

# EUROPE: EAST AND WEST UNDERGRADUATE RESEARCH SYMPOSIUM 2004

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### SOME NOTES ON THE SYMPOSIUM:

On March 26, 2004, 23 undergraduate students from a variety of majors and schools presented their research papers on Europe or Russia as part of the third annual Undergraduate Research Symposium, a competition modeled after graduate-level conferences. In addition to students from the University of Pittsburgh in Oakland, this year's symposium included the participation of students from Baldwin-Wallace College, Carnegie Mellon University, Juniata College, Mercyhurst College, University of Pittsburgh in Johnstown, and Washington and Jefferson College. All students were selected to participate based on abstracts of their papers by a committee of faculty affiliated with the Centers for Russian and East European Studies and West European Studies. The committee also placed each student on one of six panels (Economics of Transition: Cold War and After; Borders of Truth and Identities; Status, Sex, and Money in European Literature; State and Non-State Terrorism, Spies and Organized Crime; The European Nation-States in the Post-Modern World; and EU Enlargement in 2004: Prognosticating Change) according to research topic). The students then had six weeks to revise their papers for submission and prepare their presentations. They were assisted by two doctoral students with experience in presenting research and teaching undergraduate students.

For each panel, a team of three judges, consisting of two faculty members and one graduate student, evaluated both the students' papers and their presentations. A First Prize was chosen for each panel, and one Grand Prize was awarded for overall best paper and presentation. The awards and cash prizes were presented to the students at the closing reception. Members of the University of Pittsburgh community as well as from the other colleges represented attended the presentations and the closing reception, all held in the William Pitt Union on the University's main campus.

The Grand Prize and First Prize papers are included in this publication.

## Grand Prize

### **Economics of Transition: Cold War & After**

**Margareta Chudnovsky** for "Privatizing Russia: Case Study of Yukos Oil Company"  
University of Pittsburgh, Majors: Economics and Business Administration

## First Prizes

### **Borders of Truth and Identities**

**Michael J. Sechler** for "A King Can Do No Wrong': The English Reformation and the Rise of the Modern Nation State"  
University of Pittsburgh, Majors: Economics, Psychology, and Political Science-Philosophy

### **EU Enlargement in 2004: Prognosticating Change**

**Megan McCaffrey** for "The Continuing Communist Legacy in East Europe"  
University of Pittsburgh, Majors: History, and Political Science

### **State & Non-State Terrorism, Spies and Organized Crime**

**Timothy Krysiak** for "Global Operations: The Intelligence Community of the Russian Federation"  
Mercyhurst College, Majors: Intelligence Studies and Russian Studies

### **Status, Sex and Money in European Literature**

**J. Elizabeth Strohm** for "Money and Moral Economy in the Early Works of James Joyce"  
University of Pittsburgh, Majors: English Writing, Religious Studies and Psychology

### **The European Nation-State in the Post-Modern World**

**Brian C. Andersen** for "Fishing for Sovereignty: Norway's European Voyage"  
University of Pittsburgh, Majors: History and Political Science

The Center for West European Studies/European Union Center and the Center for Russian and East European Studies would like to express their appreciation to Ms. Samantha Hryciuk for her work on editing these research papers for publication.

We would also like to acknowledge the following professors, graduate students, and organizations for helping to make the third Undergraduate Research Symposium a success:

**Selection Committee:**

Dr. Shirley Cassing  
Dr. Lisa DiBartolomeo  
Dr. Irina Livezeanu  
Dr. Anne Weis

**Panel Judges:**

Dr. Patrick Altdorfer  
Ms. Alessandra Beasley  
Dr. Daniel Berkowitz  
Dr. Lisa DiBartolomeo  
Dr. Robert Dodge  
Dr. Robert Donnorummo  
Dr. Bernard Hagerty  
Mr. Daniel Hammer  
Mr. Jason Koepke  
Dr. Ronald Linden  
Dr. Irina Livezeanu  
Dr. Antoni Moskwa  
Dr. Marianne Novy  
Ms. Claire Piana  
Dr. Ilya Prizel  
Dr. Daniel Thomas  
Ms. Yadviga Semikolenova  
Mr. Ron Von Burg

**Keynote Speaker:**

Dr. William Brustein

**Closing Speaker:**

Dr. Robert Hayden

**Graduate Student Mentors:** Mr. Jason Grant and Ms. Danika Kazmer

**URS Webmaster:** Mr. Octavio Herrera

**Organizing Committee:**

Ms. Stacey Beggs  
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Ms. Gina Peirce  
Mr. Stephen Salas

**Financial Sponsors:** United States Department of Education, University of Pittsburgh College of Arts and Sciences

## UNDERGRADUATE RESEARCH SYMPOSIUM 2004 PROGRAM

### Economics of Transition: Cold War & After

**Joshua C. Andy:** *A Comparative Study of Military Spending and Policy in the Soviet Union and the United States, 1953-1964*

**Margareta Chudnovsky:** *Privatizing Russia: Case Study of Yukos Oil Company*

**Jason Freeman:** *The Russian Economic Transition and its Effects on Poverty*

**Michael Margarucci II:** *A Historical Analysis of Skoda Automobilova a.s. during Czechoslovak and Czech Economic Transition*

### Borders of Truth and Identities

**Lela Gibson:** *From Former Yugoslavia to Germany and Back: A Study on Roma Returns*

**Allison Hahn:** *Orthodox Stalinism: Chinese and Russian Propaganda in the New York Times*

**Michael J Sechler:** *"A King Can Do No Wrong": The English Reformation and the Rise of the Modern Nation State*

### Status, Sex, and Money in European Literature

**Nick Goldberg:** *A Fugitive from Guilt in A Woman Killed With Kindness*

**Benjamin D. O'Dell:** *Sex and Physicality in Modern Adaptations of Jane Austen's Work*

**J. Elizabeth Strohm:** *Money and Moral Economy in the Early Works of James Joyce*

**Laura Witman:** *Bringing the Novel to Life: Jane Austen's Pride and Prejudice and Other Works on Film*

### State & Non-State Terrorism, Spies and Organized Crime

**Timothy Krysiek:** *Global Operations: The Intelligence Community of the Russian Federation*

**Mary Swalligan:** *Struggling Against the Arc of Instability: Russia's Responses to September 11<sup>th</sup>*

**Eric R. Washabaugh:** *Organized Criminal Groups in Russia and the Russian Federation*

**Kathryn E. Wilson:** *Tilting the Balance of Power: The Rise of Women Terrorists in Europe*

## **The European Nation-State in the Post-Modern World**

**Brian C. Andersen:** *Fishing for Sovereignty: Norway's European Voyage*

**David C. Shearouse:** *The Triple-P Foreign Policy Plan for Romania*

**Ryan Thornburg:** *Ireland: Solow Growth Model Explains its Extraordinary Growth*

**Michael Tooshi:** *New Public Management Reform and the Reassertion of the State*

## **EU Enlargement in 2004: Prognosticating Change**

**Thomas Folsom:** *EU and the Balkans: Are "Carrot and Stick" Policies the Right Idea?*

**Meghan McCaffrey:** *The Continuing Communist Legacy in East Europe*

**Andrew Peters:** *The European Union's Eastward Expansion and Beyond*

**Igor A. Voloshen:** *The "Other" Europe: Distinctiveness and Uniqueness of East and Central Europe*

## The Center for Russian and East European Studies



For over a decade, the region that includes the former Soviet Union and the states of Central and Eastern Europe has been undergoing fundamental and, at times, tumultuous change. Societies are being transformed, and economic and political systems are being rebuilt under a variety of models and conditions. But even as new dynamics are emerging and new alliances are being formed, long-standing traditions persist. In the United States, a new generation of scholars, familiar not only with the area and its history, culture, and language, but also trained in social science

approaches and methods, is addressing these issues in sophisticated and increasingly integrated ways. The Center for Russian and East European Studies (REES) plays a vital role in forging these new directions of research and teaching, thanks to its faculty, dedicated staff, strong commitment to crossing traditional cultural boundaries and active partnerships with institutions and scholars in the region of study.

Established in 1965, the Center for Russian and East European Studies is designated by the U.S. Department of Education for Title VI funding as a National Resource Center. This distinguishes REES as one of the nation's strongest language and area studies centers. The Center is responsible for coordinating the efforts of the University of Pittsburgh in teaching, research, and public service related to the former Soviet and Central/East European world region. The 71 faculty members affiliated with REES are based in 14 arts and sciences departments and five professional schools. This diverse and highly accomplished faculty allows REES to embrace a broad, multidisciplinary teaching and research mission.

## The Center for West European Studies / European Union Center



The Center for West European Studies (CWES) promotes the study of Western Europe at the University of Pittsburgh by coordinating existing departmental activities and by developing new courses, lectures, symposia, and conferences with international participants. Through its outreach efforts, the Center also builds relationships among the University, the business community, policy-makers, and community organizations. Since 1984, CWES has built an international reputation for excellence in research on the European Union and its Member States. Other Center research foci include comparative public policy, social and intellectual history, questions of identity, and Europe's historical and contemporary role in the world.

In July 1998, CWES was selected in a nationwide competition as one of only 10 European Union Centers (EUC) in the United States. In 2001, the EUC at the University of Pittsburgh was re-designated as one of the U.S. network's 15 centers. The goals of the EUC at the University of Pittsburgh include promoting research and teaching related to the European Union, developing a regional outreach network to disseminate EU knowledge, and creating a transatlantic (EU-US) policy network to bring together academics and practitioners through policy conferences, distance learning education, and other collaborations with European institutions.

# **Privatizing Russia: Case Study of Yukos Oil Company**

**Margareta Chudnovsky**

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*The Russian privatization program has been surrounded by over a decade of controversy. This paper serves as a model for analyzing the processes involved in and consequences of Russia's highly controversial privatization program through a case study of Yukos Oil Company.*

## **INTRODUCTION**

The Russian privatization program has been surrounded by over a decade of controversy. On the one hand, the program has been criticized for contributing to the criminalization of the economy and the highly inequitable distribution of wealth in Russia. On the other hand, the program has been defended as the best politically feasible option in Russia at the time, which has gradually led to a developing market economy and the establishment of property rights. This paper presents a case study of Yukos Oil Company to serve as a model for analyzing the processes involved in and consequences of Russia's controversial privatization program; particular emphasis is placed on analyzing the privatization of the oil industry, one of the Russian economy's most strategic sectors. The initial stage of privatizing Yukos, from 1992 to 1995, proved to be unsuccessful in establishing an efficient private enterprise. Even after the full transfer of Yukos' ownership to private agents in 1996, the company's management, headed by CEO Mikhail Khodorkovsky, chose to strip the company of its assets and thus diminished its value. A more long-term analysis of Yukos as a privatized company, however, demonstrates that since 1999 Yukos began to demonstrate an increasing growth rate. This was primarily because since 1999, until his recent arrest in 2003, Khodorkovsky began improving Yukos' corporate practices and skeptical foreign investors subsequently became more confident to invest into the company and thus increased its value. This paper thus demonstrates that contrary to the expectations of Russia's reformers, privatization alone is not sufficient for a company to realize the anticipated efficiency gains of privatization. There is a need for management to expose the company to those investors who bring in new capital and technology and upgrade the company's inefficient corporate practices.

## **STAGE ONE: VERTICAL INTEGRATION**

The early years of economic reform in Russia, and particularly in the oil industry, convey that privatization contributed to the criminalization of the economy and the inequitable distribution of wealth in Russia. These early years of economic reform followed the disintegration of the Soviet Union, when all of the oil industry enterprises were entirely state owned and reported directly to the Ministry of Fuel and Energy. Yet by 1992, presidential decree number 1403 established the first three Russian oil companies

to be partially privatized and restructured into a vertically integrated oil company (VIOC); Yukos Oil Company was among these first three companies. The VIOCs were organized according to the principles of vertical integration, which consisted of a parent company and its production, refining, and marketing subsidiaries; the parent company received a 51% equity voting stake in its subsidiaries. Table 1 (see Appendix) illustrates Yukos' pyramid structure after this initial restructuring process (Henderson and Radosevic 4-5).

The intended goals of Russia's reformers in restructuring the oil industry were to promote growth and development and to create efficient private enterprises; the assumption here is that in efficient private enterprises, management is focused on utilizing company resources productively and effectively, which should result in company revenue. There were, however, no domestic legal frameworks intact to ensure that the partial privatization would establish efficient private enterprises. Privatization alone thus proved to be insufficient for promoting growth and development because the country lacked a basic infrastructure of laws and law enforcement, such as legal protection for minority and majority investors and regulation of managers' fiduciary responsibilities, which govern a firm's corporate practices. These are, however, the basic tenets on which efficient market economies are built (Wheelan 208). Furthermore, in a well governed private company with a corporate board, inefficient and corrupt business practices should not be tolerated. This suggests that privatization should have created the incentives for choosing such managers who would follow acceptable corporate governance practices in managing the VIOCs. However this did not occur primarily because "the establishment of the VIOCs in 1992 was [in actuality] facilitated by the general directors of the former Soviet oil enterprises who wanted to keep their newly gained autonomy and control over their enterprises" (Iji 10). The distribution of assets and subsidiaries among the VIOCs resulted more from former Soviet contacts and influence than from economic or strategic logic. The restructuring of the oil industry into VIOCs became a method for appeasing the former Soviet oil industry ministers and managers to ensure that they would support the privatization program. It was thus the only politically feasible strategy at the time.

In the VIOCs ownership structure, the federal government intended to retain a 51% ownership stake for three years in all of the oil producing, refining and marketing subsidiaries. The remaining 40% ownership shares were sold in investment tenders and 15% were distributed to the employees,

management and the public through privatization vouchers. Furthermore, according to presidential decree number 1403, which established the VIOCs, only 15% of the parent companies' shares were legally open to foreign investors during privatization (Moser and Oppenheimer 309). This restriction was put in place partly to prevent the conversion of Russia's strategic oil industry into "a raw materials appendage" for the West (Sanko 4). The majority of shares, however, ended up in the hands of the VIOCs management and employees. In fact, according to some of the reformers "the ownership structure emerging from Russian privatization . . . [gave] managers too much control relative to what is needed to speed up efficient restructuring" (Black, Kraakman, and Tarassova 1742). It is difficult for a company to realize the anticipated efficiency benefits of privatization when much of its control and ownership remains in the hands of former Soviet managers.

