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## Capitalism Russian-Style

For a decade Russia has been dismantling communism and building capitalism. Describing a deeply flawed fledgling market economy, *Capitalism Russian-Style* provides a progress report on one of the most important economic experiments going on in the world today. It describes Russian achievements in building private banks and companies, stock exchanges, new laws and law courts. It analyzes the role of the mafia, the rise of new financial empires, entrepreneurs and business tycoons, and the shrinking Russian state. Thane Gustafson tells how the Soviet system collapsed and the new market society was born. Evaluating the impact of the crash of August 1998, Gustafson shows how the crisis revealed the flaws of a Russia still halfway to a new order, but also the resilience and energy of the Russian people. Identifying investment as vital to preserving Russia's status as a major industrial power, in his final chapter he examines the prospects for an economic recovery in Russia in the twenty-first century.

THANE GUSTAFSON is a Professor in the Government Department at Georgetown University and Director of the Eurasia/Former Soviet Union Service of Cambridge Energy Research Associates. He is the author of *Crisis amid Plenty: the Politics of Soviet Energy under Brezhnev and Gorbachev* (1989), (winner of the 1990 Marshall Shulman prize for the best book on Russian affairs), and *Reform in Soviet Politics: Lessons of Recent Policies on Land and Water* (1981), and co-author of *Russia 2010, and What it Means for the World* (1993).

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To Dan and Angela,  
in friendship

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## Foreword

### Russia in the New Century

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*Daniel Yergin*

As the new millenium begins, one of the biggest questions for the emerging global economy is the role that Russia will play in it. Russia's power and wealth are at their lowest ebb since the 1920s. Yet for how long can it be counted out? Its enormous natural resources and talented people, spanning eleven time zones, and its vast strategic position, argue that Russia could be a major player in tomorrow's world. But in what role? Will Russia be an important and constructive player in building tomorrow's global economy and a world order based on peaceful technology? Or will it be left behind, nursing bitter resentment over a lost empire and a dead ideology, concentrating its meager resources on rebuilding militarily? The answers depend on the outcome of the new Russian revolution. At the beginning of the twenty-first century – almost eighty-five years after the Bolshevik Revolution that sent such shock waves through the twentieth century – Russia is again caught up in a revolution. It is partly political – the effort to establish secure foundations for democracy. And it is partly economic – the struggle to transform the very archetype of the centrally planned economy into a market system that is anchored in the new global economy.

What will be the outcome? That depends on whether Russia can make good on its historic bet to build an open market economy, founded on private property, contract, law, and enterprise, and on the free movement of people, capital, and ideas. Only a market economy can generate the wealth and the dynamism that will renew Russia. Only a market economy will enable it to be a major force in contributing to the global society that is transcending the old boundaries of nation-states and empires.

All that is the story that Thane Gustafson tells in *Capitalism Russian-Style*. This book is an absolutely essential companion for anyone in the West seeking to do business in Russia and the rest of the former Soviet Union. It provides the framework and insight they need to understand the business environment in which – and with which – they are seeking to work. Simple prudence requires that they read it to understand the risks and

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challenges. The book is essential for those concerned with Russia's turbulent transition from communism and its place in the world of the twenty-first century. This narrative will also prove fascinating and illuminating reading for anyone interested in markets and the shape of the global economy. And, I am convinced, Russians themselves will profit from the clarity and structure – and agenda — that it brings to the great drama through which they have been living.

Thane Gustafson is uniquely qualified to tell this story. He is Professor of Government at Georgetown University and Director of the Eurasia Service at Cambridge Energy Research Associates (CERA). We have worked together as colleagues for many years, and as co-authors, including on *Russia 2010, and What It Means for the World*. There are few westerners who can match his deep knowledge of Russia and his balanced judgment of Russian reality, and his commitment to exploring and understanding in an informed and open-minded way the great transition through which Russia is going. His standing as one of the leading scholars of both the Soviet Union and Russia was underlined by his selection for the Shulman Prize, one of the most prestigious awards in the field. He also has the practical and hard-headed knowledge that comes from working with western companies as they struggle to find and develop businesses and investments in the former Soviet Union. He brings this rich perspective to the new scenario project he is leading, *Rekindling the Future: Russia Scenarios toward 2020*. He understands both conceptually and in a very down-to-earth way what a market system requires, and what is missing in Russia. And he is deeply schooled and engaged with Russian culture. To the many other talents he brings to the present task must be added the unique one of having had the Russian newspaper *Izvestia* describe his command of the Russian language as “impeccable.”

