

Up for Debate: Privatization: Who Wins? Russia's Reform Compromise Yegor Gaidar

Naive capitalism

INTERVIEWER: [Reform adviser and entrepreneur] Boris Jordan, says that a lot of your team were naive, that you didn't really have a plan at the time. How do you feel about that?

GAIDAR: You know, without any doubt, we were naive, first of all because the whole country for seventy-five years didn't have the experience of working in market conditions. And there wasn't anywhere to import [this experience] from. The whole of society was endlessly naive about everything that concerned the market. Now the level of understanding of the realities of the market in [the Russian] society is qualitatively different from the 1990s. And in this connection, what Boris says, of course, is true. We, of course, were rather naive concerning the many problems and realities of the market economy: in the underestimation of the many risks connected with loans-for-shares, and in many other areas as well.

GAIDAR: The loans-for-shares deals took place at a time when I hadn't worked in the government for a long time. There were people with more authority, who were responsible for that question. That would be Yeltsin, Chernomyrdin, Anatoly Chubais. But I discussed that subject, at least with Chubais, many times, and I had my own understanding of the situation. In my opinion, the major motive at that moment was a political one, connected with providing stability and not allowing the return of communists to power. In 1995, a large portion of the property in Russia belonged to the so-called Red Directors, people who sympathized with the Communist party, who stole money from their enterprises, which they directed badly. And the point was that they were not attracted to the new regime. And if I understand correctly, the loans-for-shares deals were first and foremost directed at creating a critical mass of influential and powerful political forces that would have been vitally interested in not allowing the return of the communist regime. For these deals, we paid endlessly a great deal during the second term of Yeltsin's presidency. Masses of things that we dreamed about, that we could have done in the second term of Yeltsin's presidency, were not done because there was this compromise. A great many characteristically unpleasant features of Russian capitalism today were brought about as a result of that series of compromises. Nonetheless, when, in the intervening years, I asked myself the question: would it have been better to take the risk of the communists coming to power and see what would have happened, knowing what the Communist party was and knowing what Russia was like and knowing how dangerous the situation was for ourselves and for the rest of the world-well, I cannot convince myself that this would have been better.

INTERVIEWER: A necessary evil?

GAIDAR: I think so. In any case, I wouldn't have attempted, relying on all the subsequent experience, to say: Well, friends, let's not undertake it, even if the price for it would be still another communist experiment in Russia. The past was too expensive in experience for all of us.

INTERVIEWER: What kind of capitalism will we eventually see in Russia. Will it be different from the capitalism that is practiced in the US and Western Europe?

GAIDAR: Socialism leaves a long birthmark. In a normally functioning market economy, in the first place, you need a system of tradition, which is formed over the passage of generations and centuries. And you can't import such a system of traditions. It can only grow gradually. And without this system of traditions, capitalism is very wild and very ugly. This is an objective problem, it isn't a question of choice. In Russia socialism was much more implanted than in Eastern Europe. It had larger roots, and they went much deeper. There was a very weak respect for property, a very weak respect for carrying out contracts, inefficient bureaucracy, and many, many other things. [These] may change, but only with time and with sensible policies. So in this connection, strictly speaking, for the present, Russia is not going to be a country of orderly and calm capitalism backed by a mountain of traditions. Russia will be a country of young capitalism.

Up for Debate: Privatization: Who Wins? Russia's Reform Compromise Grigory Yavlinsky

Criminal capitalism?

YAVLINSKY: Loans-for-shares privatization was a way of creating criminal capitalism in Russia. We learned a very important lesson [in the process], by the way. Karl Polanyi, as you know, wrote a book *Open Society and Its Enemies*, and he described two main enemies of the open society—fascism and communism. In the last 10 years Russia has found out that open society has one more enemy. That enemy is capitalism that is not limited by laws, by civil institutions, by tradition, by belief, by trade unions, by anything—simply the wild will for profit at any price. That was the key idea of privatization here, that was the key of all changes here.

INTERVIEWER: Yegor Gaidar believes that loans-for-shares privatization was a necessary evil that helped save the country from the surging communist party.

