a country, by residents or foreigners for reasons like fear of public disorder or persecution leading to personal danger to its owners, fear of confiscation or drastically increased taxation, and fear of rapid inflation leading to a loss of its value by the country’s currency. In short it means the flight of capital into assets denominated in foreign currencies and usually held abroad. It was not only the capitalists that were involved in depositing their capital in abroad countries i.e., in Western banks, but even small and medium businessmen, including the managers of the state enterprises and people in general. This was either to evade taxes, to resist the attention of the Mafia or the criminal groups, or to save the money from the fluctuating economy of Russia.
Simon Pirani and Ellis Farell (1999) say that the idea that capital flight is an entirely criminal activity is a misunderstanding. The predominant form of capital flight is the export of natural resources and the holding of profits from their sale offshore; the beneficiaries are not only the oil and metals companies that own the resources but also financial institutions that leech on them and western traders that do business with them. Their analysis pinpoints four particular routes for capital flight: (i) manipulation of insurance and transport costs incurred on the export of oil and other high-earning commodities; (ii) the violation of capital control requirements by banks that are (a) frequently controlled by the big exporters and (b) in the process of being bankrupted; (iii) the creation of trading partners in other CIS countries, the export to them of ruble-denominated Russian goods, which are subsequently re-exported for payment in dollars; and (iv) bad debt. In short, they say it means that the main sources of flight appear to be non-repatriated export proceeds and prepayments on fake import contracts.

Liberal economists attributed the capital flight to high taxes, a poor legislative base, entrepreneurs' uncertainty about their future prospects and crime. Russia had over 200 taxes in the 1990s. Each region invented its own taxes, mostly in the form of licensing fees or penalties, to cover their expenditures. This meant that the revenue from the regions did not make its way to the center. Moreover, many capitalists, especially the oligarchs failed to pay taxes. They indulged in barter and other nonmonetary transactions, while extracting additional subsidies from the federal government, which amounted to tax avoidance (Åslund, 2007: 136).

Before the third stage of privatization came the new Russians had already created sufficient wealth through the earlier two privatizations and the lifting of restrictions on private trade. The entrepreneurs especially did not use profits for further investment and development; the profits were deposited in Western banks, usually in private foreign-currency holdings that served as a hedge against inflation and a protection for large-and medium-sized operators from the taxation agencies of the government (Dynnikova, 2002 and Tikhomirov, 1997). The methods of capital flight are not only direct transfers of money, but also phony import-export documents and insider price manipulations. Tikhomirov (1997: 593) emphasizes that foreign trade in Russia is an attractive option for capital flight as it involves flexible trade operations and it is non-traceable.
for the state taxation agencies. He identifies three ways of exporting capital using foreign trade
deals: barter trade, sham credits and double-invoicing (double-contracting). Similarly, Åslund
(2007: 123) says that the origin of capital flight was in under-invoiced commodity exports,
mainly oil and metals where the private windfall was kept in banks in offshore havens. This was
due to the fact that the state managers were stealing from state enterprises through transfer
pricing, evading export tariffs and so in order to escape the unstable Soviet ruble deposited their
profits in foreign accounts.

Capital flight has been calculated and estimated in various ways (Tikhomirov, 1997; Solongo,
2001; and Dynnikova, 2002). According to expert accounts, the overall quantity of capital that
‘fled’ the country between 1992 and the end of Yeltsin era exceeded US $ 150 billion
(Kagarlitsky, 2002: 98). The Institute of Economics (based in Moscow) and the Canadian Center
for Study of International Relations of University of Western Ontario reviewed alternative
assessments of capital flight from the Russian Federal Departments, the Central Bank of Russia
and the international financial institutions, under the leadership of Leonid Abalkin. Taking an
average, they estimated the capital flight to a total of $133 billion from 1992 to 1997 (Solongo,
terms capital flight as outflow, which means accumulation of foreign assets by the private sector
in any form. According to this definition, she estimates the outflow between 1993 and 1999 as
$162 billion (7.4% of GDP) including cash purchases of foreign exchange, and $133 billion
(6.2% of GDP) excluding them30 (Dynnikova, 2002: 78). Most of the capital that is laundered31
in Offshore Financial Centers return back to the home country through disguised legitimate
foreign investment. Therefore, it is difficult to differentiate in Russia as to what money is capital
flight or outflow and what is laundered.

The key factors in limiting capital outflows are not only administrative measures, but also a
sensible tax system and legislation, and balanced budget policies that stimulate rather than

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30 Dynnikova does not separates direct investments abroad from capital outflows as it is not large and hence does not
alters the results of the analysis.

31 Anti-money laundering law had not been passed up to 2000. Moreover, the offence of money laundering was
recognized within the Criminal Code of the Russian Federation approved in 1997. Chapter 22 deals with economic
crimes with 31 articles detailing penalties.
impede investment in the Russian economy (Dynnikova, 2002). Moreover, this problem does not create an investment friendly environment due to non-payment of taxes and money laundering. Low investment, low savings and capital flight are three further problems associated with high inflation (Gwynne et al., 2003: 88). To the government it means shortfalls in revenue earnings. The 1992, 1994 and most importantly the 1998 financial crisis led to hyperinflation resulting in the exodus of capital from Russia (Åslund, 2007), leading to the dollarization\(^\text{32}\) of the Russian economy. Stiglitz (2000) points out that insufficient attention paid to the institutional infrastructure eased the flow of capital in and out of Russia. The Yeltsin government took neither any step to stop the capital outflow out of Russia nor did it punish the offenders. This revealed the government’s linkages with the economic Mafia and their ineffectual control over the economy (Chenoy, 2001: 208).

C. Use of Offshore Subsidiaries:

A key difference must be made with regard to money-laundering and capital flight. Financial Action Task Force on money laundering (FATF)\(^{33}\), associated “money laundering” with criminal acts (illegal arms sales, smuggling, the activities of organized crime like drug trafficking and prostitution rings, embezzlement, insider trading, bribery and computer fraud schemes) by individuals or groups whereby the proceeds or profit gotten from these acts are disguised through “legitimize” the ill-gotten gains\(^{34}\). This is done by disguising the sources, changing the form, or moving the funds to a place where they are less likely to attract attention. The amount of capital flight from the Russian Federation related to money-laundering was estimated at $133 billion during the 1992-1997 (Solongo, 2001:1). It is difficult to detect or observe activities\(^{35}\) related to money laundering be it in Russia or other countries.

\(^{32}\) Dollarization is 'expressed in the use of US dollars as a means of payment (currency) and as a means of savings (assets) (Solongo, 2001: 5).

\(^{33}\) The work of the FATF focuses on three principal areas: (1) Setting standards for national anti-money laundering and counter terrorist financing programs; (2) evaluating the degree to which countries have implemented measures that meet those standards; and (3) identifying and studying money laundering and terrorist financing methods and trends.

\(^{34}\) FATF (Financial Action Task Force on Money Laundering) What is Money Laundering?, http://www.fatf-gafi.org/document/29/0.3343.en_32250379_32235720_33659613_1_1_1_1,00.html Paris: OECD.

\(^{35}\) FATF in their reports have identified that money is laundered in three stages—placement, layering, and integration. That is, once the illegal money enters the financial system, the launderer can convert or move the funds, in order to distance them from their source, through the purchase and sales of investment instruments, or the launderer might simply wire the funds through a series of accounts at various banks across the globe. The latter
Offshore subsidiaries and offshore financial centers are used to move money in and out of the home country. The key reasons as to why individuals and corporations utilize offshore services are:

- **Privacy and Confidentiality** in financial, business and banking affairs in order to circumvent the reporting requirements of government agencies as offshore countries don’t have these reporting requirements.
- Utilization of offshore vehicles such as trusts, International Business Corporations, bank accounts, and others enable asset protection from creditors and possible judgments arising from law suits.
- Offshore countries offer favorable foreign tax laws as they have minimal, or no tax legislation that apply to residents and exempt companies such as International Business Corporations. This aids individuals and corporations to avoid overtaxes or high taxes.
- Offshore countries allow access to international markets which offer very competitive rates of returns on mutual funds, investment certificates and other investment vehicles. The lack of taxes in the various jurisdictions allows for higher returns making it attractive to investors.
- The laws in many offshore jurisdictions make estate planning process less complicated.
- Having offshore banks allows a company to utilize bank services for its own operations such as loans, mortgages and debentures.
- **Transfer pricing** is the pricing of cross-border transactions between non-arm’s length parties. For example, a company may have its manufacturing operations situated in an offshore jurisdiction. This offshore structure would sell its products to its retail operations.

36 Lakeway International Equities Ltd is one of those offshore centers, for financial investment, that provide services including offshore banking and investing, asset protection, gaming licenses and incorporation of International Business Corporations (IBC’s) in a wide variety of tax haven countries. They assist with residencies, passports and citizenships. See the website for more information and its dealings http://www.lakewayinternational.com/index.html
worldwide, who in turn would sell its products to the public. One of the objectives here is to trap most of the profits in the offshore jurisdiction which has no taxes.