All this enables him to capture the positive side of the drama of Russia's forced march towards capitalism – the excitement, the energy, the entrepreneurial creativity. At the same time, he brings the negative sharply into focus – the corruption, the crime, the instability, the human costs, the inadequacy of the institutions. He does something else very unusual: he tells his story in terms of people – whether it be the new tycoons to emerge out of communism's rubble or the scientists who gave up their careers to operate a tour boat on Lake Baikal. But he puts the people and the human story into a rigorous analytic framework of the making of a market society.

### The “Wild Nineties”

It has been nearly a decade now since the Soviet Union collapsed and Russia was thrown, almost without warning, out of the familiar world of

state planning and one-party control in which it had spent seven decades. The new leaders had no recipe for the future. All the rules were gone. Many Russians felt as though they had abruptly been transported to the other side of the moon.

There followed a decade like no other: Russia's "Wild Nineties". It began with the attempted coup of August 1991, which broke the back of the government of Mikhail Gorbachev and ushered out the Soviet era. And it almost seemed to end in August 1998, with the disastrous default and devaluation by the Russian government. And yet by the autumn of 1999, the Russian economy was once again demonstrating vitality, and some confidence was returning. The Wild Nineties have been rollicking years of fortunes made and lost, a spectacular boom for some, set against the backdrop of one of the deepest industrial depressions in world history, years of a frantic scramble of Russian against Russian for power, property, position, and rents. These are years of great hopes raised and dashed, of commitments made and broken and, yet, years in which Russia has moved towards the market economy.

For, obituaries notwithstanding, the Russian market economy is not dead, the reforms have not been reversed, and the post-communist generation continues to expand its influence. Russia's journey continues toward the next crossroads, now looming immediately ahead, with an impending change of president and the advent of a new generation of Russian leaders. Whoever follows Boris Yeltsin into power in the Kremlin, it is certain that there will be no going back to the Soviet era. Today in Russia, the market is not a theory as it was a decade ago. Whatever its many and grave imperfections – it is a reality.

Just what is this new Russia? The first decade of market reforms produced a badly flawed quasi-market, what Thane Gustafson calls "a no-man's-land" between socialism and capitalism. Building a new economic system is turning out to be far harder than the hopes of the early 1990s. "What the Russian Nineties have also taught," he writes, "is how enormous an undertaking it is to change from one world view to another, from one political system to another, and from an old economy to a new one." Reversing seventy years of history would be an enormously daunting job under any circumstances. Russia did not have the advantages of China's slow opening to the market, nor access to a dynamo like the overseas Chinese, with their entrepreneurship and capital. Nor did Russia have the advantages of a Poland – with its border with Germany and a tradition of private property that been preserved in its agricultural system. Except for the black market, Russia had no market institutions, no market culture, no market memory on which to draw: all that had been wiped out. The job was made even harder by the false starts. The new institutions of the private sector are badly built, in all too many cases geared more to



extracting (and exporting) quick profit than to promoting efficient growth. The political leadership of Boris Yeltsin has, at least since 1996, been destabilizing and demoralizing and has cost the Russian people heavily. Crime and corruption have spread far more deeply into the fabric of society than market behavior or money. A good part of the country's new private property has become part of an elaborate "virtual economy" based on barter and subsidies. Counterpoised against the virtual economy is a "shadow economy," which is "strictly cash" and "lives by its wits." The state itself has barely begun adapting; indeed, in many respects Russia resembles a country that has been abandoned by its government.

Yet, as Thane Gustafson asks, "how could it have been otherwise?" Better and more consistent leadership would surely have helped. As it is, the Nineties have been ruinous to Russia's prospects as a great power. For a decade there has been essentially no investment in Russia's resources and its people. Russia has been saved by its exports of commodities, but those will run down inexorably if they are not renewed. There is a growing health crisis, the result of bad care, polluted air and water, and the self-destructive lifestyle of a population adrift. The wrangling of the political system has bred cynicism. Little wonder, then, that Russians remain deeply ambivalent about this quasi-market system that has brought most of them wrenching change, hardships, and demands for which they had no preparation.

Where will Russia go from here, under the new leadership that will soon take the helm? The nation, once again, is at a vital crossroads. Russians face a crucial choice, either toward a renewed commitment to the market and to closer integration with the global economy, or toward a return to some form of state interventionism, likely to be aimed at restoring the Soviet-era heavy industry and military technology. Many Russians, however, fear that citizens and elite alike will duck the hard choices, and opt instead for muddling along, milking the inheritance of the Soviet era as long as possible. More and more, young Russians express their fear of a second *zastoi*, or "era of stagnation," the name they gave to the corrupt and lazy Brezhnev period of the 1970s.