The VIOCs proved to be structurally inefficient and were utilizing the operational practices of Soviet oilfield development methods. In fact, Yukos' oil production had consistently declined after 1992, so that by 1994 the company produced merely 196 million barrels per day, compared to its 1986 level of 520 million barrels per day. The VIOCs proved to be even less operationally efficient than their Soviet predecessors. The evidence from Table 2 (see Appendix) suggests that, on average, 35.5% of the company's total oil wells were idle by 1995, which partially explains this decline in oil production. However, this decline in oil production was not unique to Yukos alone because since 1993 there was a decline in Russia's total oil production from 357 million tons to 305 million tons by 1995 ("A Higher Law"). Furthermore, by 1995 the federal government still maintained a controlling stake in the VIOCs, these companies were legally denied access to substantial foreign investment, and their operational and managerial practices were still based on the practices of their Soviet predecessors. This suggests that the failure of the vertical integration to ignite the growth of Russia's economy reflects structural flaws in this initial privatization stage itself as a transition mechanism. Although the initial restructuring of the oil industry did not result in the anticipated efficiency gains, the illicit corporate practices and inequitable distribution of wealth intensified during the second stage of privatization, the loans-for-shares program (Black, Kraakman, and Tarassova 1733).

## STAGE TWO: LOANS-FOR-SHARES PROGRAM

The second stage of privatizing Russia began with the loans-for-shares program. It was proposed by the owner of Oneksimbank, Vladimir Potanin, and supported by several other major Russian banks at the time. The financial institutions that supported the program were to be its primary beneficiaries. These were the banks that had thrived from 1991 to 1994, a period of hyperinflation in Russia. However by the end of 1995, given the rapid currency depreciation, the commercial banking business became much less profitable for them. At this point, the financial institutions began to gradually shift their focus from the banking sector to the industrial sector and were thus very much in favor of the proposed loans-for-shares program (Shleifer and Treisman 41-5).

The loans-for-shares program was formally approved by the federal government in September 1995, due to the government's need for funds, primarily to finance Boris Yeltsin's re-election campaign. According to the conditions of the loans-for-shares program, the financial institutions proposed to lend funds to the Russian government, with the loans repayment secured by the governments' controlling stakes in Yukos Oil, Surgut Holding, Sidanco, LUKoil, and Sibneft. This would be phase one of the loans-for-shares program. If the government failed to repay their loans by September 1, 1996, the lending institutions could set into motion phase two of the program by selling those government shares that they were holding as collateral. The persisting condition was that the 15% cap set on foreign investment was still in effect. But despite the federal government's pressing need for funds, there was little competition during phase one of these auctions and most purchases were significantly below their market prices. Consequently, the government received considerably less revenue than they had anticipated and needed (Rutland 9-11).

In the case of Yukos Oil Company, Bank Menatep, in a syndicate with Tokobank and Stolichnyi Bank, arranged the company's first auction. Bank Menatep was formed by Mikhail Khodorkovsky and several other Soviet bureaucrats in 1988 and was considered to be the only Russian bank to demonstrate an industrial focus from its inception. In fact, in 1992 Bank Menatep created the company Rosprom to administer its industrial group of enterprises, which primarily consisted of six groupings: chemicals, construction, textile, consumer goods, mining, and oil (Goldman 146-47). ZAO Laguna, a Menatep

affiliated company, won Yukos' auction in December 1995. In fact, through this auction, Menatep obtained a 33% stake in Yukos for a mere a loan of \$159 million to the federal government; this was a very profitable deal for Menatep, given that Yukos had annual sales of roughly \$3 billion at the time (Moser and Oppenheimer 307-8). Once the Menatep-Rosprom group gained control of Yukos in December 1995, the company became "the central part of their [industrial] empire" (Iji 13).

As the lending financial institutions expected from the outset of the loans-for-shares program, the federal government did default on repaying their loans by the established due date of September 1, 1996 (Rutland). To a certain extent, the government's loan default here reinforced the disregard for capital market laws practiced by Russian companies at the time. The lending financial institutions consequently began selling the shares they were holding as collateral from the government and Bank Menatep organized Yukos' second auction as well. "A basic pattern emerged [during phase two of these auctions], which broadly reflected the array of restrictions and special deals established in 1995" (Moser and Oppenheimer 309). The financial institutions that organized the second loans-for-shares auction again acquired controlling stakes in the same companies that they were auctioning off. Furthermore, the auction restrictions again prevented many outside bidders from competing in them because the 15% cap set on foreign investment in November 1992, was not officially removed until November 7, 1997 (Moser and Oppenheimer 309).

The winner of Yukos' second auction was ZAO Monblan, another unknown Menatep affiliate. At the news conference after the sale, a Menatep executive could hardly restrain his laughter when he stated that he did not know who owned the company that had just purchased Yukos. Thus, as was the case in December 1995, Menatep had run the auction and also controlled the company with the winning bid. The government's shares of Yukos were purchased for merely \$160.1 million, a price that was barely above the original loan amount of \$159 million in 1995 and just above the required minimum bid price of \$160 million in 1996. Seventy percent of capital gains from this sale were to go to the federal government and the remaining thirty percent were to be retained by the selling financial institutions. The result was a major loss of revenue for the government even though "the auction technique was meant to ensure that the government received loans close to the market value of the shares [they were selling]" (Moser and Oppenheimer 308).

## THE AFTERMATH OF LOANS-FOR-SHARES

The structure of Russia's oil industry changed considerably following the loans-for-shares program "by favoring the emergence of financial-industrial groups [FIGs]," such as the Menatep-Rosprom group (Locatelli 445). By the start of 1997, the Menatep-Rosprom group owned more than 85% of Yukos' shares; the company's ownership structure at this point is shown in Table 3 (see Appendix) (Iji 13-4). The loans-for-shares program also gave rise to the Russian oligarchs, a small group of bankers and industrialists who received billions of state assets in exchange for funding President Yeltsin's re-election campaign. The newly emerged oligarchs, such as Khodorkovsky, exploited the "atmosphere of uncertain property rights, an underdeveloped legal system, and poor investment conditions" in Russia, to gain control of strategic companies, such as Yukos, at a fraction of their true value (Schroder 963). In fact, according to a popular Russian joke, the loans-for-shares program was referred to as *prikhvatizatsia*, from the Russian term *khvatat'*, to grab, which referred to it as the grabbing of assets program (Alexeev 3). In economics, an oligarchy is a market divided between a few main players and that is precisely the market structure, which emerged in Russia following the loans-for-shares program. But as explained by the program's main proponent, Vladimir Potanin:

Historically, there has always been a very high concentration of capital in Russia. . . . During the Soviet era numerous giants of all kinds were created, natural and artificial monopolies. It is only natural that these monopolistic tendencies still continue to exist today with the beginning of a transition to market relations. That is how we arrived at a situation where ten to fifteen very big businessmen ensure the production of more than one half of the gross national product. (Schroder 974)

Much of the criticism regarding the loans-for-shares program focuses primarily on the emergence of this disproportionately wealthy oligarchy. Of course, a large redistribution of wealth is expected to occur in a transition economy. In fact, a lack of wealth redistribution following privatization in a transition economy would suggest that not much genuine reform had taken place. The real controversy, however, concerning the wealth redistribution in Russia, was that a very slim margin of the population, the oligarchs, had benefited. In the years following the loans-for-shares program, the wealth gap between the oligarchs and rest of Russia's population grew because the oligarchs, such as Khodorkovsky, pursued asset-stripping versus value-creating strategies in managing the enterprises that they had purchased (Alexeev 3).

After securing control of Yukos, Mikhail Khodorkovsky appointed himself as the company's CEO and had to determine whether to pursue a value-creating or an asset-stripping strategy in managing the company. The value-creating strategy is one in which investments are made to increase the firm's value; the asset-stripping strategy is one in which the firm is stripped of its assets and its' value is thus extracted, for example by extracting the firm's cash flows that would otherwise go to the government as taxes and to minority shareholders as dividends (Black, Kraakman, and Tarassova 1731). The reformers expected that privatization itself would create a class of owners and managers who stood to gain from building up the firms' values and who would thus pursue value-creating strategies in managing them. "That didn't happen. Instead, company manager's [and owners] opposed efforts to strengthen or enforce the capital market laws. They didn't want a strong Securities Commission or tighter rules on self-dealing transactions. And what they didn't want they didn't get" (Hoff and Stiglitz 2). In fact, due to a combination of market and firm-specific elements, the management of many potentially profitable firms in Russia chose to pursue asset-stripping strategies. In the case of Yukos, the unstable Russian political and economic environments provided Khodorkovsky with more profitable incentives to pursue an asset stripping strategy in managing the company; the assumption here is that the political state affects a firms economic actions. "Self-dealing was easy, running a business for profit was hard, growth prospects were dim . . . capital markets were rudimentary, managerial skill was scarce, [and] unprofitable firms were subsidized while profitable ones were heavily taxed" (Black, Kraakman, and Tarassova 1765). Furthermore, without a significant presence of investors outside the Menatep-Rosprom group to check Yukos' corporate practices, there were no enforceable restrictions on the asset-stripping strategy that Khodorkovsky chose to pursue.

During Yukos' initial years as a fully privatized company, between 1997 and 1999, Mikhail Khodorkovsky and other senior management of the company chose to strip Yukos of assets and funds versus make any long-term investments into the company, its employees, or shareholder value. But such "corruption is not merely an inconvenience . . . it is a cancer that misallocates resources, stifles innovation, and discourages foreign investment" and this is precisely what happened with Yukos (Wheelan 208). In fact, further evidence of Khodorkovsky's asset-stripping strategy, during the period from 1997 to 1999, is evident from Yukos' financial statements at the time. The reported per barrel profit

in these statements is \$8.60, a price substantially below the domestic market price of roughly \$10.50 per barrel, and significantly below the world market price of roughly \$18 per barrel; the assumption is that the company exported 25% of their output. Khodorkovsky was thus pocketing over thirty cents per dollar of company revenue while not paying workers their salaries, defaulting on Yukos' tax payments, destroying the value of Yukos subsidiaries, and not reinvesting into the company's oil fields. In fact, because management was pocketing so much money from Yukos' subsidiaries, they went from earning a pretax profit of approximately \$1 billion to having minimal profits or outright losses. It is unlikely that by pursuing a value-creating strategy in managing the company Khodorkovsky could have earned anything close to what he did earn from pursuing the asset-stripping strategy. And although this was not an advantageous strategy for Yukos in the long-run, Khodorkovsky preferred pocketing guaranteed short-term profits versus investing into uncertain future profits (Black, Kraakman, and Tarassova 1736-37).

In an effort to consolidate Yukos and its subsidiaries, the period from 1997 to 1999 witnessed a series of hotly disputed swaps, transfers of subsidiary shares offshore, and a significant dilution of minority shareholders. Khodorkovsky himself proposed "a massive new share issuance [package of its subsidiaries] at prices that valued the [subsidiaries] at 1% or less of their true value, and perhaps 10% of their [already] depressed trading prices. Even that modest amount would be paid not in cash but in promissory notes... of dubious legality and even more dubious value" (Black, Kraakman, and Tarassova 1070). The shareholders who opposed these proposals could sell their shares back to Yukos at a total price of \$33 million for the production subsidiaries or at a \$.0025 price per barrel of proven reserves even though the production subsidiaries proven oil and gas reserves equaled to approximately \$13 billion. In order to implement Khodorkovsky's proposal, Yukos needed 75% of shareholders' votes, of which they already owned 51%. The day prior to the subsidiary shareholder meetings, Yukos found a judge who deemed that the minority interest shareholders were violating Russia's Antimonopoly Law. Everyone but Yukos and its affiliated shareholders were consequently excluded from voting on the proposed package. The proposal was then passed and Khodorkovsky was able to consolidate the Menatep-Rosprom group's control over Yukos; this was among the numerous questionable means used to consolidate Yukos and its subsidiaries. (Black, Kraakman, and Tarassova 1769-71). It is thus evident from Yukos illicit corporate practices, that by 1999 the necessary capital market laws, such as those protecting minority interest

investors, were not being enforced in Russia. Furthermore, although the Securities Commission was created as early as 1994, it had a minute budget, and lacked the political authority to investigate such corrupt practices. Yukos' abusive corporate practices thus continued to be unrestrained.

Overall, Yukos' initial years as a fully privatized company, convey that the anticipated efficiency gains from privatization were not realized; in fact, quite the opposite was occurring. As a fully privatized enterprise, from 1997, Yukos had become even less operationally and financially efficient by 1999. The asset-stripping strategy practiced by Yukos' management became the norm, not the exception, and its corporate governance practices became notoriously illicit. A more long-term analysis is, however, necessary to determine if Russia's privatization program did, with time, lead to the establishment of efficient private enterprises, a more equitable distribution of wealth, and the development of a capital market.

### **MODERNIZATION MAKEOVER**

A more long-term analysis, from 1999 and on, of the consequences from Russia's privatization program conveys that with time, Yukos' management began developing incentives to invest in the company and build up its value. In fact, managements' strategy changed immediately after the consolidation process ended in 1999. Thus, although Khodorkovsky was just another Soviet business tycoon when he acquired Yukos, in 1999 he decided to detach himself from their previous corporate practices and give himself and Yukos a foreign led modernization makeover. Foreign led modernization is considered in this paper to be "a process of technological upgrading and productivity improvement where foreign firms control key aspects of the [production] process" (Henderson and Radošević 2). This process is a necessary component of privatization, for a company to realize the anticipated efficiency gains from privatization. In addition to Yukos' internal modernization, the significant increase in oil prices worldwide, following the 1998 financial crisis, significantly helped Yukos boost its growth and value in subsequent years. Thus, a combination of these market and firm-specific changes led to substantial productivity gains, improved financial performance by the company and a more equitable distribution of company wealth among its shareholders.

In an effort to reverse its operational and economic underperformance, Yukos formed a strategic alliance with a Western oil field service company, Schlumberger Limited, as early as 1998. Schlumberger specialized in the development of service technologies for exploration and production activities, as well as renovation of oil wells. The aim of this alliance was to upgrade and develop Yukos' oil production practices. Since 1998, Schlumberger was also given increasing authority to renovate Yukos' outdated oil wells and to train the company's staff in Western management techniques. Among Yukos' first Western employees was Joe March, an oil-industry veteran who joined Yukos from Schlumberger. His responsibility was to upgrade the outdated oil wells and to cut company costs, which were among the highest in the oil industry worldwide. Mr. March also opened a high-tech training center in Moscow, where dozens of Yukos employees came on a monthly basis from all over Russia to test new company technology and equipment. By bringing in the Western managers and technology to renovate the company and particularly its outdated oil wells, Yukos' production was boosted rapidly. This boost in production translated into an average annual growth rate of 26% in operating revenue, from \$9.03 million in 2000 to \$11.37 million by 2002. The willingness of Yukos' management to give up some control over the company to its Western partners provided Yukos with increasing access to the latest foreign technology and modernized operational and financial practices. This played a crucial role in improving the company's operational efficiency and achieving such a remarkable annual growth rate since 1999 (Henderson and Radosevic 13; Yukos Financial Reports).