- To avoid taxes on *inherances and gifts* people utilize offshore services. (Lakeway International Equities Ltd., 1998)

Only tax evaders and money launderers are involved in the offshore activities wherein they also deposit their cash in the offshore banking and financial centers, in short called the ‘tax havens’. A tax haven is wherein a country whose laws and regulations allow foreign investors (both individuals and corporations) to reduce their tax liability through the utilization of offshore vehicles such as trusts, International Business Corporations (IBC), bank accounts, and credit cards (Lakeway International Equities Ltd., 1998a). Types of tax havens are: no-tax haven, low-tax haven, special tax haven and countries that impose taxes only on locally produced income. In choosing a tax haven country, there are many factors that should be considered, some of which are: tax legislation, political stability, foreign exchange laws, ease of IBC formations, legal systems, secrecy and nondisclosure laws, location and proximity, languages, tax treaties, financial institutions, residency and immigration laws, foreign marine registrations and corporate filing requirements (Lakeway International Equities Ltd., 1998a). Therefore more than one tax haven is utilized. Through the offshore affiliates, the parent company is able to use creative accounting methods to avoid taxation (Goldman, 2004). The essence of these sophisticated accounting methods is quite simple- the parent company moves taxable offshore to accounts that are outside of home country’s tax authority. Then this money is re-directed to the home accounts of the parent company or company owners in a form that is not taxable.

Gwynne et al., (2003: 184) explain that offshore banks typically offer depositors a range of benefits compared to banking in most core countries, which include: banking secrecy laws; asset protection against creditors or lawsuits originating outside the host country; the ability to

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37 One may want to incorporate International Business Corporation in Turks and Caicos for tax and privacy reasons, have a bank account with a bank in Antigua; have a credit card with a financial institution in Aruba and have a trust created in Nauru because of its excellent trust legislation.

38 One of these is ‘creative accounting methods’, which includes ‘income averaging’. Amat et al. (1999) give a general definition of creative accounting as, ‘a process whereby accountants use their knowledge of accounting rules to manipulate the figures reported in the accounts of a business’. It means that the corporations or other organizations use accounting practices that deviate from the standard accounting practices, in order to misrepresent their true income and assets or liabilities.
maximize corporate returns by setting up holding companies and subsidiaries, and using transfer pricing; lower income tax rates on earnings from bank deposits (some jurisdictions even offer tax-free investment categories); and higher interest rates paid on tax-free bank accounts (this is possible because of lower capital reserve requirements, and therefore the ability to lend out a larger share of deposits). Many offshore financial countries (OFCs) do not keep banking transaction records. This allows ‘dirty money’ to flow through the OFC and then to a bank in a home country, at which point the money’s origins cannot be traced.

**D. Transfer-Pricing or Arbitrage:**
As part of the liberalization process of shock therapy, the prices were freed. However, prices of natural resources like oil and gas was kept low. This induced the capitalists to take advantage of the price differential between the domestic and world market prices. Transfer pricing is one of the most reliable methods used by the Russian tycoons. The tycoons forced Russia’s oil production companies to sell oil to parent companies at below-market prices. A portion of that oil is then resold on world markets at the prevailing price. The managers and private owners siphoned off the profits from the oil field extraction companies into an offshore private ‘trading company’. An extraction company sold oil to another company at an artificially low price, say, $2 a barrel. The second company then sold it for export abroad at a much higher price, say, $18 a barrel. The wealth was transferred from one company to the other, often in secret using shell companies and offshore havens (Hoffman, 2002 and Goldman, 2004).

The tycoons would thus systematically strip value from operating companies and their stakeholders. For example, in the first nine months of 1999, Yukos forced its three partially owned subsidiaries to sell it some 240 million barrels of oil at approximately $1.70 per barrel- at a time when the average market price was about $15. Yukos then exported nearly a quarter of that oil to world markets. Therefore, Khodorkovsky’s Yukos managed to siphon off some $800 million during a span of approximately 36 weeks (Wolosky, 2000: 21-22).
E. Dilution of Capital:
The massive dilution of capital has been another method of pillage. The owners of a parent company $X$ would issue new shares of its production company $Y$ at a below-market price and sell them to the affiliates of $X$. They then transfer these shares to the $X$ itself. This transaction will dilute the equity of existing stock holders of the $Y$ by a huge percentage. Because the stock was sold below market price, the transaction also results in the transfer of capital. Later the owners use their super majority voting power to merge the $Y$ out of existence. For example in September 1997, Sibneft (controlled by Boris Berezovsky and Romanov Abramovich) engineered the issuance of more than 44 million of new shares of its principal production company, Noyabrskneftegaz, at a below-market price. Those shares were sold to affiliates of Sibneft, who then transferred them to the parent company to itself. The transaction diluted the equity of existing Noyabrsk stock holders by 75 percent. Because the stock was sold below market price, the transaction also resulted in the transfer over US$ 400 million in value. Berezovsky and Abramovich later used their super majority voting power to merge Noyabrsk out of existence (Wolosky, 2000: 22).

F. Asset Stripping from State and Foreign Enterprises:
The owners loot the companies they control even more directly—by stealing valuable assets, including wells, equipment, and anything else that can be found on an oil field from their subsidiary companies. This asset stripping occurred due to the implementation of the privatization process without proper legal framework and legal infrastructure (Stiglitz, 2002). Over the past two years, Yukos has forced its subsidiaries to transfer substantial assets to new companies—notwithstanding a conflicting February 1998 order by the Russian Federal Securities Commission. In fact, from 1997 to 1998, Yukos made the oil production companies it controls part with assets having a book value of some US$ 3.5 billion (Wolosky, 2000: 23).

Asset stripping has victimized major international oil companies. The method used here is ‘restructuring’. Fridman’s Tyumen Oil Company (TNK) allegedly stole Sidanko’s most valuable assets by manipulating the bankruptcy process. According to defrauded Sidanko shareholders (who include BP Amoco), the theft was carried out through the corrupt appointment of a TNK-
friendly receiver, the unlawful reduction of the claims of major creditors such as the European Bank for Reconstruction and Development, and a rigged bankruptcy "auction" in which only TNK-affiliated companies could bid (Wolosky, 2000: 23). Here Sidanko was restructured which led to the reduction of BP Amoco's shares. Similarly, Yukos Oil (where Dart Industries lost its shares), Norilsk Nickel and UES have used restructuring schemes (Goldman, 2004).

Russia in December 1994 signed the European Energy Charter. It stipulates that the foreign investors would be treated with same terms as the domestic investors. However due to lack of stringent property and shareholders rights, the terms of the Charter does not amount to a business friendly environment. Even as the process of privatization was initiated in 1992, the Russian government was not able to evolve the legislative system and taxation system to ensure stability towards privatization. There was no proper evaluation of the state property, such as land, machinery, etc. Moreover the state failed to build effective legal infrastructures to protect the properties of its citizens and the rights of the investors. These failures can be largely attributed towards the constant engagement of Yeltsin to consolidate his power and to appease the regional governors. The Russian capitalists failed to invest in industry and development; the profits were siphoned off to off-shore companies and foreign credit institutions and through tax evasion.

G. The Negative Elements-Mafia and Organized Crime:
Many authors are of the opinion that the hasty reforms have led to acute criminalization of the society. Rosalina Ryvkina (1998: 30), gives a list of social factors that have led to the criminalization of the Russian society: a moral vacuum that arose after the USSR disintegrated and the CPSU abandoned its leading role; liberalization of the economy that which produced a 'shock wave of freedom'; influence of the criminal structures and types of criminal behavior inherited from USSR; weakness of Russian state that emerged to replace the former USSR; and the emergence of many marginal and unprotected social strata and groups whose situation makes them a potential reserve for crime.
Shelley (2006: 99-100) divides the criminal world into three levels of crime groups. The lowest level groups operate only at the local or regional level. The middle-level groups are called as Chestniaki. They carry out complex criminal activities like running large-scale rackets, trade in narcotics, smuggling illegal alcohol and contraband, and run illegal credit operations in the
financial sphere. The third level consists of criminal organizations have large network-like structures with two or three levels of hierarchy. They have large financial interests in banks, real estate, joint ventures, casinos, restaurants, construction, transport and private protection services. Because of their nexus with the politicians or a protector or krysha within the government bodies, they usually do not get caught or they buy off members of the law-enforcement apparatus.

The form of organized crime changed post 1991. During the Soviet period as dealt in chapter one, they functioned under the ‘Thieves Under the Code’-wherein they followed their own code and were anti to the state laws and state authorities. However, the years following the disintegration of the USSR, some of the members of the crime groups have infiltrated into ‘legitimate’ business activities which is achieved through corruption and violence. Many members have moved into positions of political power (mention the statistics or percentage). As these groups have been operating well into the economy, we cannot rule out the argument that the business elite are connected with the crime groups.