YAVLINSKY: It's not true, because it's very likely that [those behind the scheme] were paying the communists to [reinforce this point of view]. It would have been much better not to pay the communists and to take a different approach. The mob of communists in the country was growing together with the poverty. Communism is a social disease coming from poverty. You can have a lot of disease from poverty. For example, if you have no soap you have a lot of disease. Communism is something

like that. If you have a poor society and poverty in the country, you have communists. The reform as these guys were doing it was creating more and more poverty. And the poverty was producing more and more communists. So it was absolutely possible to use a different approach and not to distribute the property between 10 personal friends. There was no need for that. The task was to give the property to millions of people. The [privatizers] were not doing anything for small and middle businesses, and that was one of the key issues. They were all the party of big business. But the big business in Russia was [corrupt] business.

INTERVIEWER: [Businessman Vladimir] Potanin described great battles he had with the Soviet director who ran Norilsk Nickel. And he presents himself as somebody who brought efficiency and reform in the face of disaster that had been brought on by Red Directors.

YAVLINSKY: This is a different story. The business people who were using the [situation]-this is no subject for our discussion. Business in every country takes on the behavior which is formulated by the State. If you're giving [the business people] such rules of the game, they are going to move [according to these rules]. If you had loans-for-shares in the United States, 99% of the business people there would use that. It's a problem of the State, whether the State is giving them a game, which would make profit for all society or which would be perpendicular to the interest of the entire society. The State [in Russia] is not representing the society. That's why we have no small businesses, that's why we have no small and middle private property, that's why we have no competition, that's why we have no private property rights yet even.

The key issue that came from [Russian reform], for example, was that the sources [of your money] are not important. What's important is to have money and to have property; the sources are not important. That's an approach that says that goals justify the means. But that's how Bolsheviks had made the revolution in Russia, and that is why [the country] is a disaster. Always when you are using the formula that the goals are justifying the means you are destroying the goals.

The Russian experience vs. the experience of eastern Europe

INTERVIEWER: Considering everything that you just said, what do you think will be the nature of capitalism in Russia? And why has it been so different from the experience of Eastern Europe?

YAVLINSKY: The economic side of this shows that there are two different types of countries. One type of countries is like South Korea or Poland or the Czech republic-countries relying mainly in their economic development on incentives, on people, on interest and so on. In such countries economic policies are extremely important and fruitful and have a success. But there are other types of countries, like Russia, which are relying on their natural resources. When you have unlimited resources, the first thing you should do if you want to have a market economy is institutional changes. Democratization, private property rights, competition, legal system, and, by the way,

human rights. Until Russia understands that private property rights is a part of human rights, you can't create anything reasonable. In Europe a lot of politicians forget already that their success started the day when the State put human rights at the center of its policy together with the private property right. That's what Russia doesn't understand, that's what Russia doesn't care about. Until today, not one president of Russia-neither Yeltsin, nor Putin-has said that private property will be protected by all means.

One of the main reasons why in Eastern Europe the reforms were very successful and in Russia they were not was that in 1991 in Eastern Europe the real democratic revolutions happened. New people came to power. It was a real replacement of the political elite, like it was after the war in Germany and Japan, when the Nazi leaders were completely ripped out and new people came in. The same happened in Eastern Europe after 1991. In Russia it was [different]. The same people changed their jackets and changed the portraits in the rooms, and instead of saying "Communism" and "Lenin" and "five-year plan" started to use "market democracy" and "freedom" as their key words-with the same substance that was with "Lenin" and "Communism" and "five-year plan." They came to power, and you can see: we had Mr. Yeltsin, who was a member of the Politburo, as president of the country. For ten years we had a member of the Politburo as a leader of the country. But we also had 8 or 7 Prime Ministers during the 10 years; all of them were members of the Central Committee of the Communist Party or representatives of the KGB, with one minor exception of Kirienko, who was a Komsomol leader of his region. So it was the mentality of these people, the approach to life of these people that was the main factor of our failure. These people hired young economists to present a business card [of reform] to the world. And they were very successful, because they got about \$50 billion in loans [thanks to] the so-called [economic] dream teams-nice faces speaking English. Mr. Yeltsin certainly used them, and they brought in money to support the new system. \$50 billion, that's a pretty big number.

For sure, capitalism is the future for Russia, but capitalism which is limited by institutional [changes]. But Lenin is still in Red Square; we have a communist party which Putin thinks-and he's said it many times-is the most important party in the country. So we are not even at the end of the end [of communism]. We are still in the agony of the end. We have a lot of good signs, but we need much more time.