"In January 2000 Khodorkovsky made his first [formal public] statements about increasing shareholder value and improving corporate governance as part of a deliberate policy to increase the market capitalization of the company" (Henderson and Radosevic 13). Khodorkovsky recognized that even after the 15% cap, set on foreign investment into Russian companies during privatization, was officially lifted in 1997, there was still a significant lack of foreign investment in and foreign led modernization of Yukos. The absence of new foreign investment prevented any significant managerial and productivity changes, especially since Russians themselves learned to keep their savings away from domestic banks, and thus were unavailable to provide firms with new investment. This was the case primarily because of the substandard corporate governance practices in Russia and in Yukos at the time. In fact, as of September 1999, Yukos and its' three subsidiaries, Yuganskneftegaz, Samaraneftegaz, and

Tomsckneft, all had the lowest corporate governance rankings according to a rating of the twenty-one major Russian companies. Among the corporate governance measures considered in this survey were disclosure and transparency, asset stripping, limits on foreign ownership, and management attitude towards shareholders. Although it was initially more profitable for Russian companies to pursue asset-stripping strategies and follow weak corporate governance practices, when there are incentives to raise funds in international markets, such practices become less profitable. And according to a World Bank study, there is a clear and causal relationship between company growth and development and better corporate governance practices. Yukos thus had numerous areas to improve and develop itself and its subsidiaries in, before foreign investors would feel confident to invest in them. In fact, Yukos and its subsidiaries would need to prove themselves as exceptionally enticing investments because Russia itself was a country with weak legal frameworks and standards governing firms' behavior (Black 94-7).

In an effort to increase transparency and improve its corporate image, Yukos spent roughly \$300 million. Khodorkovsky even brought in several Western executives, a Western public relations and accounting firm, and several foreign professionals to his board of directors. Among these were Raj Kumar Gupta, a former vice president of Phillips Petroleum, Sarah Carey, a Washington lawyer, and Michel Soublin, the treasurer of Schlumberger Ltd.. A corporate governance charter was also introduced company by the company in 2000 and more independent foreign directors were brought onto the board. Furthermore, since 2001 the company began issuing annual financial statements in accordance with the United States' Generally Accepted Accounting Principles (GAAP). This was done in an effort to be listed on the New York Stock Exchange, which has extremely strict corporate disclosure requirements (Goldman 149-50; Iji 31).

After the launch of Yukos' modernization makeover in 1999, foreign investors became less skeptical about investing in Yukos. This is evident from the company's ownership structure as of 2002, which is shown in Table 4 (see Appendix). This ownership structure conveys that despite Bank Menateps' continuing majority stake in Yukos, there also began to develop a growing presence of foreign investors, a phenomenon that really did not exist prior to 1999 (Henderson and Radosevic 9). In addition to that, Yukos shares also began trading on the Berlin, Frankfurt, and London stock exchanges and on the over-the-counter (OTC) market in the United States. Given that Yukos' focus, from 1999 and on, was on

attracting foreign investment, the company's listing on these developed markets is considered a valuable indicator of the company's increasing ability to raise capital in international markets. The company's improved corporate governance practices also created favorable conditions for those stockholders who would decide to sell their shares, especially to strategic foreign investors. Thus, by 1993, Yukos was able to increase its value from \$1 billion in 1999 to over \$20 billion dollars (Goldman 149-50).

## **CONCLUSION**

This paper has presented a model for analyzing the controversies surrounding Russia's privatization program through the case of Yukos Oil Company. This case study conveys that Yukos' initial stages of privatization, from 1992 to 1999, did not result in the anticipated efficiency gains of privatization. This was primarily because the reformers "in Russia thought that the central tenet of their faith, private property, was ultimately all that mattered" (Hoff and Stiglitz 2-3). But Yukos proved them wrong. In fact, Yukos shows that the economic and political environments, conducive for the establishment of an efficient market economy, must first be intact to ensure that privatization would establish efficient private enterprises. Otherwise, the incentives created by privatization may lead to asset stripping rather than wealth creation, as was the case with Yukos until 1999. This case study further conveys that once Yukos' management began introducing transparency and significantly improved the company's corporate governance practices, then skeptical foreign investors began to feel confident about investing into the company. Only then was the company exposed to those investors who brought in new capital and new technologies, which allows the privatized Russian company to upgrade its inefficient corporate practices and begin developing into an efficient private enterprise.

## **WHAT'S NEXT FOR YUKOS**

The question facing Yukos now is whether the company will be capable of sustaining the value-creating strategy and its steady growth rate in the long-run. Since Mikhail Khodorkovsky's arrest in October 2003, Yukos has entered a new stage and faces new political and economic challenges. A more

prolonged time span is necessary to determine if Yukos will be capable of sustaining the steady growth under the management of its new CEO, Simon Kukes.

In order to determine if Yukos will indeed be capable of sustaining the value-creating strategy, which led to its steady growth rate, it is necessary, in my view, to understand the current interplay between politics and the economy in Russia; the assumption here again is that today's political state affects today's economic actions. This interplay can be observed from Khodorkovsky's arrest and Yukos' investigation, which most western observers presume has a political, not a legal basis. The controversy concerning Khodorkovsky and Yukos has alarmed the international investment community, which was just beginning to trust Russia's newfound economic and political stability. And because a value-creating strategy often requires investing capital today for generating future profits, Russia's resurging political and economic instability will make strategic enterprises, such as Yukos, skeptical about investing into an uncertain future. Yukos will accordingly, in my view, be incapable of sustaining the value-creating strategy and the steady growth that the company demonstrated between 1999 and 2003 in the long-run.

## APPENDIX

**Table 1**

SUBSIDIARIES	YUKOS
Oil Production	Yuganskneftegaz Samaraneftegaz
Oil Refining	Kuibyshev Refinery Syzran Refinery Nobokubishev Refinery
Oil Distribution	Bryanskneftprodukt Voronezhneftprodukt Samaranefteprodukt Orelneftprodukt Lipetskneftprodukt Penzaneftprodukt Ulyanovsknefteprodukt

Source: Yuko Iji

**Table 2**  
Yukos Idle Oil Wells

January 1, 1995		July 1, 1995		October 1, 1995	
Idle Wells	% Total Wells	Idle Wells	% Total Wells	Idle Wells	% Total Wells
5,927	36.2	5,675	34.4	5,947	35.8

Source: "A Higher Law"

**Table 3**

<b>Yukos Ownership Structure in 1996</b>	
<b>State Share (pledge to Menatep via loans-for-shares)</b>	<b>33.30%</b>
<b>Yukos Invest</b>	<b>7.05%</b>
<b>Companies Controlled by Menatep</b>	<b>38.57%</b>
? Astarta	18.0%
? Makhaon	15.0%
? Tonus	5.57%
<b>Russian Investors</b>	<b>12.79%</b>
<b>Others (mostly Yukos insiders, including employees and management)</b>	<b>8.29%</b>

*Source: Yuko Iji*

**Table 4**

<b>Yukos Ownership Structure in 2002</b>	
<b>American Depository Receipt (ADR) holders</b>	<b>12.8%</b>
<b>Union Bank of Switzerland Exchangeable Bonds</b>	<b>2.5%</b>
<b>Other individual and institutional shareholders</b>	<b>10.6%</b>
<b>Veteran Petroleum Trust</b>	<b>10.0%</b>
<b>Treasury</b>	<b>3.6%</b>
<b>Group Menatep</b>	<b>60.5%</b>

*Source: Henderson and Radosevic*

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**“A King Can Do No Wrong”:  
The English Reformation and the Rise of the  
Modern Nation State**

**Michael J. Sechler**

The English Reformation under Henry VIII changed the political and religious face of 16<sup>th</sup>-century England; the break with Rome and the establishment of a Church of England independent of the papacy created, for the first time, an English 'empire.' It was also under the auspices of the Reformation that Henry and Thomas Cromwell were able to justify the dissolution of the monasteries, thus adding greatly to the royal coffers. The birth of a sovereign nation-state whose king was the sole adjudicator in matters ecclesial and secular was unprecedented in Western Europe; the unification of Church and State was an English idea born out of the mind of an English king. The Reformation gave Henry VIII the power of becoming "a never erring judge' – the instrument of revolution by which the medieval church was swept away" (Smith 119). The assertion that "a king can do no wrong," fortified by centuries of legal custom, found renewed vigor in Tudor England; "Tudor and early Stuart lawyers, working within the order theory of kingship, generally interpreted the maxim as guaranteeing royal immunity" (Greenberg, *Grand Maxim* 216). The English Reformation created an empire in which the king had no other peer but God. Not until the English Civil Wars and the Glorious Revolution of the Stuart era would the maxim "a king can do no wrong" waver from the interpretation placed on it by the Henrician Reformation. Royal supremacy was born.

Henry VIII's decision to rid himself of Catherine of Aragon, "his fat, sterile, forty-two-year-old wife" (117), and to marry Anne Boleyn was born out of a lack of a male heir (Catherine had given him a daughter, Mary) to inherit the crown after his death. Henry Tudor knew well that a male heir was the only way to secure the Crown and ensure the continuation of the Tudor line of kings. To do so, Henry would need an annulment from Pope Clement VII. Obtaining an annulment might have been much easier for Henry had it not been for Catherine's nephew and Emperor of the Holy Roman Empire, Charles V. On May 16, 1525, the forces of Charles stormed Rome; "the city was taken . . . and plundered for several days, about 5,000 being killed. The Pope, with seventeen cardinals, fled . . . but was forced to render his person" (Burnet 9). Unable to receive an annulment from a Pope now subservient to Catherine's nephew and with his back against the wall, Henry Tudor summoned the Reformation Parliament to carry out the king's wishes of a divorce.

The Reformation Parliament, which lasted seven years, confronted a major obstacle: how to legitimately break all ties with the papacy in Rome. To do so, "reformers, under royal sponsorship,

probed historical records for proof that the English church represented the one, true religion that papists had long ago corrupted" (Greenberg, *Radical* 79). Henry needed to prove that he held rights "by ancient prescription and grant from God: [that] kings had always held powers which the papacy had then usurped" (Elton 163). Convenient for Henry's purpose was the correspondence between Pope Eleutherius and King Lucius, which supposedly occurred circa 140AD. In response to the mythical king's request for a copy of the Roman laws, "the pope declined, reminding Lucius 'that all nations are not of like conditions'" (Greenberg, *Radical* 84). Eleutherius went on to say that the English king was the "vicar of God in your kingdom . . . A king is named by virtue of ruling and not for having a realm" (84). As Henry's apologists quickly realized, such writing, though fabricated and historically inaccurate, would indeed serve to legitimize a break with the papacy. As Richard Rex notes, "as the need to establish royal supremacy and independence from Rome became pressing, the role of the papacy in English history was either written out or written off" (Rex 27). The fictitious papal message to an English king of old fit this need of 'writing off' perfectly.

Eleutherius' message to Lucius "even found its way into the Act of Restraint of Appeals of 1533. Its preamble supported the king's 'imperial' kingship by reference to 'sundry old authentic histories and chronicles' that described ancient English rulers as empowered by God with plenary power to govern both church and state" (Greenberg, *Radical* 85). The Act held that

This realm of England is an *empire*, and so hath been accepted in the world, governed by *one Supreme Head and King* . . . unto whom a body politic, compact of all sorts and degrees of people, divided in terms, and by names of spirituality and temporality, be bounden and owe to bear, next to God, a natural and humble obedience. (Pill 60, emphasis added)

Important in the wording of the Act is the word 'empire'; though it is true that previous kings "claimed to be emperors . . . the meaning here is different" (Elton 161). Kings of old claimed the title of 'emperor' because they "ruled, or claimed to rule, *more than one kingdom*" (161, emphasis added). The England of Henry VIII was different: "the word [empire] here denoted a political unit, a self-governing state free from . . . the authority of any foreign potentates" (161). Furthering the idea of a sovereign nation-state was the phrase 'one Supreme Head and King,' which effectively denied the existence of any other ruler in England; henceforth evolved the doctrine of royal supremacy, which would be expanded upon in 1534 by another act of Parliament. This doctrine of royal supremacy, which stated that "within his realms a king

was not only the head of State . . . but also the head of the church – that he was the source of not only temporal but spiritual jurisdiction – was unprecedented” (Rex 13).

With the passage of the Restraint of Appeals, Parliament’s quill “decreed that all spiritual cases ‘shall be from henceforth . . . definitely adjudged and determined within the king’s jurisdiction and authority’ and ‘not elsewhere” (Smith 121). No doubt the Act was more so the work of Cromwell than Henry himself; the former suggested that “it was monstrous . . . to have two governments in one country” (Gairdner 101). Cromwell convinced Henry that “the king should make himself supreme head of the Church in England, and then it should be treason to withstand his will in any matter” (101). The passage of the Act meant that tribunal power now flowed directly from the Crown; “a month later Henry appeared before a tribunal . . . to hear sentence delivered by an archbishop of his own selection” (Smith 121). His marriage to Catherine of Aragon finally nullified, the King was now legally married to an already very pregnant Anne Boleyn. With that, Henry VIII at long last had his wish, and in June of 1533, the realm of England had a new queen.

The story of Henry Tudor’s divorce crisis may have had a happy ending, except that in September of that year Anne Boleyn gave birth to the future Queen Elizabeth of England. The news of another female Tudor heiress came as a surprise to “physicians, astrologers, witches, and wizards, all of whom affirmed that it would be a boy” (Smith 121-22). Henry, however, could not afford to sit around lamenting his lack of a male heir; “Elizabeth’s rightful claim to the throne had to be protected, the break with Rome completed, and Englishmen ‘reeducated’ on the subject of religious and political truth” (Smith 122).

The Henrician Reformation was made official with Parliament’s 1534 Act of Supremacy. Parliament recognized that “the King’s Majesty justly and rightfully is and oweth to be the supreme head of the Church of England, and so is recognized by the clergy of this realm in their Convocations” (Sheils 85). With the passage of this Act, “the King’s new title was clearly stated; no allowance was made [however] for convenient consciences with the words ‘so far as the law of Christ allows’ [as would be found in the Coronation Oath]” (Pill 63). A short time later, “on January 15, 1535, an order was made in Council that the title ‘on earth Supreme Head of the Church of England’ should be added to the king’s style” (Gairdner 155). The Act declared England to be a sovereign state “governed by a ruler who is both

supreme head in matters spiritual and king in matters temporal” (Elton 161). Any question that may have arisen previous to the Act regarding the proper place of King and pope was forever answered; “the first [and longest lasting] effect of the Henrician Reformation was to put a new pinnacle on the ecclesiastical pyramid – the king instead of the pope” (Rex 56).