In 1994 the institute of Applied Policy did a study on the question “The New Millionaires.” In the course of research and investigation approximately 40% of those surveyed admitted that they had previously been involved in illegal business dealings; 22.5% admitted that they had been taken to court because of this; and 25% at that time of the survey had still connections with organized crime (Medvedev, 2000: 199). However Medvedev points out in his work that the connection of the oligarchs and that of the Mafia is more of an exception than rule. There is no direct reference of the association of the oligarchs with that of the Mafia or organized crime. Initially, when Smolensky started Bank-Stolichny, it is believed that he serviced more of suspicious accounts, especially, those who had criminal links (Hoffman, 2002). It is alleged that Berezovsky had links with the Chechen mafia. The rise of oligarchs and their accumulation of wealth in a short span of time were linked with the criminal activities and the Mafia-like tactics. A CIA (Central Intelligence Agency) study asserted that ten out of twenty-five largest banks owned by the oligarchs including Menatep were linked to organized crime (Goldman, 2003: 98).
If it was not enough for the Russian capitalists to scale the top rung of the society as the *business elite*, the 1996 presidential election offered them the opportunity to come closer to the corridors of political power.

3.4 Capitalists to the Rescue of President Yeltsin:

The second power crisis occurred in 1996 when the ratings of President Yeltsin were dipped to 6% due to his absence from the office and his health deteriorating. The crisis reached a crescendo with the Communist Party of the Russian Federation (CPRF) winning a majority in the Duma elections in December 1995, followed by Liberal Democratic Party of Russia (LDPR). Our Home is Russia party of PM Viktor Chernomyrdin, which supported Yeltsin, received only 10% of the total vote. This threatened a reversal to the Soviet past or nationalization which would be harmful to the interests of the oligarchs.

Initially the first deputy PM Oleg Soskovets and the presidential bodyguard, Aleksandr Korzhakov, designed Yeltsin’s campaign casting him more as a nationalist and communist. It also included Nikolay Yegorov and Mikhail Barsukov (head of the FSB Federal Security Bureau, formerly the KGB). Georgiy Satarov, Yeltsin’s advisor on political affairs, and his group felt the need to campaign on issues like continuance of reforms and stability. This found common ground with the capitalists. The seven most powerful financial oligarchs were brought together at the World Economic Forum at Davos, Switzerland in January 1996 by Boris Berezovsky, in order to sink their differences and unite behind Yeltsin. They hatched the scheme to rescue Yeltsin’s campaign (McFaul, 1996). The oligarchs publicly expressed their position in the "Appeal of the 13" and subsequent documents (Pirani and Farell, 1999). The members who were largely involved were Boris Berezovsky (Chairman of the Board of ORT Channel One), Anatoly Chubais (who was removed from the post of First Deputy PM), Vladimir Gusinsky (NTV television Channel Four), Mikhail Khodorkovsky (Menatep holding company), Vinogradov and the mayor of Moscow Yuri Luzhkov to aid Yeltsin’s campaign. This alliance came to be known as Davos Pact (Hoffman, 2002).
Chubais headed this campaign “council” (McFaul, 1996) consisting of leading Russian financiers and media barons (all later called oligarchs) who sponsored the Yeltsin campaign, guaranteed coverage on television and in leading newspapers directly serving the president's campaign strategy. Other entrants to this campaign council were joined by Prime Minister Viktor Chernomyrdin, Viktor Ilyushin, Alexander Voloshin (Chief of the Administration Staff), Tatyana Dyachenko (daughter of Yeltsin)\(^{39}\), Valentin Yumashev (former Chief of Administration Staff), Deputy PMs Yuriy Yarov and Sergey Shakhray, Sergey Filatov (Chief of Staff), and Igor Malashenko (general director of NTV).

Deputy PM Yuriy Yarov was in charge of the organization of the campaign work, whereas Sergey Filatov (Chief of Staff) was in charge of the All-Russian Movement for Social Support for the President (Russian acronym, ODOP). McFaul (1996: 328) writes that the ODOP consisted of 'over 250 parties, unions, civic groups, and social organizational of all ideological stripes’. He says that the original list of the 21 organizations that founded ODOP were Our Home is Russia, Aleksandr Yakovlev’s Social Democratic Party, Lev Ponomaryov’s Democratic Russia, Vladimir Shumeyko’s New Course And Arkady Volsky’s Union Of Industrialists and Entrepreneurs.

The tycoons offered Yeltsin all their resources- media, regional contacts, funding talented political operatives experts in election campaigns, the enormous power of their television stations, and the front pages of their newspapers for the election campaign. Berezovsky's television channel, ORT, and that of Vladimir Gusinsky's NTV, provided rich coverage to Yeltsin's campaign. Igor Malashenko, the president of NTV, along with Yevgeny Kiselyov and Oleg Dobrodeyev (all three helped Gusinsky establish NTV) played an important role in the media and public relations for the campaign (Hoffman, 2002). They were responsible for his image makeover as a clean politician. Yeltsin’s campaign worked his image towards the key issues like unpaid wages and the war in Chechnya. Apart from televised coverage, almost all the national newspapers and regional papers endorsed Yeltsin’s candidacy by giving him extensive coverage as against Gennady Zyuganov, the CPRF candidate. Zyuganov was supported by

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\(^{39}\) Tatyana Dyachenko became the de facto member of the presidential team in March 1996. In 1997, she was appointed, through a presidential decree on personal matters, as adviser to the head of the state wherein she handled the questions involving the image of Yeltsin.
national patriotic parties which comprised of one bloc. The only newspapers that did not support Yeltsin were 'Sovetskaya Rossiya, Pravda and Zavtra (earlier known as Den) (McFaul, 1996).

As Yeltsin's candidacy was supported by rich businessmen, industrialists, financiers, there was no dearth for campaign funds. Moreover, the election law that did not incorporate a limit on spending for campaign facilitated an unlimited budget. There were many irregularities in the election process like no limits on campaign finance, media bias for Yeltsin, falsification in Chechnya (McFaul, 1996: 319). The capital, which was fused into the campaign indirectly, belonged to the government. With the help of Chubais' campaign headquarters they created a hidden scheme in which they obtained government bonds cheaply. The bonds were deliberately sold to the tycoons' banks at a deep discount. The banks could resell the bonds at a higher market price raising quick cash which they then used for the campaign activities (Hoffman, 2002).

In the first round of voting in 16 June 1996 presidential election, Yeltsin notched 35.28% and Gennady Zyuganov scored 32.04% of votes out of ten presidential candidates. Alexander Lebed secured 14.52% and Grigory Yavlinsky finished with 7.42% and Vladimir Zhirinovsky with 5.7%. The other candidates received less than one percent. According to political forecasts, Yeltsin could win only if he took more than 40% of the vote in the so-called Red Belt regions, which for the most part voted for the left candidates in the parliamentary elections and for Zyuganov in the first round of the presidential ballots. With no candidate securing an absolute majority, Yeltsin and Zyuganov went into a second round of voting.

In the meantime, Yeltsin co-opted a large segment of the electorate by appointing Lebed to the posts of national security adviser and secretary of the Security Council. The Zyuganov campaign had a strong grass-roots organization, but it was simply no match to the financial resources and access to patronage that the Yeltsin campaign could marshal. To assuage voters' discontent, he made the claim that he would abandon some unpopular economic reforms and boost welfare spending, end the war in Chechnya, pay wage and pension arrears, and abolish the military draft program (he did not live up to his promises after the election, except for ending the Chechen war, which was halted for 3 years). In the end, Yeltsin's election tactics paid off. In the run-off on 3 July 1996, with a turnout of 68.9%, Yeltsin won 53.8% of the vote and Zyuganov 40.3%. High
voter turnout, compared to the first round, also aided Yeltsin’s victory (McFaul, 1996: 343). He received overwhelming support in Moscow, St. Petersburg and other large industrial and cultural centers. In the Red Belt provinces he lost to Zyuganov only in the Bryansk, Voronezh, Kursk and Ulyanovsk regions and failed to net 1 to 2 points to overcome the 40% barrier in the Altai territory.

The business tycoons or the bankers approached Yeltsin on their own initiative to help him in the 1996 presidential election. Yeltsin (2000: 93) writes in his autobiography that they ‘came to defend not Yeltsin but themselves, their businesses, their lost hundreds of millions of dollars, which they would soon have to return to their creditors’. He says that the businesspersons were interested in political stability. He further defended their involvement in the political processes of Russia because they were willing to invest money in political stability. After the intervention of the business capitalists in the presidential elections, the title the oligarchs, best described them. The oligarchs, also, came to be called as ‘the third government’ (Goldman, 2003: 98) because of their, consequent, interference in the economic and political decisions of the Russian government.

3.5 Emergence of the Oligarchy:
The Russian capitalists are called by several terms, although some are semantically mixed. The “new Russians” were the small entrepreneurs who became wealthy due to the reforms initiated by Gorbachev. They are relatively affluent businesspersons, administrators, luxury service workers, and criminals. In terms of the affluence and influence, they are second to the Russian capitalists or especially the oligarchs. The top stratum within the economic sphere was first bestowed attention by the mass media who called them as ‘elite’ (Kukolev, 1997).