Up for Debate: Privatization: Who Wins? Russia's Reform Compromise Anatoly Chubais

Russian capitalism

INTERVIEWER: Some have said that you started out as a market economist and an idealist and sold your soul in the process of privatization. What's your response?

CHUBAIS: Well, the answer could be very simple. You can never please everybody, especially when you are transforming a country like Russia. If you're speaking about the corruption: after all the attacks by the prosecution, by the communists, by the former KGB-there were hundreds of them [attempting] to have a criminal case against me-not one of them led to any result. If you're speaking about the soul, my soul and my goal is to fight communists in my country. And I have succeeded. There is no communist president in Russia, and there will never be a communist president in Russia. There is no way now in Russia to go to the public and say, Look I am suggesting to kill all private property, I'm suggesting to nationalize the whole economy. It's impossible now, because [if you do], you will not be recognized as a serious politician; you will be recognized as something marginal. I forced communists to forget about nationalization. I forced them to accept this rule in my country. And that's the result. I don't think that I've sold my soul. I have achieved what I tried to achieve.

INTERVIEWER: Looking to the future, what kind of capitalism do you think Russia will have? Will it be it's own distinct kind of capitalism? Will it gradually become the same as in Western Europe or in the US? And what's Russia's role in the new global economy? How will it be a part of it?

CHUBAIS: I think that that there are no two countries with the same economic mechanism or the same capitalism. American capitalism differs from British or French or Austrian capitalism. I don't think that Russia will follow the United States way; I don't think Russia will follow the French way. I'm sure Russia will find its own way in this family. What are the main problems now? We have [created a foundation]. We [have created] major institutions. There is private property, there is freedom of speech. There is free election in Russia, there is the division of power in Russia. There is [a] constitution in Russia. None of these things existed 10 years ago. They are existing now-and not just existing, they're working now. But the way they're working is very inefficient. Their way they operating is sometimes wrong. Sometimes it produces corruption, it produces mistakes, it produces mistrust. And that's the main problem. The kind of capitalism I hate more [than anything] is the crony capitalism, when a few friends are deciding: I will get this, and you will get this. These are the things that should be killed in Russia, and that's a very complicated task.

[We've had] only 10 years of non-communist history. That's a small historic time. We had four generations of people who grew in the communist era. We need to have at least one generation who've grown up after communism. It takes time, and it will bring us a lot of problems. But I believe that the strategy is determined. I believe that there is the irreversibility. I believe that there is no way back, that's for sure.

Up for Debate: Privatization: Who Wins? Russia's Reform Compromise Joseph Stiglitz

The Russian road

INTERVIEWER: What went wrong in Russia's case?

STIGLITZ: Well, there [were] an enormous number of mistakes, one after the other. They began with the shock therapy of liberalization, of eliminating price controls for most of the commodities. The result of that was that there was a massive inflation. So the high levels of inflation were, in fact, a consequence of the shock therapy strategy in the beginning. That wiped out the savings of an enormous number of people. You didn't at that point have any basis of people having wealth to have a legitimate privatization process. They then had a privatization process that was corrupt and in which the country's assets were turned over to a few, to the oligarchs. The strategy was privatization at any cost. Do it quickly, is what the IMF kept telling them. The IMF kept a score card-how many privatizations had you done. But it's easy to privatize, give away the state assets to your friends. And in fact, it's not only easy-it's rewarding, because then they give a little bit of money back to you. So that was the strategy that was advocated and pushed. They then had policies like capital market liberalization before they were ready.

So what did that mean? You had an illegitimate privatization. The people who had been able to use their political influence to get these billions and billions of dollars of natural resources for a pittance were then told, Well, you have a choice, keep your money inside Russia or take it to the United States. United States was having a boom, Russia, because of the policies, was in a depression. Well, if you were smart enough to persuade Yeltsin to give these billions of dollars, you were smart enough to figure out it's better to take your money to the United States or, even better, to Cyprus, to secret bank accounts, to Switzerland, knowing full well that there'll be a change in government. When there's a change of government, there'll be a questioning of whether those privatizations were legitimate. If you had your money in Russia, people might say, we want to do that over again; you effectively stole the country's assets. So the experiences in Russia show that in some sense economists are right: incentives matter. But under the IMF strategy, you put in place incentives that lead to asset stripping rather than wealth creation and to the implosion of the economy rather than to economic growth.