Let there be no misunderstanding, however, as to Henry's power in the Church. Formerly, “the Pope had claimed to exercise two kinds of power, entitled *potestas jurisdictionis* and *potestas ordinis*” (Pill 63). With the passage of the Act of Supremacy, Henry VIII assumed the former title; “he claimed the highest jurisdictional authority in the Church” (Elton 162). As the ‘supreme head’ of the Church, he exercised power over both legislation and administration (162). The King of England could not, however, claim any rights associated with the *potestas ordinis*, “the right to administer the sacraments, to excommunicate or to preach,” since Henry was not an ordained priest (Pill 63). Though he could not change the religious details of the Church, he was in control. Parliament granted him this power in the Act when they held that “our said sovereign lord, his heirs and successors kings of this realm, shall have full power and authority from time to time to visit, *repress*, redress, *reform*, *order*, *correct*, *restrain* and amend all such errors, heresies, abuses, offenses, contempts, and enormities, *whatsoever they be*” (Sheils 85-6, emphasis added). With these words, “Henry had now become ‘the ideological vicar’ of his kingdom whose duty was to mold public opinion and root out political and religious error” (Smith 122). In this way, “conformity of mind now joined control of the body as instruments of state security and unity” (123).

The most dramatic and widespread change that took place during Henry's Reformation was not, interestingly enough, the break with Rome. Instead, the destruction of the monasteries was the most notable manifestation of ‘the ideological vicar’ in Henry VIII. The monasteries were “an anomaly within a national church, and the crown soon viewed them as seminaries of ‘factious persons’ who recognized at heart, if not at law, an authority higher than that of the state” (123). For the new ‘supreme head’ of the Church, the monasteries were a threat that had to be eliminated.

Another theory regarding the dissolution of the monasteries focuses on money. Keeping in mind “the wealth of the monasteries, perhaps it is not surprising that an impoverished Crown, having nationalized the Church, should decide to take some of that wealth for itself” (Pill 76). The Crown was

well aware of the wealth of the monasteries; “commissions [were] issued for the valuation of all ecclesiastical property in England . . . [and the task] was done within six months” (Elton 143). The result, “the tax-book known as the *Valor Ecclesiasticus*, has been carefully tested by modern historians and found [to be] astonishingly good” (143). This tax book showed that “the monastic income was more than three times the income from all royal estates” (Pill 76). Either way, the time for monasteries to close had come.

Many now believe that such was Cromwell’s plan all along; the inclusion of the words ‘visit,’ ‘repress,’ and so forth into the Act of Supremacy would lend itself to such a conclusion. Indeed, “Cromwell . . . had had it in mind for some time, and he had precedents to guide him: he himself had been trained by Wolsey’s dissolutions in the technical details of the task” (Elton 143). While “the *Valor* of 1535 was merely a tax assessment . . . the nationwide visitation of religious houses set in motion by Cromwell later that same year was primarily intended as an assertion and practical demonstration of the royal supremacy” (Rex 60). The visitations were aimed at proving to the government (particularly Parliament) that the monasteries had failed “to perform their religious duties and to live up to Christian ideals” (Pill 77). Expectedly, the visitors found instances where

There were monks and nuns who forgot their vow of poverty and lived the life of country gentlefolk, eschewing the coarse habit of their order for the fashionable dress of the court; there were those for whom chastity had no appeal and who were not without their mistresses and lovers; there were those who were far from obedient to their superior or to the rules of their order. (77)

However, “it is natural in any human society to find people who do not quite reach the standard expected of them,” and not all monasteries were so lax (77). Even so, the visitors continued with what could easily be considered the “systematic exaggeration of monastic abuses” (Rex 61).

The scope of such inspections by Cromwell’s team was haphazard at best: “the gathering or manufacture of rumour and evidence about sexual misdemeanours, and the reporting of dubious relics and popular superstitions connected with them, form the staple of their letters” (61). From the beginning, Elton notes, “the visitation of 1535 was never intended to mend but always to end; it was an hypocritical weapon” (Elton 144). Perhaps this is why the visitations were finished with such speed; how the visitors “managed to interview all the monks and nuns in a hundred and twenty houses, and outsiders as well,

between 22 December 1535, the earliest date at which they could have started their progress through the North, and 28 February 1536, when they claimed to have finished, is hard to imagine" (Pill 82).

Afterwards, "the evidence gathered by the visitors was collated for presentation to Parliament and . . . was decisive in rallying support for the bill [calling for the total dissolution of the smaller monastic houses in England], which became law in March [1536]" (Rex 61). The presentation of the visitor's findings went along with Cromwell's plan; he had been drafting a bill calling for the suppression and dissolution of the poorest monastic houses early in 1536 (61). The Act called "for the dissolution of all religious houses . . . with a net income of less than £200 a year, the excuse being that the smaller monasteries were places of 'manifest sin, vicious, carnal and abominable living'" (Pill 82-3). In fact, nothing could be further from the truth; the decision to dissolve the smaller monasteries first came as Cromwell realized "that he could not carry out the whole dissolution at one stroke" (Elton 144). As the first phase of the dissolution began, government officials "went the rounds of the monasteries affected, dissolved the institutions, took surveys of the lands, made inventories of lead, gold, silver, and precious stones found, and disposed of the monks" (145).

The dissolution of the smaller monasteries continued (and no doubt included some institutions larger than the £200 limit legislated by Parliament) until 1537, when "the Government at last [officially] decided to make total dissolution its aim" (Pill 89). Another visitation commission was sent out in 1538 and "in the Parliament of 1539, the second Act of Dissolution validated the king's title to all monastic properties surrendered hitherto or thereafter" (Rex 67). Cromwell's process of dissolution proved to be "financially lucrative as well as politically expedient" (Smith 123). Monastic reform channeled much into the Crown's hands, as the nationalization of monastic land added nearly two million pounds to Henry's coffers (123). By the beginning of the 1540s, "Henry's income [had] almost doubled, making him one of the richest sovereigns per capita in European history" (123). The destruction of the English monasteries achieved its goal; it "destroyed the last possible refuge of papalism, enriched the crown, and anchored the new order firmly" (Elton 150).

Perhaps more important than money to Henry VIII was the new power granted to the kings of England. "This realm of England is an empire," and Henry knew that for the first time in history, an English king was its sole leader. In this manner, "God and Caesar were joined, and the medieval tenet

that divine law stood higher than either man or society vanished when Henry VIII monopolized all secular and spiritual jurisdiction" (Smith 122). The English Reformation was essentially both an expression and extension the power of the crown (Rex 71). "A king can do no wrong," originally meaning that no writ ran against God's anointed, now insinuated that the kings of England were never-erring, all-powerful, and completely in charge. James Gairdner perhaps summarizes the Henrician Reformation best when he states:

The revolution affected by Henry VIII was a thing without a parallel in history, and it is hard to realize it all at the present day. Professing to the last zeal for religion, which in early days was not altogether insincere, he had destroyed the old autonomy of the Church, suppressed the monasteries, confiscated an enormous mass of property, and hanged, beheaded, or intimidated all who looked for the restoration of the system he had broken down." (240)

That the Crown was supreme was clear; "although Parliament gave legal sanctions to the dissolutions [*inter alia*], they remained an expression of royal rather than parliamentary power" (Rex 71). Henry VIII's actions "made the nature and extent of the supremacy clear. There was nothing it could not touch short of divine and natural law" (71). In this way, "the Tudor revolution produced a much more effective example of the paternal state than anything the Middle Ages knew – something so effective that only the twentieth century has come to eclipse it. The sixteenth century called this sort of thing 'commonwealth' or 'common weal'" (Elton 185). And thus Henry Tudor's empire of England "is called a COMMON-WEALTH, in latine CIVITAS. This is the Generation of that great LEVIATHAN, or rather (to speak more reverently) of that *Mortall God*, to which we owe under the *Immortall God*, our peace and defense" (Hobbes 227).

The English Reformation transformed Henry VIII into Thomas Hobbes' 'mortal god': a man without, save God, a peer on earth. Henry's supremacy "was taken from the monarchical papacy, and it remained monarchical, even despotic" (Elton 164). The secular and ecclesiastical spheres had been united under one sovereign ruler. The Reformation of Henry VIII strengthened the Crown immensely, enough to make one wonder what may have happened if future circumstances had been different: "If he and his children had succeeded in retaining the monastic loot, the English crown might have been assured a sufficient revenue, free of parliamentary purse strings; in that case Parliament might never have found the instrument with which to transform the monarchy into the servant of the landed classes" (Smith 123). Of course, such was not the case, and approximately a century after Henry VIII secured

royal supremacy for the future kings of England, Charles I stood on the scaffold outside the Banquet Hall, awaiting execution. By that time, “a king can do no wrong,” the phrase infused with renewed vigor by the Henrician Reformation, had been turned on its head. As the radical Whig Sir Robert Howard stated, “Whereas there is a maxim in the law that the king can do no wrong, I think ‘tis very true provided you will take it in that sense which many able lawyers of old have done: That when a king *ex mere motu* does wrong, he thereby ceases to be king” (Greenberg, *Grand Maxim* 226).

The ‘grand maxim of state’, originally bolstered by the English Reformation to add “the quality of perfection to timelessness, immortality, and ubiquity,” was seen by Stuart radicals as a tool to clip the wings of the kings of England, forcing God’s anointed to abide by the laws and prescriptions laid out by his newly-declared peers, the two Houses of Parliament (214). Without Henry Tudor’s interpretation of “a king can do no wrong” and Charles Stuart’s pushing of that maxim to its extreme, the 17<sup>th</sup>-century may have never seen the rise of great thinkers such as Milton and Locke; indeed, the Civil Wars, Interregnum, and Glorious Revolution all helped to shape today’s Britain and its form of constitutional monarchy.

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**The Continuing Communist Legacy in  
East Europe**

**Megan McCaffrey**

World War II was the cataclysmic event that completely reshaped and formed the modern world. It witnessed the alliance of countries with differing ideologies on such diverse issues as economics, the law, and citizen's rights under that law. Following the defeat of Hitler, the once strong front that was the Allied powers, that is, Great Britain, France, the United States, and the Soviet Union, quickly split into two different factions; capitalist democracy, the other Soviet communism. The Iron curtain descended upon Europe, dividing the eastern and western parts of the continent. The Soviets vastly increased their sphere of influence throughout much of Europe, as they took over the governments and nations of Poland, Hungary, Czechoslovakia, Romania, Bulgaria, Albania, and Eastern Germany among many others.

Although there were several attempts to change the imposed communist regimes in the East, each failed, and the communists held on to their power over the people. However, by the 1980s, despite their total control of society, the governments could no longer hide the fact that the communist countries of east Europe were far behind the West. Whether evidenced in standards of living, or gauges of human rights, the people under communist rule realized there was more in the world, and they wanted to be a part of that world. Thus, 1989 was the year of (almost entirely) peaceful revolutions, where the citizens of the nations rose up in protest against their communist repressors. The oppressed east Europeans called for a "return to Europe" and a governmental system different from the one that had been ruling their lives for the past decades. The 1989 euphoria was felt around the world, as the communist empire quickly and unexpectedly collapsed. And yet, "Some of the hopes for the dawn of a new world order of co-operation and mutual trust espoused by politicians proved unrealistically optimistic" (Pribán 2). There were impractical expectations of the quick implementation of democracy in these nations, all of whom had just spent 40 repressive years behind the iron curtain. Many felt that the Soviet vacuum would be quickly filled through democratic institutions (which did not even exist), and that the privatization of the state controlled economy, and the subsequent participation in the capitalist world, would be a smooth and easy transition.

However, these idealistic notions were not achieved. "In 1990, 'Freedom' was on everyone's lips. Many anticipated that the relationship between the citizen and the state would change immediately. But it did not happen" (Macovei 1). The ramifications of the transformation to democracy, in countries with no

democratic traditions, are still being felt almost fifteen years later. Functioning democratic institutions, a civil society based on these ideas, and a more or less stable capitalist economy, free of corruption, were not achievements that occurred overnight in the non-communist, westernized sectors of the globe. Thus, it is completely unrealistic to believe that such institutions and ideals can be implemented and internalized in such a short time in these recovering nations. For example, there is no question that five years from now, there will still be the defining notion of an "East Europe." Due to its time under communism, and the ensuing legacy of that communist rule, the wrenching adjustments to democracy and capitalism will most definitely be difficult for these countries to surmount. "History does matter and Leninist legacies have importantly influenced the choices of political elites since the collapse of communism" (Tismaneanu 1).

This "Leninist legacy" that is evident today is the product of the Soviet interpretation of communism that was imposed upon East Europe and its citizens. Such Soviet ideology included the centralization and collectivization of all industry and agriculture, and the complete elimination of the private sector of the economy. This intervention therefore resulted in a directly state run economy, that would later prove to be ineffective, unproductive, and eventually, too backward to compete with West Europe. While there was, basically, full employment within the centralized state, it was not necessarily merit or skill based. Therefore, due to the socialist ideal of a fully employed society, many companies lost money, and maintained out of date machinery and production tactics in order to insure employment, despite economic disadvantages. By maintaining so many of these ineffective workers, industries did not modernize to the same standards as the West, and consequently fell greatly behind the industrial and consumer advances of its western neighbors.

In conjunction with these economic protocols, these nominal "People's Republics" were forced to recognize the superiority, and therefore, supreme power of the communist party, whose leaders were often installed by the Soviet Union. The nation and its citizens were made to repudiate the democratic ideals that were conducive to the idea of a "Republic." Soviet directives mandated the elimination of all other parties, and the centralization of the government and society through the totalitarian state. In conjunction with this external pressure, local communist parties internally desired the elimination of dissenting political groups; neither group tolerated opposition. This therefore meant the negation of the democratic processes, as the communist party ruled the state in all its manifest forms, including the police

force, legislative branch, and the judiciary. Rule was imposed from above, and repressive regimes, which completely ignored civil and human rights, maintained their legitimacy with a combination of fear and erratic, unpredictable purges of their respective societies. This culture of fear permeated the everyday citizen's life, and many became embittered and distrustful of both the communists and their local governments and institutions.