There is no unanimity amongst the authors as to who all comprise the oligarchs. Though the Russian capitalist class was called as the oligarchs, not all capitalists could be categorized so. Few prominent capitalists controlled Russia politically due to their enormous wealth. Oligarchy simply means rule by the few or in the Aristotelian sense, it means a small group of people having control of the state. The Oxford University Press Dictionary defines it as ‘government in the hands of a few’. Therefore, we can attribute this title to those capitalists who wielded
political power or influenced the power structures. As a rule, the term refers to small group of leaders in the largest financial and industrial structures, who are closely tied to the regime (Zudin, 2000). Gaetano Mosca (1939: 57) was apt in saying that ‘if the powerful are as a rule the rich, to be rich is to become powerful’.

An ‘oligarch’ Anders Åslund (2007: 256) defines in context of Russia, Ukraine and other former USSR republics having this characteristic, is a ‘very wealthy and politically well-connected businessperson, a dollar billionaire, or nearly so, who is the main owner of a conglomerate of enterprises and has close ties to the president’. He claims that it might be more appropriate to call them plutocrats, because their aim is to make money rather than rule the state. In particular, the term Russian oligarch describes best those Russian businesspersons who came to prominence during the presidency of Boris Yeltsin. The authors, scholars, and the journalists dealing on the subject of Russian oligarchs, also refer to this class as ‘plutocrats’ wherein it means the government by the wealthy.

Peter I. Lyashchenko (1949) in his comprehensive work ‘History of the National Economy of Russia to 1917 Revolution’ detects the emergence of a ‘financial oligarchy’ in the Czarist Russia (Chapter 1). In 1890s, the rise of industries and the growth of banking and their fusion led to a small group of Russians ownership to vast wealth. Some of their methods were similar to the present day oligarchs. This merger did not allow the change in the social structure of Russians as whole; the change took place only at the top-most of the societal stratum. However, none of the present oligarchs have any relation with the previous ones.

Olga Kryshtanovskaya, a noted sociologist, discovered that the Russian capitalism that emerged from the Gorbachev reforms and the early 1990s was more of a ‘financial oligarchy’ 40. Kryshtanovskaya (1996: 5) described them as ‘a closed group of people who control large amounts of capital and branches of industry with the permission of the authorities. The “self-made men” have been squeezed out, going into medium-sized and small businesses….An oligarchy has taken shape in Russia under conditions of regression in industry and progress in financial institutions. The concentration of capital took place with banks playing the leading role.

Therefore, the resulting oligarchy is, above all, a financial oligarchy. The type of corporations or the holding companies emerging were bank led. The financial crisis undermined the position of banks. Oligarchs in Russia came to be the financial-industrial elite as they controlled not only mining, oil but also in financial sectors—banking, funds etc. When the state continued to sell its enterprises during the privatization, these bankers or the oligarchs established holding companies or the financial-industrial groups (FIGS) (Goldman, 2003).

The rise of the Russian oligarchs is lies in the reforming of Russian socio-economic system in its attempt to make a transition to market economy. The privatization of 1995 and the 1996 presidential elections propelled the rise of oligarchs. The prominent ones were the seven leading oligarchs, namely Boris Berezovsky, Vladimir Gusinsky, Mikhail Fridman, Alexander Smolensky, Vladimir Potanin, Mikhail Khodorkovsky, and Vladimir Vinogradov. They were bankers and had their interests in oil, gas, metals, and the media. When the Russian government was strapped for funds for the budget, the oligarchs bailed out the government and bought up Russia’s biggest assets.

The most common qualities amongst the oligarchs are that they possess mostly oil companies, ore fields, media, banks, automobile factories etc. Secondly, they amassed wealth from a weak state; their creation of wealth was not through proper channels. They used power to gain more wealth. They have no intention to build the economy of Russian state, but search for ways to strip the state of its wealth. Mostly, the study of oligarchs revolves around Yeltsin who gave certain amount of leverage to the oligarchs. Oligarchs need to be examined from the perspective of their financial-industrial holdings in relation to the political posts or influence they enjoyed and also the media concerns they owned. This is what grafted their wealth with that of political power (Hoffman, 2002) and influence. Political power, however, was directly wielded by only two oligarchs as given in Table 3.2 (Potanin and Berezovsky). Vladimir Potanin, the head of Oneksimbank became the deputy prime minister in charge of Russia’s macroeconomic policy. Boris Berezovsky was appointed as the deputy secretary of the Security Council. He was in charge of conducting negotiations with the Chechens. Political influence was definitely enjoyed by those capitalists called as the oligarchs.
A. Inside the Corridors of Power:

For the part played by the oligarchs in the election campaign, they were either rewarded with political posts or through economic gains. This changed the composition of Yeltsin’s government. The economic benefits enabled the oligarchs to amass a great fortune as listed in Table 3.2:

Table 3.2: List of the Oligarchs and their Holdings in 1996-1999

<table>
<thead>
<tr>
<th>Oligarchs</th>
<th>Holding company</th>
<th>Primary Industries</th>
<th>Political posts held</th>
<th>Media concerns</th>
</tr>
</thead>
<tbody>
<tr>
<td>Vladimir Gusinsky</td>
<td>Most bank</td>
<td>MOST Development</td>
<td></td>
<td>*Media-Most, NTV, Segodnya, Itogi Magazine, Obschestva Gazeta, 7 dnei, Echo Moskovy radio station.</td>
</tr>
<tr>
<td>Mikhail Fridman &amp; Peter Aven</td>
<td>Alfa Bank</td>
<td>Tyumen Oil</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Vladimir Potanin was given the post of first vice-premier for the economy and planning in 1996. From August 1996 to March 1997 he served as First Deputy Premier. In January 1997, Potanin, in his capacity as first deputy prime minister chaired the Commission on Financial, Credit, and Monetary Policy that slashed the number of fully authorized banks from 85 to 16 (the group of “universal agents”), while the total number of federally authorized banks fell to 54 (Dmitriev et al., 2001: 220). Although some of Russia’s biggest banks did not make the top list, all of the eight banks the centre of FIG’s retained their fully authorized status (Johnson, 1997). Moreover the state Customs Committee’s two central accounts in which the receipts from regional customs offices were deposited were handled by Oneksimbank and Mosbizness Bank. It was only in September 1997, they were transferred to the Bank of Russia.

As a reward for his efforts Berezovsky on October 29, 1996 was appointed deputy secretary of the Kremlin Security Council and was given responsibility for working out the settlement in Chechnya. In April 1998, the Council of CIS (Commonwealth of Independent States) Heads of State appointed Boris Berezovsky as the Executive Secretary. Chechen wars were fought between 1994-96 and 1999-2001. Shamil Basaev, Salman Raduev, Khattab (an Arab Wahhabite, who also appears to be trained in insurgency by Russian instructors) along with Aslan Maskhadov, Udugov and other Chechen leaders, appeared to be in regular contact with powerful men close to the Russian presidency as Boris Berezovsky (who, in 1996 served as the deputy secretary of National security) (Russell, 2002: 85). It is believed that Basaev confirmed that Berezovsky had given him $3 million to finance the incursion into Dagestan, along with the apartment bombings as the pretext for the second invasion of Chechnya (Russell, 2002: 85). In his 1996 profile of Berezovsky in Forbes, titled *The Godfather of the Kremlin: The Decline of*
Russia in the Age of Gangster Capitalism⁴¹, Paul Klebnikov claimed the tycoon had siphoned off hundreds of millions of dollars abroad and had links with the Chechen mafia. Vladimir Kadannikov was also a minister in the Russian government from 1996. He was the director when the AvtoVAZ was turned into a joint-stock company during the perestroika period.

Apart from awarding political posts other oligarchs were bestowed economic gains. After the elections the state natural gas monopoly, Gazprom, purchased 30% of NTV shares from Gusinsky. Yeltsin also signed a decree giving Gusinsky 24 hour access to the airwaves on Channel 4, an important concession that allowed more time to broadcast commercial as well as news and films. The old state-owned Agroprombank was one of Russia's largest banks with 1,254 branches. It was failing due to poor management and stagnation of Russian agriculture. It had only 6 to 8 weeks of being closed and the government could neither a bailout nor could it close the bank which had branches in the farm belt where the Communist (Hoffman, 2002: 363) Agrarian Parties dominated. So it was auctioned wherein only two banks competed for the bid. Smolensky won the bid for $21 million, defeating Bank Imperial which was backed by Gazprom. To properly construct a new bank branch in Moscow requires about $2 million. Smolensky purchased 1,254 new branches for the equivalent one for every $19,000 of his investment (Hoffman, 2000).

The system of transfer of assets came not only with the rewarding of political posts but there was the ongoing of appointments between businessmen and government officials. High officials in the banks moved freely from their posts within their banks to work in government posts and the case has been same with that of those in bureaucracy and government officials (Johnson, 1997). For instance, after his firing in early 1997, the first deputy finance minister Andrei Vavilov became the president of the ONEKSKIM Bank-controlled MFK; Alexandr Turbanov, the former vice president of Inkom Bank revealed the association of the Russian banks found him a place on the party list for the party of Russian Unity and Accord in the 1993 Duma elections where upon he served in the Duma from 1993 to 1995 and then became a deputy director of Central Bank of Russia (Johnson, 1997: 350).