### **The New Economy**

The central message of Thane Gustafson's book is twofold. First, as flawed as the new Russia may be, the feverish building of the new private institutions that took place in the nineties succeeded in laying the basis for a new economy, which obeys, however imperfectly, the laws of the market. Second, the changes that have taken place are so deep and fundamental that they continue to drive Russia forward in the first decade of the

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twenty-first century. Russia's transition to the market may be flawed, but it is real, and it is irreversible.

Yet, while Russia struggles through its change, the rest of the world has not been standing still. Russia today faces intensified competition from a fast-moving global economy, based on services and information, in which heavy industry and commodities, on which the Soviet economy were built, are increasingly glaring losers. That is the deeper challenge for Russia, and it is one for which its experience in the twentieth century leaves it poorly prepared. The best resource it can bring to bear for this new competition is, of course, its people. The challenge is to harness their talents, education, and skills, to a competitive economy.

Russia's experience in the twentieth century is that although its first revolution ultimately led it down the wrong path, 1917 did create the conditions under which Russia became, for a time, the second most powerful global power and a model, if a severely defective one, to many throughout the world. It is ironic that Russia's second revolution, despite bringing Russia back to the mainstream of western nations, is so far having as its first result – at least in the eyes of many Russians themselves – a vast and humiliating loss of status and power.

Will Russia continue its odyssey to join the global market, and will it gain the wealth and pride and standard of living that its energetic and talented people have suffered for so long to attain? Thane Gustafson's book explains, with balance and without illusion, why such hope has real basis. The results will be something unique. Call it "Capitalism Russian-Style."

Daniel Yergin, chairman of Cambridge Energy Research Associates, is co-author with Joseph Stanislaw of *The Commanding Heights: The Battle Between Government and Marketplace that is Remaking the Modern World*. With Thane Gustafson, he co-authored *Russia 2010, and What It Means for the World*. He received the Pulitzer Prize for his book, *The Prize: The Epic Quest for Oil, Money, and Power*.

## Acknowledgments

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Westerners of all backgrounds, once exposed to Russia at some point in their lives, are often hooked permanently, fascinated by a country that seems forever at a crossroads. It happened to me when I was twenty. The literature and then the language of Russia entranced me first. In the mid-1960s, as a Peace Corps volunteer in West Africa, I spent the tropical nights reading Tolstoy and Gogol, and in my imagination I was transported from palm trees to the wintry nights of St. Petersburg and the snowy mountains of the Caucasus. Russia was in my blood, and I've never looked back.

I've been a Russia-watcher ever since, living and traveling in Russia for the last twenty-five years, trying to understand how the political and economic systems of the Soviet Union, and now of the new Russia and the other successor nations work. Since 1990 I have combined university teaching with advising businesses, crisscrossing Russia in every direction for clients, mostly Western energy companies and financial institutions. This has given me the opportunity to observe the new Russia in many settings. I have had the good fortune to witness some of the key symbolic events of post-Soviet Russia, from the raising of the new Russian flag over the House of Soviets in Tiumen', the capital of West Siberia, to the barricades in front of the White House and the first shareholders' meeting of a privatized defense industry. I have spoken to thousands of Russians in every setting, from jobless geologists above the Arctic Circle to ministers and bankers, and at least one of Moscow's powerful godfathers.

This book is a reflection on the new Russia that emerged in the 1990s from the ruins of the Soviet collapse. It follows an earlier book, *Russia 2010*, which I wrote jointly with Daniel Yergin and Angela Stent a few years ago. We asked then, "What paths will Russia follow?" Our answer was, "By 2010 Russia will have its own unique form of capitalism." But back in the summer of 1993, when we were writing *Russia 2010*, describing capitalism Russian-style was no less a work of imagination than the nineteenth century Russia that had captured me originally; indeed, it was

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practically science-fiction. Now it is becoming a fact. Whether it will survive and prosper is the subject of this book.

Any book about Russia in the 1990s begins with a miracle – the miracle that it has become possible to travel freely in Russia, to speak without hindrance to nearly any Russian, and to share views without masks or euphemisms. This book owes everything to the many Russian friends and colleagues who have given their time and thought to answering questions and debating ideas, sometimes over hundreds of hours, with the sincerity and wholeheartedness that are the special hallmarks of the Russian character.

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This book also takes its inspiration from the support and guidance of many western friends, but none more than Dan Yergin and Angela Stent, my close colleagues at Cambridge Energy Research Associates and at Georgetown University. Both of them read through several drafts of this book and offered innumerable and valuable points of advice and criticism. To Dan and Angela, warm and staunch friends for over twenty-five years, this book is affectionately dedicated.

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