The year 1989 saw the dismemberment of the Soviet sphere and the end of Soviet domination across Europe and around the globe. However, despite the initial euphoria, overwhelming evidence points to a sluggish realization of many of the revolutionary goals. East European citizens are not seeing many of the tangible benefits of the switch to a capitalist system. In the political arena, although many strides have been made, political instability, which so often accompanies democratization, is still common in some nations. Economic hardships, such as the loss of guaranteed employment and soviet social and security benefits, have also made the situation difficult to bear. To achieve results in a democratic system takes time, and many critics worry that, with the political instability, the economic hardships, and the rampant corruption of these countries, citizens will turn to radical measures to solve their concerns. Some such extreme measures have already been seen in the wars in Yugoslavia, and the rise of nationalist, xenophobic political parties in select states. Others worry that many will look upon the securities of the old Soviet regime in a nostalgic manner, and once again, see the rise of unreformed communist parties. "Envy, disappointment, rising crime and continuing corruption have all spawned disillusionment. Former communist politicians have traded on those emotions to bring themselves back to power or closer to it in practically all post-communist states" (Bransten *Ten Years* 3).

Although some orthodox, hard-line communist parties do exist in the region, many of the current communist parties are not looking for a return to Soviet style domination and hegemony. In fact, many communist parties, such as those in Poland and Hungary, have shown themselves to be strongly committed to neo-liberal economic policies and western integration. This highlights the fact that, despite the difficulties of overcoming the long tradition of authoritarian and non-democratic rule, many East European countries have undoubtedly progressed since 1989. The region has truly made some extraordinary achievements in such a short amount of time. This is not to say that there are not still many issues the area needs to tackle, or that the communist legacy is fading, because it is still unquestionably

strong. But rather, the extraordinary progress of the region should be noted here; it is most definitely on its way toward the long-term realization of many of its goals.

Yet despite its many achievements, the region is still lagging behind in key areas. One such goal, and a hallmark of the '89 revolutions, is in the sphere of democratization. As authors Rose, Mischler and Haerper caution, "democratization is a process that requires time. Kenneth Jowitt cautions, 'it would be more accurate to think of a "long march" rather than a simple transition to democracy.' A regime starting to democratize faces many uncertainties; the only certainty is that its predecessor has failed and left a legacy of problems" (Rose 45). One such problematic legacy is the absence of a pluralistic society. The notion of such a society ". . . in which different interests compete for power and influence is alien to great parts of the population in Easter Europe. Values like self-restriction, capability of compromise and negotiating which facilitate, both on the side of the ruling as well as one the side of the governed, a balance of interests in a parliamentary democracy, have not yet been established in the post communist societies" (Wiedenfeld 27). This is not to say that political values are completely absent within the region. In analyzing the nations of the Czech Republic, Hungary and Slovakia, Miller, White, and Heywood have highlighted the existence of socialist (equality and the proper role of the state), nationalist (the integrity and uniformity of the state), and liberal values (individual freedom and limited government) as well as values of popular control (the right of citizens to determine how they are governed) (Miller 2). Most citizens of these nations are committed to liberal, populist, and nationalist values as well as multiparty elections.

However, the differing stances of parties in these arenas are murky. For example, the analysts found that, in Hungary, those who preferred the socialist party and those who were opposed to it, and therefore supporters of the Free Democrats, were all similar in their votes in three of the four listed values, and only differed in their support of nationalism. The Free Democrats were found to be 20% less nationalist than the socialists due to their cosmopolitan background. Furthermore, the governing Hungarian Democratic Forum was also incredibly similar to the socialist party in their support of socialism and nationalism (Miller 321). So, while there is the presence of political values within some of these formerly communist countries, there is a difficulty in discerning different political stances. There is even difficulty in placing these parties on a political left-right spectrum. "Of course . . . people might well adopt

coherent sets of principles without finding a simple word or phrase to describe them or, if they did, that word might not be 'left' or 'right' . . . in post communist countries any simple left-right ideological distinction was 'blurred and distorted' because 'virtually all parties were overtly committed to dismantling state socialism'" (Miller 307-08). This distortion within the political sphere is something these countries will need time to overcome as they continue on their path of democratization.

For instance, in the case of Poland, one of the most democratically advanced nations of Eastern Europe, the political party system is only gradually emerging as a more powerful institution. Analyst Marjorie Castle argues that political parties remain as an important intermediary group between citizens and the government, but that many parties within Poland have not developed ". . . strong linkages between themselves and their constituencies, [and] they end up unable to lay representational and mobilization roles" (Castle 1-2). Once again, this trend points to the communist legacy present in modern East Europe. "As a result of the Leninist legacy, party systems in new East European democracies tend to be dominated by new parties and newly competitive successor parties, to which neither leaders nor followers feel much loyalty" (Crawford 155). These parties were created in the turmoil of 1989, and were therefore created in response to the fall of communism. Because of this political turmoil, parties and their political leaders are seeking to establish their niche within the political spectrum, and have not developed concrete ideals and long standing party platforms. "In contemporary Eastern Europe almost all votes are up for grabs. The near absence of preexisting party loyalties not only increases the stakes and unpredictability of early electoral contests, but it also contributes to the unpredictability and apparent opportunism of party behavior" (Crawford 157). The legacy of communism is unquestionably still present in the newly formed political parties and democracies of Eastern Europe. "It is reasonable to expect that at the beginning of post-communist democratization legacies are the strongest factor affecting . . . party formation, because institutions . . . [and] reform strategies . . . tend to be indigenous to legacies at the time or because actors have not yet learned to take advantage of the new arrangements. As time elapses, however, the independent causal efficacy of institutions and new political-economic relations is likely to assert itself" (Kitschelt 60). These countries merely need time to institute such changes, thus necessitating the continuing east-west demarcation.

In conjunction with the importance of political parties in the democratic system, the development of a civil society and culture is key to the continuation of democracy. Once again, these nations have no tradition of a civic culture. Rather, these democratic and national traditions were destroyed by the communist rule. Throughout the forty years of Soviet dominance, societies and the people within them were atomized in order to destroy any sort of solidified community within the communist regime. It was a further attempt by the Soviets to stamp out all activities that did not pertain to the Soviet-communist experience. Other factors that hinder the development of a civic culture, or in other words, a consensus on some basic values and democratic beliefs, "are connected to the totalitarian experiences of socialization. These experiences include, among others, wide-spread political apathy, distrust of state structures, reluctance and hesitation when faced with party systems of the western type, egalitarian trends . . . as well as scarcely developed structures of international awareness" (Weidenfeld 25). These impediments are holdovers from the communist legacy and will take a long time to dissipate. As Czech sociologist Jirina Siklova stated, "You can take power away from people relatively easily, as well as their property. But when you return that property, teaching them creativity, entrepreneurship, generosity—that can't be decreed and it can't be done in an expeditious way. That demands time" (Bransten *Ten Years* 2).

The idea of a civic culture includes the inculcation of democratic values and the notion of giving back to one's community through volunteerism, among many other factors. However, an increase in volunteerism, which many view as a positive component to functioning democratic nations, is also hindered by the communist past. Obviously, many citizens cannot afford to make contributions to the nonprofit sector, as post-communist societies have witnessed a rapid decrease in their real wages. Yet volunteerism is also hindered by this communist past.

After forty years of communism. People's attitudes are not changed overnight. One of the concerns facing the idea of volunteer service is that many citizens in the communist days were forced to spy on their neighbors and family members, reporting to proper authorities information they learned. This developed into a deep mistrust of your neighbor, and destroyed much of the cohesiveness of society . . . the remnants of this attitude represent a major obstacle to the formation of community and participation in voluntary service organizations. (Davis 3)

Due to this mistrust of voluntary, non-profit organizations, and the greater lack of a true “civic culture” within the post-communist East European states, the lines of demarcation between West and East will still be visible in the years to come.

While the previous absence of democratic institutions and a civic culture are intrinsic to the understanding of the continued distinctiveness of East Europe, perhaps an even greater qualifier lies in the economic sphere. “Profound economic transformation is taking longer than many had hoped ten years ago. In 1999 in Eastern Europe, there is no revelry. The mood among ordinary people is sober, if not downright somber” (Bransten *Ten Years* 1). Many citizens of the East European nations, and people the world over, expected a quick transition to a capitalist economy; one in which the participating countries could achieve economic success and stability, and move away from the communist past. Privatization, a necessary component in a capitalist system, has occurred throughout the region. As the European Bank for Reconstruction and Development stated in its 2000 transition report summary, “Progress has been achieved across most countries and dimensions of reform, as several countries . . . have taken significant strides towards a market economy, particularly in the areas of privatization and liberalization” (*Transition report 2000* 1). However, it also further states, “Countries continue to face considerable challenges in developing the institutions that are necessary to support their nascent market economies” (*Transition report 2000* 1). Furthermore, in its 1999 executive summary, the EBRD stated, “It [privatization] has not led to quality investment and the development of new products and production methods” (*Transition report 1999*). While privatization and some modernization has occurred within the post-communist nations, the ideological changes necessary to the development of a market economy, especially the idea of entrepreneurship, are lacking in some areas. Innovation is key to the success of any nation today, and under communism, innovation was hindered and squelched. This legacy still permeates within the post-communist societies. “Innovation is constrained by the institutions inherited from the past which limit the space of potential action, and, in fact, induce some continuity [with the old communist regimes]” (Genov 70-1).

In conjunction with this lack of innovation, a less productive workforce, yet another communist legacy, can still be seen in many East European nations. There has been undeniable improvement in the production levels and capabilities of the area, especially following Western capital investment. However,

“despite their vaunted flexibility, workers in many parts of Eastern Europe are still far less productive than those in Western Europe. Studies by labor unions here say it will take 10 to 20 years for even a relatively developed nation like Hungary to catch up to the living standards of Western Europe” (Cowell 3). This issue, combined with a decrease in foreign investment, attributed to increasing EU restrictions and a more expensive labor pool, emphasizes the continued existence of the demarcation between East and West Europe (Cowell 2-3).

Due to the transition to a market economy, the citizens of East Europe have seen a decrease in their income, and therefore, have not witnessed the supposed upswing that would come with their entrance in to the capitalist world. Inflation and massive amounts of unemployment have colored east Europe’s entrance into the world market as well. “In Hungary, the consumer-price Index rose 9.6% in July 2000, up half a percentage point from June’s 9.1%. In Poland, the figure clocked in at 11.6%, well above analysts consensus forecast of 8.7%” (Hofheinz 2). The rapid increase in unemployment, while a consequence of transformation from a state controlled economy to a capitalist, market style economy, did not make the situation any more palpable. Unemployment, a problem for both east and west Europe, coupled with rapid inflation, has also therefore served to sour the euphoric mood of the ’89 revolutions.

Yet both problems of inflation and unemployment appear to be difficult to fix in the near future. “Eastern Europe . . . is still very much an economy in transition from socialism to the free market. Policy makers there don’t spend their time trying to figure out how to fight youth unemployment. Instead, they try to make sure that their economies grow at a manageable pace, without overheating” (Hofheinz 2). Such inflation is difficult to curtail when economies are growing at such a fast rate. This problem, known as the Balassa-Samuelson effect, is yet another way in which East Europe will continue to be divided from the more advanced west. It appears that inflation may not decrease, at least to the very low numbers of the west, within the next five years. This inflation problem, coupled with unemployment rates like Bulgaria’s, which touched 20% in 2001, will be difficult to circumvent (Finn 5). In the case of Bulgaria, with a per capita GDP of only 22% of the EU average, and an average monthly salary of \$100, it is obvious that a vast chasm remains between East and West Europe. According to “the latest EU studies . . . even with 5-6 percent annual growth rates, it will take another 30 years for the leading post-communist countries to match average EU living standards and purchasing power. There are no shortcuts it seems”

(Bransten *Ten Years* 4). And without any shortcuts, it appears that the East/West divide will be around much longer.

Another issue tied to the economic problems plaguing the nations is that of crime and corruption within the post-communist states, The United States Central Intelligence Agency denotes that both the Czech Republic and Hungary are susceptible to “money laundering related to drug trafficking [and] organized crime” (“Czech Republic” 12 and “Hungary” 12 CIA world fact book). This organized crime is often headed and composed of “a portion of the old Communist political elite [who were] also able to parlay political influence into economic power. . . . [This] new economic elite of Eastern Europe is often intertwined with the criminal underworld. With the weakening of the state, central authorities are less and less able to stem the tide of criminal activities” (Róna-Taj 38). According to former Hungarian chief of the Investigation Department of the National Police, Geza Katona, “Organized crime did explode after 1989” (Mink 1).

This new criminal underworld arose due to the power vacuum that was apparent following the downfall of the communist control. And, due to the weakness of the democratic state, and its inability to persecute these criminals, it is truly a thriving world. The criminal underworld and black market economy are an illustration of the intertwining of the Soviet legacy and the new market institutions. Many of the “old commies” used the tradition of the black market, shadow economy (which was active under the communist regimes) and their old communist connections and information to entrench themselves in the new market system. Thus, this criminal world is truly an institution tying the old communist world to the new one.

It is quite normal for a newly established market economy to face serious capital shortages. The financial foundations of the private enterprises are usually very shaky and unstable. In such a situation the role of the state in the enforcement of private law becomes extremely important. The court's rapid, reliable, and effective enforcement of contracts, bankruptcy, and debt collection are crucial for the new economic actors. In this respect, the Hungarian state has miserably failed in the last few years . . . [so citizens] try to defend themselves and find other non-legal or semi-legal ways to defend their interests, without legal support from the state . . . their [organized crime's] ‘violence’ organizations have simply taken control of this area. (Mink 2)

This criminal underworld is a byproduct of the communist world because, during the communist reign, citizens were never able to turn to the state for help, as it was inevitably corrupt and ineffective. The everyday citizen was not able to get many of their basic items through the “legal” apparatus of the state,

so they turned to black market economies and personal connections to purchase those items. It is no wonder that, with the weak state institutions, this black market, and the inevitable violence that comes along with it, has continued into the post-communist nations. Once again, its longevity heralds back to the simple fact that attitudes and ways of life cannot be changed overnight. It will take a strong state, judiciary, and police force to enforce the rules of a legal market system. And, it will take time for the average citizen to inculcate these ideals in their everyday lives.

For many citizens of these nations, one of the most concrete realizations of the corruption of these post-communist nations is the presence of the old Soviet elite in the economic and political sectors. It is the notion that the “Old commies are still on top” (Bransten *Ten Years* 3). This can be witnessed in the newfound political power some former communists have gained and the wealth some have accrued due to their previous communist connections. For example, the former communist nomenklatura in Bulgaria placed themselves well in the beginning of the economic transition by quickly positioning themselves in the fledgling market, and “bilking large state-owned enterprises through various financial schemes involving shady transactions with private firms” (Nikolov 4-5). In retrospect, it is obvious that these former elites used, and continue to use, their soviet connections in order to gain economic wealth and posterity. “Former cadres who were politically purged viewed the newly emerging market not merely as a refuge, rather as a gold mine in which they could flourish . . . what sets these former members of the nomenklatura apart is that they possess know-how, money, and the ability to organize themselves. Moreover, their previous experiences and connections allow them to exploit the destabilized and poorly functioning state for their own gain” (Nikolov 4).