Similarly in February 1997, CBR (Central Bank of Russia) deputy director Rinat Setdikov resigned and went to work for SBS-Agro; Yelstin’s former press secretary Vyacheslav Kostikov became the deputy director of Media Most in July 1997; Leonard Vid, former executive director of Gosplan, became the head of the Alfa Bank’s board of directors in early 1996; Alfa’s Bank’s president Pyotr Aven was Russia’s Minister of Foreign Economic Relations until 1992 (Johnson, 1997: 350). Hence this gave rise to the free flow of valuable information from ‘insiders’ in the corridors of power to the holding companies. This was one of the causes why the holding companies could direct the political course of the government. It was thus state patronized graft that enabled the new capitalist class to become part of the top echelons of the Russian elite.

**B. Oligarchs and the Media:**

During the Soviet period, the party closely monitored and directly controlled newspapers, radio and television, books, journals, plays, and other means of expression. The publishing industry was completely state owned and state controlled. The largest national newspaper, *Pravda*, was an organ of the CPSU Central Committee, and the other important newspaper, *Izvestia*, was a government organ. The party assigned editors to various magazines and newspapers, and employed a large network of censors who engage in screening everything that was fed to the people.

When General Secretary of USSR, Mikhail Gorbachev came to power in 1985, tremendous changes took place in almost all the fields, most importantly in that of media. After the passage of the landmark Soviet press law in June 1990, the policy of Glasnost (meaning openness) gave the media was freed from censorship. Along with this the production and the distribution costs in the media sector remained artificially low. This ‘golden age’ was cut short as financial troubles immediately threatened the existence of most media outlets in the early 1990s and the later developments eroded the editorial freedom gained at the start of the decade (Belin, 2002: 139).

Laura Belin (2002: 139) gives two main reasons that constrained the independence of Russian media. First, the economic realities forced most print and broadcast media to seek outside financial support from the corporations, wealthy individuals, and political patrons. Second, the reassertion of state power over the media sector in the late 1990s constrained news reporting.
even in the privately owned media. Therefore, Belin says the economic troubles laid the ground for the corporatization of the Russian media sector. The media outlets which most of the oligarchs came to own indeed played a very significant role in the outcome of Yeltsin’s second presidential campaign.

During Yeltsin’s 1996 election campaign a fusion took place between the information-propaganda apparatus and the state. A typical instance was the appointing of Igor Malashenko, the head of the ‘independent’ television channel NTV, to the job of establishing the president’s ‘image.’ It was the NTV which had been harshest in criticizing the Kremlin in 1994 and 1995, especially the Chechnya war. In 1996 the same television company became the principal mouthpiece for the Kremlin’s propaganda. Everything was decided by the television, the press and the spectacles of every imaginable kind, organized by the authorities.

The oligarchs by 1995 had secured wealth and had assets in the field of energy resources, finance and media. What was the need for the oligarchs to own media? The main aim was power and a means to stifle negative opinion against their largesse. This was the best means through which it could praise those who were for them or denounce those who were against. Eventually it proved to a good weapon to enable Yeltsin win the 1996 presidential elections. The transfer of mass media to the oligarchs (Table 3.2) had created the conditions for restoring political censorship while leaving formal democratic liberties completely untouched. MediaMOST, United Bank, Menatep, ONEKSIMbank, Imperial Bank and SBS-Agro tried to own the central publications. Most of the newspapers ended in the hands of the banking capital. ONEKSIMbank easily got the shares of Komsomolskaya Pravda from Gazprom (Razuvayev, 1997). Nezavisimaya Gazeta was taken over by agents of private security firm hired by Boris Berezovsky on 12 September 1995. Though the editorship of the paper was given to its founder, it was funded by Berezovsky (Kagarlitsky, 2002: 121).

Berezovsky’s influence emerged starkly with every political crisis that affected the magnate’s interests. When Primakov’s government came to power in 1998, Berezovsky launched a real war against it, and Nezavisimaya Gazeta could not stand to one side. The same occurred in the autumn of 1999, when the newspaper had to defend Berezovsky from the charges that he was linked with the terrorists. So during the second Chechen war the newspaper became a
mouthpiece of Russian general staff. Well known publications were seized by ‘politicianized
capital’ (Kagarlitsky, 2002: 122). Journalists described Berezovsky’s group as a ‘shadow holding
company’, since the Moscow billionaire chose to pretend that he exerted no influence on the
press, nevertheless it was Berezovsky who held the decisive position in the television industry,
controlling the huge television company ORT, as well as his numerous newspapers
(Kagarlitsky, 2002: 123; and Kotz and Weir, 2007). Powerful media holding companies came
into existence. Some, like Vladimir Gusinsky’s Media-MOST group, were formed openly; others, like Vladimir Potanin’s ONEKSI-M-Bank or the group controlled by Berezovsky.

From what is dealt above one must note that the oligarchs did not emerge completely from the
political elite especially under Yeltsin. Those who formerly belonged to the elite (political and
economic, as it was not differentiated) under the Soviet government were differentiated post
1992 due to the economic and political reforms. It was the financial crunch of the early 1990s
that Russian government faced gave them the opportunity to come into close contacts with the
government. They offered loans to the state and in turn received the shares of the large and
lucrative state enterprises as collateral. Moreover the financial backing and the media aid given
to Yeltsin led to their close proximity to political and economic power. Razuvayev, (1997: 6)
two important factors for the FIGS controlling print media: one, they want to invest their cash in
politics with an objective to wield political and economic influence and second, their preparation
for the 1996 elections proved to be compatible with such ownership. Hence this duality (both
political and economic power) led them to be called as the ‘ruling elite’ or ‘ruling class’ of
Russia. They became a part of the ruling elite as long as Yeltsin, their patron, remained in
power.

3.6 Oligarchs, a Case for ‘Ruling Class’:
The debate as to whether the oligarchs or the Russian capitalists are a ruling class or a part of the
political elite becomes imperative to the study. The capitalist as a class, in general, do not rule
due to the changes in the dynamics of capitalism. They go in search of markets, places for low
cost of production, and expansion of sales beyond the nation-state. This has led to the emergence
of MNCs and TNCs. Therefore, the oligarchic class in Russia was close to the political leaders
only to sustain their wealth, protect their privileges, and stop the state from reverting to command economy or adopting a socialist democracy.

The capitalist class being the owners of means of production and captains of finance are usually assumed as part of the ruling class due to the power they wield. However, this presumption cannot be justified as a phenomenon that keeps recurring. It is possible that societies at times have experienced the power of the capitalist class in their daily lives due to the decisions of the state favoring the capitalists. However, examples where, solely the capitalists have been at the helm of politics are rare. Instances of securing state patronage, favors or being successful at lobbying with the governments are quite natural. However, their role within the state cannot be denied because they are the owners of large concerns and have at their disposal abundant capital.

Classical writers like Gaetano Mosca, Vilfredo Pareto, Ludwig Gumplowicz, Robert Michels etc believed in ruling class, which was ever present in every society; there is a ‘circulation of elites’- an eternal cycle of rise, rule, degeneration, and fall of elites (Therborn, 1978: 134). Overthrowing any political class through revolution therefore leads to the birth of a new class that fulfills the same functions. This theory of ‘circulation of elites’ was developed by Gaetano Mosca, which was used by Vilfredo Pareto. Gaetano Mosca (1939: 329) said that ‘all human societies which have arrived at a certain grade of development and civilization, political control in the broadest sense of the term (administrative, military, religious, economic and moral leadership) is exercised by a special class, or by an organized minority’.

Robert Michels (1966), a German Sociologist in 1911, contributed to this theory of elites in his understanding of political parties through his famous thesis “iron law of oligarchy”. He asserted that every organization be it a democratic or Socialist party has the tendencies of oligarchy in his famous “iron law of oligarchy”. He says the ‘government’ or ‘the state, cannot be anything other than the organization of a minority’ (Michels, 1966: 353). He used the “iron law” as a metaphor to dramatize certain conspicuous tendencies of men in organizations under specific socio-historical circumstances (Zeitlin, 1987: 217). Michels (1966: 371) explained that, there will always be a ruling class even within a democracy, ‘When democracies have gained a certain stage of development, they undergo a gradual transformation, adopting the aristocratic spirit, and in many cases also the aristocratic forms....they end by fusing with the old dominant class;
whereupon once more they are in their turn attacked by fresh opponents who appeal to the name of democracy. However, Michels dealt with the political parties and the oligarchic tendencies within democracy. Though Russia today is a liberal democracy, the conditions under which the oligarchs emerged were altogether different. There was no organized party other than the communists. The oligarchs came together and joined the bandwagon of the presidency, especially in 1996, to thwart the efforts of the communists making a comeback on the national stage. In short, they supported parties whose ideology was anything but communist.