INTERVIEWER: So what would have been a better road?

JOSEPH STIGLITZ: Well, the better road were the roads that Poland, Slovenia, China have taken. First of all, they focused on creating new enterprises rather than just restructuring the old. They focused on creating jobs and employment. So as you restructured the old, you had new avenues to use society's resources. Moving resources from low productivity to unemployment doesn't increase societies' wealth, doesn't increase anybody's income. Moving resources from low productivity to high

productivity does. But if you have tight monetary policy that has interest rates at 25, 50, 100, 150 percent, you can't start new businesses. And if you can't start new businesses, how are you going to have the new enterprises that are going to create the new jobs? As you are re-orienting the economy, you take out the resources from the inefficient sectors to move into the more efficient sectors. In the United States we talk about what raising interest rates by one percent or two percent does to job creation. In Russia at one point their interest rates were over fifty, a hundred, and up to 150 percent. How could you have job creation? That was called a stabilization policy, but it wasn't stabilizing the society, it was actually leading to these policies that in some sense led to the implosion of the society, the economy and a destabilization of society.

INTERVIEWER: How did this affect the poor in Russia and the average person?

STIGLITZ: A number of things happened that contributed to the increase in poverty. Poverty increased from around two percent to forty percent or more, depending on how you calculate it. [It was] one the most rapid increases in poverty that the world would have seen in that short span of time, apart from a natural disaster. With the tight monetary policies that were pursued and the other policies, firms didn't have the money to even pay their employees. What was tragic about it is while they didn't have enough money to pay their pensioners, to pay their workers, they were giving away the valuable state assets to a few rich people. So in a way, resources were leaving Russia in massive amounts, billions and billions were leaving, with these open capital markets. Russia privatized before they had a good tax system in place. It's very easy to tax oil, and you can monitor the amount of oil that's being shipped abroad. It's actually relatively easy. But they privatized it before they put in the means of taxing this most basic resource of the Russian economy.

And so by not getting the sequencing right, by not pacing right, they lead to the impoverishment of massive amounts of their people. Then, with the government not having enough revenue, other aspects of life started to deteriorate. They didn't have enough money for hospitals, schools. Russia used to have one of the [best] school systems in the world. Now they didn't have enough money for that. So this began to affect every dimension of people's lives.

Up for Debate: Privatization: Who Wins? Russia's Reform Compromise Jeffrey Sachs

Three roots of corruption

SACHS: I feel that it was tragic how we in the West with our power and our wealth failed to contribute to more satisfactory change in Russia. And of course I feel deeply unhappy about how Russian elites were even more irresponsible, in general, than I could have imagined, allowing such massive corruption to take place, for example.

There were stars in this period, people I admired tremendously. Yegor Gaidar, I think, gave it his heart and his extraordinary brains. He's brilliant, and he had a vision, and maybe in the end that vision will triumph, although the path there has been so much more painful unnecessarily than it ever had to be. I believe that the 1990's in Russia was disastrously costly. Not that everything's lost. Not that Russia can't end up being a normal society. But even if Russia gets out of the mess, even if democracy survives, even if all of market reforms take root-and all of that is possible, to be sure-the 1990's was so costly unnecessarily that I'll never be able to look at it and feel that, gee, it all ended up well in the end. I think the West has missed tremendous chances, as did the Russians, as I've always believed it takes both sides in any successful transformation.

There's no doubt that after Gaidar was thrown out of the prime ministership at the end of 1992, the level of corruption rose tremendously after most of the reformers left at the end of 1993, and the oil and the gas resources started to be distributed to cronies of the government. In a sense, the floodgates were open for massive corruption.

Russia experienced a level of corruption really rare in the world. A lot of societies have corruption. But Russia had three things that I think were quite a rare combination. First, it had no organized opposition to government that could discipline government, that could keep it honest. So you had elites that were free to act, in a sense, without the restraining hand of judiciary or the Bar Association or religious groups or other organized groups.

The second thing you had was an elite that had grown up in such an amoral, and I think one should say immoral, environment under the Soviet system that they really did believe that property is theft: "Okay, now we're in a private property system, we'll steal it."