One such example of this corrupt system can be witnessed in Romania through the “government businessmen” who are closely connected and given preferential treatment by the state in the form of loans and contracts. The Paunescu brothers, owners of the Paunescu group, are the prime example of such “businessmen,” as they increased their wealth and power exponentially due to their communist connection. It was only through this communist connection that they were able to gain “preferential loads and credits from state-run banks . . . [and make their] fortune because of the ‘legislative vacuum’” (Mungiu-Pippidi 4). The corruption is further compounded because the brothers, in return, make monetary contributions to the government, and Iliescu’s (the current Romanian President) campaigns

(Mungiu-Pippidi 4). They use their connections, and the corrupt system, all legacies of the communist past, to gain the upper hand in these democratizing nations.

The heritage of the communist past continues through these organized crime units, and the average citizen is getting more and more disillusioned, as they see the cheaters, swindlers, and former communists gaining the upper hand in their hard-won democracies. The pervasiveness of corruption is widespread, and unfortunately, not only seen by the older, but also, the new generations of these democracies. Mona, a 16 year old Romanian, comments, "Rich? Maybe in something like 10 years you'll get rich. If you steal, it's easier---so everybody steals in this country" (Bransten *Romania* 4). With even the young witnessing and believing in the corruption of the system, there is no question that this communist legacy of crime and corruption will help to maintain the East/West divide.

With the impending integration of some of the former communist states into the European Union, there is no question that the gap between East and West Europe will begin to lessen. Yet, while integration may help to minimize some of the Communist legacies, it will be difficult to erase them. Strives have been made in the economic and political spheres of these former communist nations. However, as has been shown, these improvements are still hindered by the legacies of the past. And corruption, a major issue within many of these nations, is a modern day manifestation of that legacy. Possibly in internally addressing some of the issues of communism by opening archives and communication lines, the hurdles of history can be covered more quickly. Yet what the West did not understand about the east in 1989, and still does not fully comprehend, is the far-reaching legacy of the Communist past. This is a past that cannot be overcome overnight, and one that will serve to fractionalize the European continent for some time to come.

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**Global Operations:  
The Intelligence Community of the  
Russian Federation**

**Timothy Krysiek**

## INTRODUCTION

In 1991, as the Soviet Union collapsed, the USSR's powerful intelligence organization and political tool, the [Komitet Gosudarstvennoi Bezopasnosti](#) or KGB, was disbanded. However, various KGB directorates were incorporated into the intelligence organizations of the Russian Federation. A decade after the demise of the KGB, its successor organizations continue extensive operations around the world. Together, the intelligence agencies of the Russian Federation comprise one of the finest intelligence communities in the world. They provide the Kremlin with vital information on a variety of issues and conduct global operations in support of Russian interests. Due to the classified nature of this topic, this paper presents a description of the Russian intelligence community and its recent operations based solely upon open-source information. However, this research, combined with knowledge of Russia's current geopolitical situation, makes it possible to offer basic predictions about the motivations, intentions, and future development of the Russian intelligence community.

## THE RUSSIAN INTELLIGENCE COMMUNITY

### FOREIGN INTELLIGENCE SERVICE

After disbanding the KGB, the Russian government created a foreign intelligence service, the Sluzhba Vneshney Razvedki (SVR). The SVR inherited the responsibilities of foreign intelligence collection and analysis, formally the duties of the KGB First Directorate, or the Pervi Glavni Upravlenye (PGU). Gordon Bennett of the Conflict Studies Research Centre at the British Royal Military Academy at Sandhurst contends that the domestic chaos that reigned in the USSR and Russian Federation during the early 1990s did not significantly affect the PGU or the SVR, since the vast majority of these organizations' operations were conducted abroad. Victor Yasman, a correspondent for the Online Asia Times, also believes that, despite the budgetary cutbacks and bureaucratic reorganizations that were common in the Russian domestic and military intelligence organizations during Boris Yeltsin's presidency, the SVR was largely unaffected. It can be assumed that much of the foreign intelligence capability of the PGU was inherited, in fact, by the SVR. According to information provided by the Intelligence Resource Program of

the Federation of American Scientists (FAS), the SVR maintains offices in Russian embassies, consulates, and trade establishments throughout the world. The FAS contends that the SVR is likely organized as was the PGU during the Soviet era. The PGU consisted of three directorates responsible for illegal agents, scientific and technological intelligence, and the infiltration of foreign intelligence and security organizations. In addition, the PGU provided three primary services: analysis and dissemination, planning and implementation, and self-evaluation of the organization's operations. During the final years of the Yeltsin administration, the SVR took on a greater role in formulating and executing Russian foreign policy. The SVR will continue to be an instrumental force in Russia's foreign relations as President Putin enters his second term in office. His appointment of Sergey Lebedev, a man widely considered a Putin loyalist, as SVR director confirms Putin's intention to rely upon his foreign intelligence agency to serve both his professional and personal interests in the future.

#### **FEDERAL SECURITY SERVICE**

Russia's internal intelligence and security service is the Federal Security Service, or Federalnaya Sluzhba Bezopasnosti (FSB). According to the FAS, the FSB inherited the duties of the Second, Third, and Fifth Chief Directorates and the Seventh Directorate of the KGB. The organization is responsible for the federation's internal security, including counterintelligence operations. In 2002, President Putin granted the FSB control over the conflict in Chechnya. In March of 2003, Putin again significantly expanded the jurisdiction and resources of the FSB by giving the organization increased control over Russian signal intelligence (SIGINT) operations. The FSB and the Defense Ministry now share authority over the operations of the recently defunct Federal Agency of Governmental Communications and Information (FAPSI), which oversaw electronic intelligence gathering, including telephone and internet monitoring. Putin also granted the FSB control of Russia's border security forces. The addition of the border guards puts more than 100,000 troops, as well as artillery, boats, and airplanes at the disposal of the FSB (Feifer).

## MAIN INTELLIGENCE ADMINISTRATION

Following the dissolution of the USSR, the Soviet military intelligence agency, the Main Intelligence Administration or Glavnoye Razvedovatel'noye Upravlenie (GRU), became the intelligence division of the Russian Defense Ministry. The GRU is the elite division of Russian military intelligence charged with identifying emerging threats to national security and collecting information on foreign militaries and defense industries. The GRU's foreign intelligence capabilities are especially strong; they are comparable to those of the SVR. The GRU uses special agents and military attachés to gather human intelligence (HUMINT). The GRU's Cosmic Intelligence Directorate conducts intelligence operations from space; therefore, GRU retains significant signals intelligence and satellite imagery (IMINT) capability. Various directorates within the organization focus on developments in military technology, economics, and nuclear weapons. In addition, the GRU commands a large number of special operations personnel, known as Spetsnaz. These GRU commando units provide reconnaissance and engage enemy forces. The GRU remains "a cohesive, highly efficient, and professional military intelligence agency despite widespread budgetary and organizational difficulties facing the rest of the Russian military" (*The Federation of American Scientists Intelligence Resource Program*).

## RUSSIAN INTELLIGENCE OPERATIONS

Due to the classified nature of this subject, it is extremely difficult to understand the true nature and scope of Russian intelligence operations. However, extensive open-source research offers a limited perspective on the regional presence and tactics of the Russian intelligence community.

## COMMONWEALTH OF INDEPENDENT STATES

Research of Russian intelligence operations in the Commonwealth of Independent States (CIS) has revealed cooperation with the security and intelligence organizations of member states. Members of the CIS are signatories to various intelligence agreements. In 1992, representatives of Armenia, Belarus,

Kazakhstan, Kyrgyzstan, Moldova, Russia, Tajikistan, Turkmenistan, and Ukraine agreed to basic principals of intelligence cooperation. Signatories agreed not to conduct intelligence operations against one another and to cooperate in various capacities. In 1995, all CIS states agreed to collaborate against international terrorism, transnational crime, and illegal drug trafficking. Denis Trifonov, an expert on Russia and the CIS at Oxford University, claims that intelligence cooperation between Russia and the CIS has intensified since Vladimir Putin's ascension to the presidency. Putin wishes to improve security ties with the CIS to counteract Western intelligence operations in the former Soviet Union and disrupt the networks that support Chechen separatists. According to Trifonov, Belarus, and Russia cooperate very closely on intelligence matters. The SVR Academy trains Belarusian foreign operatives and the SVR uses Belarusian embassies and consulates throughout the world as cover for its own clandestine agents. Russia's intelligence cooperation with Ukrainian and Kazakh security services is less extensive, yet it remains significant (Trifonov). It is important to note, however, that Russian cooperation with the CIS has not precluded Russian intelligence operations against them.

Throughout the nineteenth century, Victorian Britain and Czarist Russia fought for control over Central Asia in a rivalry known as the Great Game. Today the region is again a focal point of international politics as Russia, the United States, the United Kingdom, and China compete for influence. In addition, Turkey, Iran, India, and Pakistan all have national interests at stake in Central Asia.

Within several decades, Central Asia will become the main field of geopolitical battles in the [CIS]. The stakes in this battle will be fantastically high. Central Asia is among a few places which has almost all elements of Mendeleyev's table. It has huge reserves of oil, gas, uranium, [phosphorus, and] non-ferrous metals. As is said, the person to control the Middle East, the Caspian basin and Central Asia will have the decisive say in the world. (Rostovsky)

Central Asia is a primary offensive target of the SVR and the GRU. "[Russia's] present economic situation does not permit it to return [to Central Asia] as a superpower but its geographic position and historical and ethnic links will allow it to play a major role in [the region]" (Bennet). Russia is concerned by the rise of Islamic extremist groups, "hostile governments, foreign military influence and the individual countries in the region becoming outposts for anti-Russian operations of third countries' intelligence services" (Bennett). It is certain that Russian operations in the region are ongoing. The threat of a hostile, foreign presence in this region is simply too severe to go unchecked by Russian intelligence.

Time is now playing against [Russia], experts are saying. The change of political elites has already begun in the region. [Nursultan Nazarbayev (President of Kazakhstan)], [Emomali Rakhmonov (President of Tajikistan)] and others could be flirting with the West as long as they wish, but thanks to their education, experience and development it is much easier for them to find common language with Moscow. However, within next few decades the majority of present-day politicians will leave the scene, replaced by the youths who have already studied at Harvard University, rather than [at Moscow State University] or Higher Party School. They will have no sentiments in relation to Russia. (Rostovsky)

It is essential that Russian intelligence organizations reestablish a presence in the region now, while their Soviet-era ties remain fresh.

Trifonov claims that both SVR and FSB maintain strong ties with Gazprom and Lukoil, two of Russia's energy largest corporations, and that "the SVR . . . has been instrumental in Russian attempts to dominate 'pipeline politics' in Central Asia." Central Asian states rely on the Russian-owned pipeline system to export resources and trans-shipment fees are a lucrative source of income for the Russian government. The Kremlin regards local projects to construct alternative transport routes as a security threat. Moscow is prepared to take steps to ensure continued control over Turkmenistan's gas sector. The SVR was accused of plotting to overthrow Turkmenistan's President, Sapirmurad Niyazov, in November 2002 shortly before Niyazov's meeting with the leaders of Afghanistan and Pakistan over a proposed gas pipeline (Blank). The completion of the Turkmenistan-Afghanistan-Pakistan project would make Turkmenistan independent of Russian-owned transportation systems and, consequently, be detrimental to Gazprom and to the Kremlin's plans for a Russian-dominated Eurasian gas cartel. In the future, Russian intelligence agencies will continue to cooperate with their Central Asian counterparts on matters of mutual interest. However, Russian offensive operations in Central Asia will continue to expand due to Russia's geopolitical interests in the region.

Russian intelligence agencies conduct operations throughout the Caucasus. Research reveals that Russian intelligence has attempted to influence Georgia's domestic situation. The role of Russian intelligence in the November 2003 coup against former Georgian president Eduard Shevardnadze remains unclear. According to the Russian press, "the intervention of Russian Foreign Minister Igor Ivanov, who was informed of the conspirators' intentions by Russian intelligence, saved Shevardnadze's life" ("Who Betrayed Shevardnadze and How"). However, Dr. Stephen Blank, a professor at the United States Army War College, contends that Shevardnadze was the target of repeated assassination plots by

Russian intelligence operatives because he failed to cooperate with the Kremlin. It seems certain that Russian intelligence agents played some a role in the removal of Shevardnadze; however the extent and nature of their involvement is uncertain. According to the Russian press, Russian intelligence forces played a key role in preventing South Ossetian President Eduard Kokoiti from being overthrown. Upon Kokoiti's return to Ts'khinvali from Moscow in January 2004, Russian agents informed him of an impending coup and, as a result, Kokoiti purged his cabinet of accused traitors. Meanwhile, Russian peacekeeping forces in the area were strategically redeployed to maintain order throughout South Ossetia ("Georgia: South Ossetian Leader Thwarts Coup Plot; Help from Russian Intelligence Suspected"). In addition to supporting pro-Kremlin forces inside Georgia, Russia has been actively supporting dissident groups throughout the region. Links between the SVR, GRU, and militant Georgian opposition leader Igor Georgadze, have been widely reported. Azeri leader Heidar Aliyev has been targeted for assassination by Russian operatives for disobeying the Kremlin's orders and Dr. Blank contends that SVR has provided support to Azeri opposition leader Ayaz Mutalibov. The incarceration of three Russian military intelligence agents in Azerbaijan in July 2002 reveals the efforts of the GRU to gather military information on the former Soviet republic.

As in Central Asia, 'pipeline politics' are a major issue in the Caucasus. In December 2003, a Georgian security official expressed concern over the safety the Baku-Tbilisi-Ceyhan petroleum pipeline project. The official identified Chechen groups or ecological activists sponsored by Russian intelligence as potential saboteurs. "The GRU has allegedly allocated money towards hiring or training eco-warriors and mercenaries to sabotage the 700km [pipeline]," reports Nick Paton Walsh of the *Manchester Guardian*. Once completed, the Baku-Tbilisi-Ceyhan pipeline will transport approximately one million barrels of crude oil per day from oil fields on the Caspian Sea to Turkey, where it can easily be exported to the European market. Kate Mallinson, a former analyst for the Control Risk Group, contends that the Baku-Tbilisi-Ceyhan pipeline will directly compete with Russia's Baku-Novorossisk line (Walsh).