C. Wright Mills (1956 and 1972b), through his examination of the American elites, calls the ruling elite as the “power elite”. Here he includes the corporate rich within the fold of the power elite as their decisions have national consequences. According to him, the power elite is a triumvirate of political, economic, and military top echelons. However, he clarifies that this definition does not imply that the members of this elite stratum are always and necessarily the history-makers; neither does it imply that they never are. However, Mills (1972b: 289) cautions about the ruling class or the rule by minority theory that, ‘it is not his thesis that for all epochs of human history and in all nations, a creative minority, a ruling class, an omnipotent elite, shape all historical events. He declares such statements as mere tautologies, and not sufficient to understand the history of the present’.

The class that gets to rule is called as ‘elite’ either (Pareto) or political class’ (Mosca) or ‘oligarchy’ (Michels) etc. However, it depends on the structure of the state and the form of the government to define the ruling class of every country. No single model is an answer to define a ruling class and hence it is more country specific. By ‘ruling class’ we understand a minority within the broad political elite. They wield power and influence decisions related to governance. They can be those who possess economic or financial power, religious authorities, nobility (as in traditional states ruled by dynasties like the Middle Eastern states) etc. The reason for influencing decisions of major consequence by the ruling class is to ensure their status quo, to protect their positions and privileges and to exclude the new entrants into positions that can affect their stay. The function of the political class being the governance of the state, they cannot be termed as ruling class unless their rule and political decisions are aimed for personal interests.
Various authors, both political and sociological, have used the terms 'ruling class', 'political class' 'political elite', 'elite', etc. synonymously. Raymond Aron (1953: 204-205) tries to clear the meaning of the terms 'elite', 'political class' and 'ruling class'. To him 'elite' in the broadest sense are all those who in diverse activities are high in the hierarchy, who occupy any important privileged positions, whether in terms of wealth or of prestige. 'Political class', he says, should be reserved for the much more narrow minority who actually exercise the political functions of government. He places 'ruling class' between 'elite' and 'political class'. It includes those privileged people who, without exercising actual political functions, influence those who govern and those who obey, either because of the moral authority which they hold, or because of the economic or financial power they possess. The meaning attributed to ruling class or ruling elite by Aron is appropriate and adaptable to the Russian condition.

By 'political elite', we here refer to those influencing policies and who make decisions. The broad definition given by Higley et al is ideal to understand the political elite within the political system. Higley et al (2003: 12), broadly define political elites include several persons and 'not only the familiar "power elite" triumvirate of top business, government and military leaders, but also top position holders in parties, professional associations, trade unions, media, interest groups, religious, and other powerful and hierarchically structured organizations and sociopolitical movements.' However, the term only 'elite' refers to those persons who are at helm of political, administrative, spiritual, temporal, civil, military and economic power.

Kryshtanovskaya (1995: 6) defines, political elite within the Russian Federation by using a positional approach, as persons who 'occupy positions involving the making of the decisions bearing on the state as a whole-specifically, deputies of the Federal Assembly of the Russian Federation, the government of the Russian Federation, the president of the Russian Federation and his immediate entourage, and others'. For Kryshtanovskaya the ruling class is part of the elite, it is not only the political elite that is part of the ruling class but also the business elite. She defines the 'business elite is that component of the ruling elite whose influence on state policy is determined by its position in the most important branches of the nation’s economy and by the size of the capital it controls' (Kryshtanovskaya, 1995: 6).
There is general consensus that the ruling class is a part of the elite. Second, this ruling class influences the decisions of national importance. Decisions related to the economy and finance finds the influence by the members of the capitalist class. However to gauge the extent to which the capitalist class becomes a part of the ruling class depends on the each country’s experience. This is solely because of the political environment. The participation of the capitalist class within the ruling class depends on factors like the receptivity by the political leadership, strength of political institutions like pressure groups and lobbies, involvement within political parties, etc. If the elite are differentiated within a state, then the threat of the concentration of power is limited. Therefore, it depends on whether the business elite (here I refer to only the capitalist class who are the private owners of production and the owners of financial capital) is differentiated from the other elite groups or concentrated so much so that it is difficult to differentiate the political from the business elite. 

Higley et al (2003: 15) examine the political elites through the variables of ‘integration’ and ‘differentiation’. They examine the political elites of the Soviet Russia and the Russia of post 1991 through their typology (Table 3.3) on ‘political elites and the regime types they create’. The political elite under Soviet Russia, especially up to the period of Gorbachev reforms, were largely ideocratic and the regime was stable, unrepresentative. The elite after 1991 were fragmented: weakly integrated but widely differentiated, with an unstable and loosely representative regime.

Table 3.3: Types of Political Elites and the Regime Types They Create.

<table>
<thead>
<tr>
<th>Elite integration</th>
<th>Weak</th>
</tr>
</thead>
<tbody>
<tr>
<td>Strong</td>
<td></td>
</tr>
<tr>
<td>Wide</td>
<td></td>
</tr>
<tr>
<td>Consensual elite</td>
<td>Fragmented elite</td>
</tr>
<tr>
<td>Stable representative regime</td>
<td>Unstable representative regime</td>
</tr>
<tr>
<td>Narrow</td>
<td></td>
</tr>
<tr>
<td>Ideocratic elite</td>
<td>Divided elite</td>
</tr>
<tr>
<td>Stable unrepresentative regime</td>
<td>Unstable unrepresentative regime</td>
</tr>
</tbody>
</table>

Source: Higley et al (2003: 15)

When the oligarchs in Russia were termed as part of the ruling class, one must question whether the financial oligarchy meets the general requirements of being a ruling class. What was the
extent of their power, especially political power? In a capitalist country like US, the capitalists enjoyed economic power to a considerable extent. However, the same cannot be said for wielding political power. Therefore having economic power to a considerable extent for the business class is acceptable and inevitable. However, enjoying both economic and political power can be precarious for the proper functioning of the state.

One of the differences between the business classes of US and Russia was that the capitalists of US rose on their own. Though they had their men within the political class and some of them even later participated in the political structures, they did not emerge from the political class to start their business ventures. Whereas, in Russia most of the capitalists emerged within the political structures and sub-political structures—i.e., the nomenklatura and komsomol respectively. That in USSR the political and economic power was concentrated in one body (nomenklatura). Since most of the members of the nomenklatura and the komsomol continued within the economic structures even after Russia’s independence and the privatization period, this could explain why the lines between the economic and political class got blurred. The classical elite theorists—Michels, Pareto, and Mosca, argued that when the ruling class loses its legitimacy, and place in the society, are replaced by the other.

The oligarchy idea proved to be correct till the term of President Yeltsin and the ‘nomenklatura privatization’ till the 1995 privatization. The nomenklatura converted its power for property. They utilized many methods to convert this property (Chapter 1). Other phrase that explains the link between capitalists and the state was coined by Joel Hellman called “state capture.” 42 Kryshtanovskaya (1995: 23-4), through her research 43 as given in Table 3.4, shows that in the post-perestroika half of all party leaders, 59 percent of new businessmen, one-third of deputies, 42 Cited by Åslund (2007: 257) from Joel Hellman (1998), “Winners Take All: The Politics of Partial Reform in Post-Communist Transitions”, World Politics, Vol. 50 (2): pp. 203-34. Hellman used this, says Åslund (2007: 257) ‘to characterize the relationship between big businesspeople and the state in a country such as Ukraine, because these businesspeople influenced the state by multiple means’. 43 The analysis is based, as claimed, is based on series of investigations conducted by the Sector on Elite Studies of the Institute of Sociology of the Russian Academy of Science. The methods employed were informal in-depth interviews and formal interviews with elite members, surveys of expert opinion. Observation, study of official biographies, press analysis, study of official documents and statistics. The core study was based on an examination of official biographical directories, together with a series of interviews conducted in association with the University of Glasgow. The biographies of elite examined were the elite under the Brezhnev, Gorbachev and Yeltsin elite.
and one-fourth of the presidential team and members of the government were not part of the nomenklatura. And the regional and presidential sub-elites drew on functionaries of the Soviet apparatus and deputies, the business elite were drawn mainly from the Komsomol (Table 3.5).