The third thing that Russia had was a lot to steal. There are a lot of corrupt places that don't have that much to steal, but Russia had this extraordinary combination of huge natural resource reserves, and they were in state hands. So they were privately defended. So you had all of these elements-the oil, the gas, the nickel, the chromium, the diamonds, the gold. They were in state hands for the taking, as it were. There weren't the restraining influences of civil society and there wasn't the ethic within government itself that you don't touch that stuff. So what happened was that in 1994, and even more in 1995 and 96, some of the most valuable natural resource deposits were simply given away to those people we now call the oligarchs, who became billionaires overnight. They were on the inside circle of the Kremlin and were able to grab one of these resource companies.

Lilia Shevtsova

Roots of a new revolution?

LILIA SHEVTSOVA: The emergence of oligarchy meant the introduction of the unequal rules of the game in the economic field. And in fact, their emergence suppressed the initiative of the grass-root and entrepreneurial movement. The oligarchs, the tycoons are big fish. They swallow. They simply erase the possibility for the small fish to emerge.

I didn't anticipate [when fighting for reform] that I would see such accumulation of wealth in the hands of such a narrow group of people. My prediction was that there would be disparities, there would be conflicts, but I never imagined this kind of disparities. This is very dangerous for the stability of society. I never imagined that part of the Russian establishment, especially top of the top, would be so unconscious of society's needs and unconscious of the imminent danger [inherent in the inequality]. In fact, what they are creating [are] pre-requisites for a new revolution. They don't even think about their own safety. They're reckless. They're aggressive. They enjoy themselves but in the end, they're digging their own grave. Because revolutions were made by people who got too frustrated and in the societies that resemble the Egyptian pyramid that has emerged in Russia. Very rich and very few at the top, and a lot of frustrated people at the bottom.

INTERVIEWER: How long will it take for Russia to become a real democracy and real market economy?

LILIA SHEVTSOVA: It seems to me that we should wait until the new generation comes to the power. The young kids who are now twenty, twenty five years old, who don't know what the word Marxism is, who are absolutely free of any complexes-of the complex of superiority, and of the complex of inferiority. Who are longing to live in a normal country. A normal country means a return back to the European civilization, because for the time being, unfortunately, we are stuck between the floors. We are stuck between the past and the future.

INTERVIEWER: A decade after the collapse of communism, do you feel that Russia is moving in the right direction and Putin recognizes the rule of law and the fair playing field as something that is vital for Russia's economic success?

LILIA SHEVTSOVA: What I see in reality is the emergence of a new illusion within the establishment and within the society itself. An illusion that, in order to overcome Yeltsin's decay and in order to bring a strong state and, in fact, a strong regime, we need to have a new personified power. In fact, we are moving towards [the myth of] a new savior. And unfortunately, when Putin talks about the so-called dictatorship of law, what he's doing in reality is to create rules of the game that are much more [beneficial] for some people. He's attacking Gusinsky and Beresovsky, because these

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oligarchs and tycoons are his own personal enemies. And in fact, perhaps very soon we'll understand that this selective approach to justice would result in the emergence of new injustice.

The new generation

INTERVIEWER: Does the legacy of communism mean a lot to the younger generation? Are they prepared to be living in a global market economy?

LILIA SHEVTSOVA: Well, I'm looking at my son who is nineteen years old, and I'm looking at other people who are twenty, twenty four, twenty five years old, and I am amazed. These are people who are absolutely free of old stereotypes. They don't remember communism. They don't know what Marxism is. They don't have fear. They're absolutely free and liberated of any complexes of inferiority. It seems to me they are ready to live in this global environment. They live in the Internet every day. They have a lot of friends abroad in all countries. My son has friends in the Philippines and in the US and in Great Britain. He spends nights at his computer talking to them, about chess, about music, about [the film] "Gladiator," about new books, about different things. And when he's lectured [at the university] about social democratic ideas, he comes home and asks me, "Mom, can you tell me about Marxism?" We have spent only ten years after the collapse of communism, and my son doesn't know what communism and Marxism is. So he's definitely not going to vote for the communist party during the next elections. He's going to vote for somebody who is straightforward, maybe not charismatic, but sober, down to earth, a guy who would lead the country to normalcy, because normalcy for them means not nukes, not submarines, but having the possibility to travel, to have a computer, to have a modern car, to speak English, to read books in English.