Allegations of Russian intelligence operations in Moldova have been widespread. Moldovan President Vladimir Voronin is unwilling to support the ethnically Russian Trans-Dniester region's plan for a Moldovan federation and this is detrimental to Russian interests in the former Soviet republic. Also, the Kremlin is displeased at the possibility of EU peacekeepers entering Moldova. Russian intelligence

services have used media outlets in Trans-Dniester to discredit President Voronin by publicizing the alleged involvement of his son in illegal arms sales, specifically those to Chechen separatist groups. This fits a familiar pattern of disinformation by Russian intelligence, particularly the FSB, in Moldova.

The same scenario was used in the case of Moldova's first president Mircea Snegur, when his daughter was involved in a 'currency smuggling' scandal staged by Russian secret services. Moldova's second president Petru Lucinschi had the same fate: one of his sons was involved in a major scandal staged at a Moscow casino. ("Russian Pressures Moldovan Leader on Dniester Settlement")

Despite the terms of the 1992 CIS intelligence treaty, Russian intelligence agents appear to be operating in Moldova and throughout the CIS.

## **THE BALTIC STATES**

Following the collapse of the Soviet Union, the Baltic states of Estonia, Lithuania, and Latvia refused to join the CIS. Rather, these three countries reoriented their economic and security policies toward the EU and NATO. According to the head of Estonian intelligence, Tarmo Turkson, Russian operations against Estonia are ongoing. Specifically, he claimed that Russian agents pressured Estonian diplomats to divulge sensitive information on the EU and NATO. Turkson also suggested that Russian intelligence considers Estonia and the other Baltic states to be preferable targets to stronger Western nations ("Russian Spies Seek to Manipulate Estonian Diplomats"). Estonian national security officials have accused Nikolai Scherbakov, the First Secretary of the Russian Embassy in Tallinn, of working for Russian intelligence ("Russian Diplomat in Drunk Driving Accident in Estonian Capital"). KGB veteran Oleg Gordievsky estimates that at least 30 SVR agents are present in Estonia alone (Sildam).

The Lithuanian parliament is currently investigating the relationship between President Rolandas Paksas and Yuri Borisov, a wealthy ethnic Russian businessman who is accused of being an illegal arms dealer and a Russian intelligence operative. Concerned by Borisov's access to the president, Lithuanian security services performed electronic surveillance on him. "Arturas Paulauskas, the Speaker of Parliament, says [the scandal was caused in part] by tip-offs from foreign intelligence services, who are keen to see Lithuania clean house before joining NATO" ("Dropping the Pilot"). Thus far, the parliamentary commission has discovered connections between Paksas' office and Almax, a Russian

public relations firm believed to be a front organization for Russian intelligence (Mainville). Borisov's access to Lithuanian leadership may extend beyond President Paksas. "A dossier given to parliamentary leaders by Lithuania's security services says that Mr. Paksas's national security advisor, Remigijus Acas, was one of several senior figures acquainted with [Borisov] ("Dropping the Pilot").

## EUROPE

The collapse of European communist regimes and the dissolution of the Soviet Union severely reduced Russian political and economic influence in Europe. However, extensive SVR and GRU operations on the continent continue. The Pruszkow mafia is a well-known Polish crime syndicate that, since the early 1990s, has been intimately linked to Solncevo, a prominent Russian mafia organization. In the mid-1990s, the FBI reported that Solncevo was the largest Eurasian criminal organization. This estimate was based upon its extensive assets, political influence, and financial operations. The FBI contends that Solncevo's leaders are, in fact, Russian intelligence commanders. With a presence in over 80 countries, Solncevo represents a powerful tool that, to a great extent, is at the disposal of the Russian intelligence community ("Mafia, Inc. - Polish and Russian Gangsters Co-operate"). Solncevo and its affiliates provide Russian intelligence with access to a variety of organizations and individuals throughout Eurasia.

Widespread evidence exists of Russian intelligence operations in the Czech Republic. The Czech Intelligence Agency (BIS) reported in 1997 that Russian intelligence agents purchased a significant amount of property in a city in western Czech Republic. Karlovy Vary, a municipality with an ethnic Russian population of almost 15,000 and ties to both legitimate and illegitimate Russian businesses, is considered to be a regional base of Russian intelligence. BIS also contends that Russian business interests are rapidly purchasing shares in Czech companies in an effort to significantly increase Russian influence over the nation's economy (Wesolowsky). A strong presence in the Czech Republic would indeed benefit Russian intelligence, since the nation is a NATO member and recently joined the EU.

In June 2003, evidence of Russian industrial espionage in Sweden was revealed. Three employees of the Swedish company Ericsson were convicted of passing classified information to a Russian intelligence officer under diplomatic cover. In this case, Russian operations were designed to recover information initially stolen by Swedish agents. According to both governments, Swedish operatives illegally obtained radio-hardware technology from Russia that Sweden needed to upgrade its JAS fighter jet (Dal). Collecting and protecting scientific and military intelligence is an important duty of the SVR because technological developments have the potential to radically alter Russia's national security.

## **THE MIDDLE EAST**

During the Soviet era, the KGB was active in the Middle East. Today, the Russian intelligence community maintains a presence in the region. Russian operatives are obviously at work in Iran. President Putin responded to international criticism over Russo-Iranian nuclear cooperation by claiming that Western firms are also actively assisting Iran with nuclear projects; he cited his intelligence services as the source of this information (Zlobin). President Putin publicly praised his intelligence agencies for accurate and detailed predictions of American and British operations throughout the Second Gulf War. The US-led invasion of was highly detrimental to the Russian intelligence presence in the Middle East. The vast majority of SVR and GRU operations in the region were based on the Kremlin's relationship with Saddam Hussein and his intelligence service, Mukhabarat ("The Russian Federation – The Presidency"). It appears that Russian intelligence services are also at work in Afghanistan. In May 2003, a Scottish newspaper claimed that Russian intelligence organizations were providing financial support to Afghan Islamic fundamentalist groups dedicated to overthrowing the American-backed government of Hamed Karzai ("Russia Denies Scottish Report of Financial Backing for Taleban"). The Afghan central government is still weak and NATO forces are concentrated only in specific geographic areas throughout the country. These conditions make it relatively easy for Russian intelligence agents to reestablish a presence in Afghanistan and throughout the Middle East.

## **NORTH AMERICA**

In 2003 the SVR received a direct order from the Kremlin to dramatically increase its intelligence gathering throughout the United States and Canada, according to former FSB officer Alexander Litvinenko. The FSB and SVR have engaged in widespread efforts to recruit Russian emigrants, using the threat of criminal charges and extradition to Russia as incentives to cooperate (“Russian Intelligence Services Denies Allegations on More Intensive Activity in Europe, US”). Former CIA director Robert Gates stated that since the collapse of the Soviet Union a decade ago, Russian intelligence services cut back operations in many countries, but intensified efforts in the United States. There is a consensus among experts that Russian espionage activities in North America are now at a level comparable to Soviet activity during the Cold War. The KGB was primarily concerned with assessing America's military capabilities. However, according to former CIA director James Woolsey, Russia's main espionage goal in the United States is to uncover technological secrets (Zakaria). In December 2003, Canada, one of America's closest military allies, expelled two Russian diplomats believed to be GRU agents collecting information on military technology (Weir). Although Moscow and Washington remain wary of one another, Russian and American intelligence services appear to be cooperating, at least on a limited basis, on issues of international terrorism and illegal arms transactions. In April 2003, the US government announced that the financial assets of organizations linked to Chechen separatist groups would be frozen (Yanchenkov). In August 2003, the American FBI, British MI-5 and MI-6, and the Russian FSB worked together to stop the shipment of a surface-to-air missile system to the United States (“FBI, FSB Cooperate in Antiterrorist Sting”). Despite limited cooperation on certain issues, the Russian and American intelligence communities continue their historic rivalry.

## **DOMESTIC OPERATIONS**

For over a decade, the Russian government has attempted to suppress separatist movements in the predominantly Muslim republic of Chechnya. The conflict began as a Chechen war of independence; however, an influx of foreign Islamic fighters has altered the situation. Stratfor and the Economist

Intelligence Unit report that Russian leadership is employing a new strategy that demands intensive intelligence operations in its campaign against Chechen separatists. At a meeting of top Russian commanders in the North Caucasus in January 2003, General Vyacheslav Tikhomirov, director of Russian Interior Forces, announced his decision to use Spetsnaz units, acting on advanced intelligence, to conduct preemptive strikes against militants. The general also stated that the support networks that aid and equip Chechen rebels will become targets of intelligence-led operations in the region ("Russia Risk: Alert - New Tactics in War against Chechen Militants"). Highly trained GRU military intelligence teams will almost certainly be the primary tool used to implement these new policies. To effectively disrupt Chechen support networks, foreign intelligence operations are also necessary. The February 2004 assassination of former Chechen President Zelimkhan Yandarbiyev by a car bomb in Doha, Qatar, may be an example of just such an operation. Although no group has claimed responsibility for the attack, Russian intelligence forces are likely behind Yandarbiyev's death ("Chechnya: A Murder in Qatar"). Russian intelligence officials accused Yandarbiyev of planning the Nord-Ost theater siege in Moscow in 2002 and providing logistical assistance to Chechen separatists. Russia's new, pre-emptive, intelligence-led strategy in the war against Chechen separatists appears to have been implemented, not only by the FSB, but also by the SVR.

## **THE FUTURE OF RUSSIAN INTELLIGENCE**

Given the capabilities and operations of Russian intelligence revealed by open-source research and considering the domestic and international issues facing the Russian Federation, it is possible to make general predictions regarding the future of the Russian intelligence community. Based on open-source research, it appears that SVR lacks the ability to conduct highly technological collection. The SVR is highly dependent upon GRU and the FSB for extensive IMINT and SIGINT. The SVR retains exceptional HUMINT capability, which, given the nature of many of its operations, is extremely important. However, in order to compete with the foreign intelligence services of other great powers, specifically the American agencies, the SVR must have unfettered access to the technological resources of the GRU and FSB. Considering the typical nature of interagency politics, it is likely that the future operations and

analysis of the SVR will continue to suffer from a lack of IMINT and SIGINT. Despite its technological deficiencies, the SVR will become the Kremlin's most valuable foreign policy instrument. SVR is a more flexible and effective than the Foreign Ministry and the agency is better prepared to respond to global challenges than the majority of Russian military forces.

As previously discussed, the extraction and transportation of natural resources in Central Asia and the Caucasus is an issue of vital importance to the Kremlin. In the future, Russian intelligence will carry out regional sabotage operations against oil and gas facilities independent of Russian control. The Baku-Tbilisi-Ceyhan pipeline may be a particularly attractive target for the Russians because it runs through southeast Turkey, a predominantly Kurdish region, and Russian intelligence actively assists Kurdish militant groups. It is fair to assume that the Russian intelligence community will monitor the CIS for evidence of enemy sabotage operations against Russian energy interests.

Russian intelligence has successfully infiltrated a number of countries through its connections with Russian organized crime groups. In the short-term, Russian intelligence operatives will continue to experience success with this tactic. However, as former Soviet satellite states in Europe integrate themselves into European and trans-Atlantic economic and security structures, the presence of organized crime groups will eventually be significantly reduced. If the SVR wishes to maintain a long-term presence in Central and Eastern Europe, it must entrench itself in these regions through legitimate economic ties. The SVR's purchase of land and property in the Czech Republic is an example of this 'entrenchment' strategy. Furthermore, considering the global reach of Russian organized crime syndicates such as Solncevo, Russian intelligence officers may employ the 'infiltration and entrenchment' technique throughout the world.

Research has revealed several Russian operational advantages. Russian intelligence agents working within the CIS and Baltic states have the benefit of operating in familiar territory, possibly against former Soviet colleagues. Russian intelligence enjoys a strong position in several NATO countries and in many new EU member states. It can safely be assumed that SVR, GRU, and FSB operations in these countries will remain at their present levels or increase because these states provide Russian intelligence with a useful platform for conducting operations against European and trans-Atlantic political and military organizations.

The Russian communities in the industrialized democratic countries have grown enormously. This network of new Russians can be explored by the SVR and the GRU, because much of what they have has been stolen and they can be blackmailed. Human intelligence has historically been Russia's strong point. Its main advantage in Russia's present economic situation is that it is cheap. (Bennett)

Russian operations in Europe and North America enjoy notable HUMINT advantages.

Economic intelligence will become a major concern for the Russian intelligence community in the future. The growth of the global economy has generally increased the importance of transnational industrial espionage. However, considering the importance of Russia's petroleum and natural gas industries to the federation's international relations, it is realistic to assume that the Russian foreign and domestic intelligence services will be used to monitor developments in the energy sector. Understanding the activities and intentions of foreign firms and Russian businessmen, especially the oligarchs, will become a primary task of the FSB and the SVR. The arrest of prominent Russian businessman Mikhail Khodorkovsky by FSB agents in October 2003 demonstrates President Putin's willingness to use his intelligence services to monitor, and, if necessary, restrain uncooperative Russian businessmen. In order to more effectively grapple with the effects of globalization, the Economic Development and Trade Ministry will propose the creation of its own economic intelligence agency in the foreseeable future ("Proposal to Demilitarize Russian Intelligence Services, Establish Economic Intelligence Unit; Airborne Forces to be integrated into Army").

As a former KGB intelligence officer, President Vladimir Putin is highly familiar with the superb quality of Russian intelligence community and the services it is capable of providing. Putin has assigned key government posts to his former colleagues, many of whom are former intelligence and security officers (Feifer). Besides enhancing Putin's personal power within the government, these appointments ensure that Russian leadership at various levels is familiar with the Russian intelligence community and its capabilities. Russia's financial weakness and military decline will force its leaders to rely more heavily upon its intelligence services to deal with the country's many foreign and domestic issues. The Russian intelligence community is now and will continue to be an essential guarantor of Russia's national security.

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**Money and Moral Economy in  
the Early Works of James Joyce**

**J. Elizabeth Strohm**

Despite the variety of characters and attitudes crafted in *Dubliners*, James Joyce's ensemble is composed largely of the lower-middle class and the petty bourgeoisie, who have enough money to squander it occasionally, but not so much to forget the constant financial pressure behind every decision they make. They possess sufficient funds to enter trivial, personal power struggles, but they cannot overcome the political, social and economic paralyses that stem from their poverty. Portrayed in a mentality of class isolation — members of the other classes, both lower and higher, enter the stories only as accessories to the action or stimulants to other characters' emotions — the trifling middle class characters in Joyce's stories devise a financially based moral code, completely independent of their traditional Catholic values. Fiscal consciousness paralyzes the characters in perpetual immaturity, preventing them from establishing responsible attitudes or fully developed relationships in lifestyles that reflect the forced immaturity and instability in Irish politics that Joyce sought to escape and amend through his work.