Table 3.4: Persons Not Previously Part of the Nomenklatura

| Persons Not Previously Part of the Nomenklatura (as % of group size by column) |
|---------------------------------|---------|--------|--------|--------|--------|--------|--------|
|                                 | Top Leadership | Party elite | Parliamentary elite | Government | Regional elite | Business elite | Total |
| Brezhnev cohort                 | 0.0      | 6.0    | 51.3   | 0.0     | 0.0    | N/A    | 11.4  |
| Gorbachev cohort                | 8.5      | 28.8   | 40.6   | No data | 0.0    | N/A    | 19.5  |
| Yeltsin cohort                  | 25.0     | 42.8   | 39.8   | 25.7    | 17.7   | 59.0   | 35.0  |

Table 3.5 Recruitment of Yeltsin Cohort from Branch Sub-elites of the Old Nomenklatura

| Recruitment of Yeltsin Cohort from Branch Sub-elites of the Old Nomenklatura (%) |
|---------------------------------|---------|--------|--------|--------|--------|--------|
|                                 | Top Leadership/President’s inner circle | Party elite/leaders | Regional elite | Government | Business elite | Total |
| Total from Soviet nomenklatura  | 75.0    | 57.1   | 82.3   | 74.3    | 61.0   | 69.9   |
| including from: Party from Komsomol | 21.2    | 65.0   | 17.8   | 0.0     | 13.1   | 23.4   |
| from soviet                    | 63.6    | 25.0   | 78.6   | 26.9    | 3.3    | 39.5   |
| from economic management       | 9.1     | 5.0    | 0.0    | 42.3    | 37.7   | 18.8   |
| from elsewhere                 | 6.1     | 10.0   | 0.0    | 30.8    | 8.2    | 11.0   |

Source: Table 3.4 and 3.5 are sourced from Kryshtanovskaya (1995: 24) and (1995:25, 1996: 2) respectively.
There is a difference between the political elite and the economic elite. More over in the Russian context there is huge difference between the economic elite and the business elite. The oligarchs are a part of the business elite. There might be an overlap with the use of the term ‘economic elite’ because of the joining of former directors of state enterprise to the ranks of the business elite. Secondly, the role of the oligarchs began to converge with that of the ‘political elite’ because of the role played by the oligarchs in the “loans for shares” scheme in 1995, the presidential elections in 1996, and thereafter, consequently, the appointments to top political posts and the governor posts in the administrative units.

The oligarchs did not emerge from the political elite. There was no business elite initially, only the economic elite. The business elite and especially the oligarchs emerged and got strengthened during the third stage of privatization and from then on, they over took the economic elite in many instances. It was the financial crunch of the early 1990s that Russian government faced gave them the opportunity to come into close contacts with the government. They offered loans to the state and in turn received the shares of the large and lucrative state enterprises as collateral. Moreover, the financial backing and the media aid given to Yeltsin led to their close proximity to political and economic power. Hence, this duality (both political and economic power) led them to be called as the ‘ruling elite’ of Russia. They became a part of the ruling elite as long as Yeltsin, their patron, remained in power. Their actions and the support given by the state can be captured through Therborn’s theory.

Göran Therborn tries to examine the character of the relationship between (i) social classes, defined by their position with the economy; and (ii) the exercise of political power through the state. Thus, he explains the character of the ruling class as an organization that ‘reproduces the economic, political and ideological relations of its domination’ (Therborn, 1978: 161). That is, the rule is exercised through state power, through the interventions or the policies of the state and their effects upon the positions of the ruling class within the relations of production, the state apparatus and the ideological system. Therefore, the class character of state power is, thus defined by the effects of state measures on class positions in these three spheres. The possibilities
and viability of the rule of a class are, determined by the tendencies and contradictions of the modes of production within which and relation to which it is exercised.

Therborn (1978: 180-82, 219-20 and 242-43) further explains that the ruling class problematic, as it is exhibited in the class struggle, is primarily characterized not by the need to secure legitimization of its rule, but by the attempt to ensure 'representation' in the special apparatus of the state together with the state 'mediation' of its rule over other classes. Therefore, if the business class wants its interests to be protected and maintained, then it requires the help of the state.

Graeme Gill (1998: 147) says that in any event, the economic elite did not throw its support decisively behind either side in the elite political conflict, and there is no evidence that that elite played a part in the structuring the course of the conflict, expect in so far as it was instrumental in bringing about the changes in the composition of Yeltsin’s government. But the business elite and the oligarchs specially threw their weight behind Yeltsin for the 1996 presidential election so as not to lose their newly gained economic freedom to be swept away by the communist gale. When the conflict of power was taking place between the executive and the Russian legislature, the business elite was just strengthening its hold over the banking capital. Secondly, the crisis did not imply the fragility of market economy because Yeltsin was still in power. Thirdly, Yeltsin sought the mandate of the masses for his leadership and the continuation of the political reforms through a national referendum conducted in April 1993.

Yeltsin legitimized himself by the April 1993 referendum against the parliament. Moreover once he increased his powers through the new Constitution approved in December 1993, the position of the ruling elite was consolidated. However new members came into the circle of new elites in which the parliament was alienated. The 1995 privatization and the 1996 presidential election campaigning brought the business elite, specifically the oligarchs, into the ambit of the ruling elite. Moreover once the position of the president’s entourage and the oligarchs was firmly embedded, the government ‘represented’ the interests of the oligarchs and ‘mediated’ on their behalf in the course of Yeltsin’s rule.
Western countries rely on interest groups and business organizations to ensure representation to influence government policies and mediation with the state. Within Russia, as capitalism began to develop, the formation of interest groups and business organizations were in their fledgling stage. Hence, the business elite, threatened by a reversal to the Soviet economic system, formed alliance with the executive leadership. This they did by aiding Yeltsin in winning the presidential elections of 1996. From then on, they infiltrated the power structures of the Russian state. The commonality that the elite, both political and business elite, during Yeltsin’s rule had was in their efforts to weed out the communist elements within Russia and to maintain status quo of their newly gained positions and wealth by professing neo-liberal precepts. Therefore, the hypothesis holds true that the Russian capitalists utilized their financial resources to become a part of the ruling elite during the second term of President Yeltsin. However, the same cannot be said for the post-Yeltsin period. Yeltsin was able to overcome his upheavals by 1996 by strengthening the constitutional position of the chief executive and through the backing of the business oligarchs. However, both did not enjoy solid mass support (Higley et al. 2003). They were blamed for corruption, financial crises, unfair business practices, etc. Moreover, if Yeltsin had consistent popular support, then the possibility of leaning towards the capitalists would have been bleak.

3.7 Realities of Economic Reform and the Concept of ‘Capitalist Class’ within Russia:
One of the recent events to have contributed to the changes of social structure is the collapse of socialist states, with the disintegration of the Soviet Union. The population of these countries had to carve a role for themselves within their respective societies. Though the classes within which they moved have been non-existing prior to the transition it is the manner in which the movement happened is to be noted. One, the changes within the social structure was neither gradual nor natural. Secondly, it was hastily brought in ‘from above’. The disintegration of the Soviet Union was induced ‘from above’ (Hahn, 2002; Kotz and Weir: 2007), which meant an abandonment of the socialist ideology. Likewise, it was ‘from above’ the neo-liberal ideology with a market driven economy that was adopted. This created new classes (hitherto existing in Western countries) i.e., those classes that were absent-separate political elite, business class,
small and medium entrepreneurs, economic groups, professionals (either working in government or private institutions or functioning independently) etc

During the Soviet times, there was no distinction between the political and the economic elite, though definitely a business class was absent due to the command economic structure. Hence, when transition towards market oriented economic system took place, transformation occurred even within the class structure. The new classes were those that owned property, land, means of production, financial elite, specialists (like doctors, lawyers, teachers, scientists, technicians etc), small and medium businessmen, capitalists etc. Broadly speaking, the strata which finds place in the list of “new” elite in Russia are: the apparatus of the president and the government, the state administration; public foundations, trade unions, leaders of current political parties, deputies of the Supreme soviet of the Russian Federation; the state economy (directors of the largest state enterprises); the business elite (proprietors and mangers of the large enterprises, established as private businesses); the mass media, culture, science, education academicians of the Russian Academy of Sciences, editors in chief and members of editorial boards of national newspapers, directors of the largest research institutes) (Golovachev et al, 1996: 41).

There is no single model of capitalism considering the variants that have grown and developed over centuries in various countries having market economy. The case of Russia strikes both unique, and intriguing. Unique, because the vestiges of capitalism were wiped, if not in post 1917, then during the Stalin regime. The capitalist class sprung only from a nascent liberal democratic state post-1991 with the absence of the capitalist institutions, when most of the market oriented economic systems were on the advanced stages of capitalism. Here a previous model of capitalism did not exist. The economic conditions under the Czarist regime too were not fertile for capitalism to take off. The economic structure within the Soviet system functioned on the principle of the command economy. The state commanded the economy through planning and resource allocation. Though the members of the nomenklatura had the authority over the political and economic structures of the Soviet system, could not own any property, capital and resources. Moreover their positions were not hereditary. It should be noted that the incomes
within USSR were all earned and not derived from property or unearned and therefore there was an absence of the leisure class.

Even though the 1970s gave rise to shadow economy, which has been described as the initial stage of capitalism, it does not account for capitalism. The very factor of capitalism that is, ownership was missing during the communist regime. Even though Gorbachev’s economic reforms, unlike his predecessors, were put in practice, the ownership of property and land was not one amongst them. Gorbachev (1990) made it very clear in his speeches and actions that he was against private ownership of property and land. He introduced the elements of market forces they were very much within the confines of socialism. To him privatization was when, through shareholding and leasing, and later, maybe, outright purchase (by employees), an enterprise is made the people’s. This property must be given to people, to let them manage it and have control over what they have produce. This is a form of privatization. Gorbachev outlined that the state’s task is to combine the socialist approach with private interest through modernizing property relations. That is to have a mixed economy: state ownership, joint-stock ownership, cooperative ownership etc. That is, the very factor of capitalism i.e., ownership was missing during the communist regime.

Therefore, capitalism as a system appears full-fledged with independence of Russia and the beginning of economic reforms under Gaidar-Yeltsin especially through shock therapy. ‘Capital in Russia’ says Kukolev (1997: 23) ‘was not personified, so that society entered the post-industrial period without the West’s traditional forms of private property relations’. The new market-oriented economic system gets firmly established through the economic reforms carried under the Yeltsin-Gaidar government, famously called the ‘Shock Therapy’. However, one cannot deny the role that the Gorbachevian reforms played in setting the scene.

The ‘capitalist class’ in the independent Russia appears to be interesting for several reasons. The methods of accumulation may be one, the very economic antecedents’ maybe another. The most

44 In a speech made by M S Gorbachev at a meeting with cultural leaders in the Kremlin on Nov. 28, 1990, he aired his personal views on the economic reforms undertaken as a part of restructuring.
interesting fact is that the capitalist class was formed from a preliminary stage when most of the countries were on the advanced stages of capitalism. The methods, manipulations and machinations employed by some by some individuals-those who finally made it to the top of the business elite- to accumulate capital are very unlike the other capitalist countries. Moreover within a decade some of the capitalists became the wealthiest not only within Russia, but also in the world. The rapidity with which few persons became business tycoons by 1997 leads further to the interest of the study. Six business tycoons of Russia entered the Forbes (1997) list of richest people in the world (Table 3.6).

Table 3.6: World Ranking of Russian Business Tycoons.

<table>
<thead>
<tr>
<th>World Ranking</th>
<th>Business Tycoon</th>
<th>Worth ($millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>102</td>
<td>Boris Berezovsky</td>
<td>3,000</td>
</tr>
<tr>
<td>141</td>
<td>Mikhail Khodorkovsky</td>
<td>2,400</td>
</tr>
<tr>
<td>200</td>
<td>Vagit Alekperov</td>
<td>1,400</td>
</tr>
<tr>
<td>223</td>
<td>Rem Vyakhirev</td>
<td>1,100</td>
</tr>
<tr>
<td>230</td>
<td>Vladimir Potanin</td>
<td>700</td>
</tr>
<tr>
<td>242</td>
<td>Vladimir Gusinsky</td>
<td>400</td>
</tr>
</tbody>
</table>

Source: Forbes (1997)

The three main inferences that can be drawn so far from the above study in this chapter in relation to the emergence of the capitalist class are, one the restructuring reforms introduced during the Gorbachev era enabled some of these capitalists to make their initial seed capital got through cooperatives, joint enterprises etc. Secondly, during the Presidentship of Yeltsin the 'Shock Therapy' that introduced liberalization, privatization, and the freeing of prices involved lot of discrepancies and loopholes that enabled the capitalists to siphon the wealth and resources of the state. Third and most importantly, the political connection that is blat ensured them to acquire stock share and ownership stakes. No individual owned property, which means that everything had to be bought and acquired. In order to get ownership through easy and cheaper means were the political connections or having the right connections in the corridors of power. Kryshtanovskaya and White (1998: 99 and 1996: 4) that the Russian economy by 1996 had accordingly the following features: It consisted of a number of major industrial and financial
groups; it was coordinated by a class of ‘agents’, or major property owners, to whom the state had entrusted the development of the market; it functioned in the absence of equal opportunities for all to ‘make money’.

The systemic change was introduced in the absence or weak institutions and lack of infrastructure. Before privatization was implemented, the Russian government failed to come up with effective tax system, institutional infrastructure like corporate governance, securities regulation etc. Goldman (2004: 134) says, ‘Russia’s corporate practices are marked by a lack of transparency, a misuse of transfer payments, tax evasion, and an abuse of the bankruptcy system to seize assets from otherwise legitimate companies. No wonder foreign investors are hesitant to invest in Russia.’ To ensure the smooth functioning of the market economy, the prior presence of institutions like legal and regulatory institutions is important. Institutions are important to enforce contracts, to resolve commercial disputes, to have proper bankruptcy procedures, strong banking regulations, to ensure that banks do not default on their depositors, to have securities regulation to protect shareholders rights-especially that of the minorities etc. Russia imposed the market, with the help of its IMF advisors, without ensuring first that its economy be supported by institutions and institutional infrastructure (Stiglitz, 2002).

Russia had inherited economic chaos from the Soviet Union: real GDP fell approximately 12%; and the budget deficit reached 26% of GDP. Foreign trade contracted even more steeply: in volume terms, Russian exports declined by 29%, while imports by 46% in 1991, compared to 1990. Consumer price inflation increased from 4% in October 1991 to 9% in the next month and 12% in December. In 1991, the price index for consumer’s goods and services was 89% higher than the year before. In the same 12 months real wages fell by 12%. Goods were missing from the shelves and queues outside the shops kept growing.

Russia has inherited the military-industrial complex of the Soviet Union. It also acquired sizable number of “mono-industrial” regional economies (regions dominated by a single industrial employer) from the Soviet Union. Since Russian industrial firms were traditionally responsible for a broad range of social welfare functions—building and maintaining housing for their
workforces, and managing health, recreational, educational, and similar facilities—the towns possessing few industrial employers were left heavily dependent on these firms, which were the mainstay of employment, for the provision of basic social services.

Thus, economic transformation created severe problems in maintaining social welfare, since local governments were unable to assume financial responsibility for these functions. The immediate consequences of the transfer of property from the state to enterprise insiders detailed in a long list of well known abuses, such as asset stripping, stock watering, literally hostile takeovers and the like, all of which had devastating effects on the country’s industrial base (Hedlund, 2001: 234).

What the Yeltsin government failed to see was the economic realities. The energy sector on which Russia depends was given away for pittance to the oligarchs who have no intention of taking part in the development of Russia; rather they transferred their capital to safe havens. Russia could have withheld large scale privatization till it reached a period when private investors could have generated the required capital to buy stocks and create holding companies through transparent means. When Vladimir Polivanov, the newly appointed head of the State Property Committee, took the risk in 1995 of publicizing data that showed the economic inefficiency of privatization, he was immediately removed from his post (Kagarlitsky, 2002: 193).

The most common qualities that one can generalize amongst the oligarchs are that they possess mostly oil companies, ore fields, media, banks, automobile factories etc. Secondly, they amassed wealth from a weak State; their creation of wealth was not through proper channels. They used power to gain more wealth. They have no intention to build the economy of Russian state, but search for ways to strip the State of its wealth. Mostly, the study of oligarchs revolves around Yeltsin who gave certain amount of leverage to the oligarchs. The capitalists under Yeltsin’s rule were a ‘rent-seeking’ class and not a productive one.
3.8 Conclusion:

When we consider the lack of institutions and infrastructure juxtaposed with the implementation of radical economic reforms, one cannot blame a few oligarchs for making the most, which was the case in Russia and also Ukraine and Kazakhstan (Åslund, 2007: Chapter 10). Other countries to feature oligarchs are Armenia, Azerbaijan, Moldova, Georgia etc.

In place of the 'new Russians', there were now oligarchs. The countries basic assets had been divided up and large financial-industrial groups had been established, with almost all the major financial channels and the most profitable areas of production under their control. The influence exerted by these oligarchs was ensured not only by their vast financial resources, but also by their closeness to the authorities. Even so the regime in turn depended on the oligarchs who lobbied for its interests, paid for the political and propaganda campaigns of the official politicians, and often simply supported 'necessary' state functionaries.

The emergence and consolidation of these classes and relationships (for example, oligarchic and patron-client relationships respectively) is so because of the weak political institutions and ineffective economic policies (the collision and collusion between the capitalist is dealt separately in Chapter 5). Moreover when the power is devolved or decentralized in every sphere i.e., when a culture of decentralization of power is absent there is bound to be the presence of undue influence of powerful individuals in politics and economy whose legitimization does not accrue from the people. Systemic change over a relatively short period of time does not ensure smooth transition. In due course of time steps taken to ensure strong political institutions and a firm elite structure can lead to the success of this kind of transition. A step-by-step process or piece meal reforms can at least guarantee that it would not have crises and problems at every corner. In the Russian case, the economic reforms were done hastily for which it triggered numerous systemic problems and negative elements within the state out of which one was the problem of the speculators and also a group of capitalists who were popularly called the oligarchs who eventual came close to controlling the political events and decisions at the helm.
The Russian capitalists put their financial resources to good use during the 1996 presidential elections. This was because they did not want a reversal to the Soviet times. Secondly they wanted a leader at the helm who staunchly supported market economy and who did everything in his power to wipe out the remnants of socialism. Thirdly, they wanted security for their ill-gotten wealth. The capital they had made through banking and trading was used to bankroll Yeltsin's presidential campaign. In this way one can say that the Russian capitalists utilized their financial resources to become a part of the ruling elite during the second term of President Yeltsin. This is so because of the political positions and the economic benefits that they received as part of their reward for aiding in the election victory. Hence, they were called oligarchs. The power of the oligarchs was to be undermined by the 1998 financial crash and by Putin's victory as the second president of Russia. The next chapter examines these aspects along with Yeltsin's resignation.