Corley and Lenehan, of the story "Two Gallants," embody the skewed values — moral, economic and sexual — that result from a life where money and the alcohol it can buy function as ultimate goals, superseding all other desires. Throughout the story, the two young men talk about a "fine tart" whom one "gallant," Corley, claims to have won and intends to pursue (*Dubliners* 30). Some minor patter is given to the sexual possibilities entailed in the encounters, but Corley's thoughts and energy turn in the end toward borrowing funds from the woman. Corley's desire for money, which outweighs his desire for sexual favors or romantic company, makes Lenehan's sincere comparison of Corley to "a gay Lothario" seem mocking and quite ridiculous; it only accentuates Corley's immaturity when he extracts booze money from a woman's fondness (*Dubliners* 31). The end of the story leaves Corley proudly displaying a coin to his expectant buddy, while the anticipated object of his affection, the woman, has left the scene.

Desperate to fit in with the high class to which he aspires, Lenehan tries to pretend money does not matter to him as much as it does. "Glancing warily up and down the street" before entering a "poor-looking shop" to eat, Lenehan seems ashamed to go into a lower-class eating establishment. Though his hunger drives him into the shop, he observes the "slatternly girl" who waits on him with scorn and feels awkward in the presence of the blue-collar customers in the restaurant (*Dubliners* 34). He makes a conscious effort to fit in by pushing back his cap and speaking "roughly, in order to belie his air of

gentility.” His deliberate act, however, does not shatter his air of snobbery as effectively as his necessary question about the cost of a plate of peas when he orders food (*Dubliners* 35). Lenehan believes his social position is above the others in the restaurant, yet he is not even certain he can afford a plate of peas in a cheap restaurant. Behind his effort to sustain a weak façade of gentility, Lenehan leads a life dominated by money (Benstock 194).

The seemingly young men, who are actually in their thirties and of an age to be raising families and holding jobs, are paralyzed in perpetual boyhood. Girls are still foreign creatures to be teased and used, but they are not yet tangible objects of desire to the men (Ghiselin 80). Lenehan can only imagine his friend and the woman as “the pair of lovers,” with Corley voicing “deep energetic gallantries” — an imagined scene that parodies a real romantic relationship (*Dubliners* 35). Feeling his own failure and immaturity more desperately when he imagines the scene between Corley and the woman, Lenehan satisfies himself with his friend’s romantic discoveries because he cannot gain any experience himself. Though he tells himself he “knew the girls” and wants to establish a stable home, he cannot imagine anything better than a “simple-minded girl with a little of the ready” (*Dubliners* 35).

Dreaming of his ludicrously anti-climactic future, Lenehan cares about finding a large dowry as much as a lass loony enough to marry him, while Corley is no more involved in a passionate love scene with his woman than Lenehan is with his plate of peas. The men are emasculated by their social, financial and sexual immaturity, which prevents them from establishing mature relationships or progressing beyond their eternally childish minds and attitudes.

Despite Joyce’s disdain for financial tyranny present in his time—as well as ours—he did not keep himself above all monetary dealings. Joyce frequently struggled to find the money to fund his writing and to sustain him during less profitable periods of work. In such times he demonstrated no qualms about procuring wealthy patrons, whom he could tap for the necessary money to sustain an artist’s life and work. Through his short stories and novels, Joyce sought to reform the system that threatened to eliminate many Dubliners’ livelihoods — including his own.

Perhaps the most striking example of a human relationship contorted by monetary values occurs in “The Boarding House,” when Polly Mooney’s mother sells her to a boarder, Mr. Doran, somewhat against Mr. Doran’s will (Williams 444). The mother treats her daughter like an investment, sending her

away to work until the “disreputable sheriff’s man,” the girl’s father, seems to infringe on the mother’s possession of Polly and she brings her daughter home (*Dubliners* 39). Possessing no doubts about her ability to make judgment calls in any situation, Mrs. Mooney “dealt with moral problems as a cleaver deals with meat” (*Dubliners* 39). She cuts through what she views as useless fluff to the heart of the issue — the profit. “She knew some mothers who could not get their daughters off their hands,” but as she thinks about Mr. Doran, Mrs. Mooney regards the situation as if she had chosen the stock in which she will invest her daughter — and in a way, she has (*Dubliners* 41). Mrs. Mooney uses her daughter as an object of transaction by manipulating the girl’s sexual services and uncertain affections to procure the financial security of a marriage. Waiting to step in until “the right moment,” Mrs. Mooney evidently does not wish to prevent the lovers’ union, but rather to capitalize on the “bit of stuff” she suspects Mr. Doran has saved (*Dubliners* 39, 41).

Mr. Doran, Polly’s lover, offers a sharp contrast to the mother’s economic morals. Though he remembers his encounters with Polly with affection and tenderness, he firmly decides that “the sin was there; even his sense of honor told him that reparation must be made for such sin” (*Dubliners* 42). Mr. Doran’s sense of wrong is rooted in the traditional Catholic conception of virtue and sin, while Mrs. Mooney gauges her values on a monetary basis and feels no shame in pressuring Mr. Doran to marry her daughter. As a result, Mr. Doran is willing to marry Polly because he feels he is morally obliged, after having had sex with her, to maintain her honor in a legal union. Mrs. Mooney is willing to give away her daughter because she considers it to be her daughter’s moral obligation to find a fiscally sound relationship and cease to burden her mother with monetary demands.

A similar daughter-into-profit transformation occurs in “A Mother,” when Mrs. Kearney bargains with her daughter Kathleen’s musical career by turning her performance into a profitable commodity — and destroying her daughter’s chance to perform when the profit fails to materialize as she hoped (Williams 444). This illustrates that Mrs. Kearney values not only the opportunity to increase her social status, but also the opportunity to earn a little money, above the opportunity for her daughter to develop a musical career. Mrs. Kearney could easily reveal what Polly will become in thirty years; she married Mr. Kearney simply for lack of a better suitor and under pressure of friends who “began to loosen their tongues about her” (*Dubliners* 91). Her esteem for social propriety, which the narrator uses to describe

her reasons for marriage, emphasizes the prevailing importance of money when she sabotages her social life for a small profit later in the story. Social pragmatism may have determined her marriage, but fiscal pragmatism, more properly called “greed” in her case, seems to determine her life thereafter.

Mrs. Kearney tells herself her biggest concern is for the status of her daughter, Kathleen, and she conducts herself accordingly by teaching her French and music and securing her a prominent role in a Society concert. She successfully manipulates people without breaking social rules in the planning of the concert, and she appears to act out of desire for status and honor, instead of money. Losing that appearance when the organizers of the concert withhold a single shilling — five percent of Kathleen’s salary and the rough equivalent of five U. S. dollars, Mrs. Kearney walks out of the theater with her daughter, destroying both her own reputation and, possibly, her daughter’s future in music (*Dubliners* 99, Logan 1).

Like Lenehan, who arrogantly entered a blue-collar restaurant but had to ask about the price of peas, Mrs. Kearney transforms and sheds her superior attitude when money becomes a factor. Though her value system tells her she wins the dispute — she walks away with a partial sum of money and the honor of not having permitted her daughter to work for a salary she would not receive — she loses any semblance of class or decency. She has lost her social status in a dispute over money — a chain of events that is repeated to varying degrees of loss throughout *Dubliners*.

Though they have progressed further than the gallants in the socio-cultural scheme of the land, both of these mothers are as paralyzed in immaturity as Lenehan and Corley. They display no evidence that they have learned to love their daughters on a human level, and if they have, their emotional maturity is masked by the greed and economic instability of their class.

The paralysis and instability in Joyce’s characters mimics the political scene that was common during Joyce’s life. After centuries under the rule of Great Britain, the Irish had invested much energy in a new wave of campaigning for independence. The Irish did not like Britain’s answer to “the Irish question” of independence, but they also faced uncertainty of whom to support. Within Ireland, different leaders competed for the support of the Irish people and, in some cases, the support of the British. During Joyce’s time, Ireland’s answer to the question was a call for Home Rule, or government from within Ireland, by the Irish.

Parties in support of Home Rule developed in both Ireland and England. Support developed in Ireland because the people wanted freedom from a long list of grievances they blamed on the English. It developed in England because the people did not want to put up with the trouble the Irish were causing over British control. The Irish demanded relief from regulated rents and a lack of land ownership, which forced many of the Irish to pay rents determined by the whim of upper class Irish landlords (Walsh 10-1). British Prime Minister William Gladstone came out in support of Home Rule in 1886, and he earned much of his fame for persuading Parliament to support the idea (Walsh 14). Gladstone earned the Liberal Party support from much of Ireland, but when his party won by a landslide in 1906, the Irish were disappointed to find it had changed from the party the Irish had come to support under Gladstone (Walsh 26). The liberals no longer seemed eager to grant Home Rule, and many Irish were left confused and conflicted about whom to support in the next election (Walsh 26).

Joyce completed *Dubliners* before Ireland and Britain played out the question of Home Rule, when the political turbulence of the time was quite intense. "Ivy Day in the Committee Room," written to take place on the anniversary of the death of Irish independence leader Charles Parnell, displays the conflicts among parties and, more importantly, the overall paralysis of Irish political advocates.

"Ivy Day" contains possibly less action than any other story in *Dubliners*, at a time when political action was necessary. The scene never changes, and only a few men come and go. The greatest movement of the majority of the characters, who have gathered on a day when they are supposed to rally support for their political candidate, revolves around the opening and distributing of bottles of stout.

Their inactivity reflects the stagnation of the Home Rule movement after the death of Parnell. Conservative reforms in England made Home Rule unnecessary, or "redundant," in the eyes of many in Britain. According to Chief Secretary Gerald Balfour, the British had developed a plan to "kill Home Rule with kindness" (Walsh 27). Though these reforms were not enough to satisfy the needs of the Irish people — reforms cannot quench a thirst for independence — they nevertheless answered some of the demands of the Home Rule Movement and struck a blow to the movement's energy.

The character Mat O'Connor, who solicited votes for his candidate, Richard Tierney, substantiates Joyce's lack of confidence in many of the political movements by admitting that he does not even know how his candidate will act in office (*Dubliners* 80-1). Though he is certain at one moment that

Tierney would never vote to present a speech of welcome to England's King Edward, he changes his mind after nothing more than a reference to his candidate as "Tricky Dicky Tierney" (*Dubliners* 80-1). His faith in his candidate is shown to be both weak and uninformed.

The social airs presented throughout the book are not abandoned in "Ivy Day," the most political of the stories. Jack, the old caretaker who addresses all the other men respectfully by their last names nevertheless complains at having to drink his stout straight from the bottle. Though his chief occupation is maintaining the fire and his character is consistently portrayed at a class below the other men, Jack must be assured by Mr. Henchy that "many's the good man before now drank out of the bottle" (*Dubliners* 85).

Joyce expressed through "Ivy Day" his frustration at the political stagnation of Ireland. Although Joyce grew up during the period of the Irish revivalists, when romantic writers like Lady Augusta Gregory and W. B. Yeats were writing tales to glorify traditional Irish culture during a politically barren period, he remained more realistic than his writing peers about Ireland's future and the action necessary to move it forward. The story ends with a grandiose poem about Parnell, who in death became a great hero to many advocates of Home Rule. Through the story, however, Joyce indicates that such glorification of the past means nothing when men are unwilling to take action. The group has garnered a few votes, but for the most part, they remain shut up in a room shortly before elections, drinking stout and recalling better — or at least more motivated — days when they still had Parnell. The division and uncertainty within the group, in which the conservative scorns the nationalist and those who revere Parnell show contempt for those who would welcome the English ruler, represent the political division and uncertainty pervasive in Ireland.

The instability present in Irish politics is also manifested in individual lives and positions in society. The situations in which Joyce's middle-class characters find themselves indicate the tenuous status of their seemingly stable social positions. Joyce presents the role of clerk, a respected but simple white-collar job, in five different characters, including Farrington, the character in "Counterparts." As with Lenahan and Mrs. Kearney, Farrington strives to create an illusion of class and affluence by acting and spending beyond his means.

Seeming physically built for a more strenuous job and consequently appearing very ill suited for his position in an office, Farrington fails in his family life, his temperance, his temperament and his ability to maintain his job. His physical description makes him appear unstable and confined, as if he is about to

burst out of his unbecoming white collar. His emotional range and reactivity make him appear ready to fall out of his place in society just as easily as he might pop out of his suit; the clicking typewriter that distracts him from his work will soon eliminate his position as a manual copyist. Farrington's unstable position in life creates a morally unstable world as well — one in which he beats his young son, pawns his watch to buy liquor, and ducks out of work to sneak a drink with no moral qualms or second thoughts. His lot in life — largely the result of his reckless actions — makes him feel only “anger and resentfulness” (*Dubliners* 62).

No matter how inappropriate his position might seem, Farrington is aggressively aware of his class and, while his pride does not suffer in the least from lying about his work on the job or arriving home drunk and beating his son, he cannot bear to walk to the bar bare-headed because of the low social implications conveyed by such an act (Benstock 194). He takes a great deal of pride in his social appearance, though he also brags about telling off his boss and seems oblivious to his poor appearance as a father and worker.

When he pawns his watch, Farrington receives six shillings, or 30 U. S. dollars, which he then spends on alcohol for himself and other people. Though he does not have money to waste on liquor for himself, Farrington “had definite notions of what was what” and tries to establish his superior class and his friends' loyalty — while also protecting his wallet from his friends' expensive drink preferences — by buying them all cheap drinks (*Dubliners* 60). Farrington regrets and resents his free spending money only when he arrives home penniless and broken, humiliated by his loss in an arm-wrestling match and acutely aware that he no longer holds top esteem among his friends. So tenuous is his position that a simple display of strength by another person can shatter his entire image.

Farrington's son also adopts the material values of his culture, transforming religious beliefs into a bargaining tool when his father beats him. “Don't beat me, pa! And I'll . . . I'll say a *Hail Mary* for you . . .” the boy cries, grasping for some means to make a deal and haggle with his abuser (*Dubliners* 63). There is no semblance of religious fervor in the young boy's cry, and he exhibits no desire to save his father's soul. His offer merely reflects the moral code that his culture teaches him: everything has a price, and nothing is wrong if one makes a profit in one sense or another — in this case, the profit of saving one's skin. The idea of simony, the attempt to purchase spiritual gifts and circumvent the process of obtaining

them through grace, also appears with thematic undertones in the first story of *Dubliners*, “The Sisters,” when several old maids question a dead priest’s piety.

Although members of a relatively wealthy society also fall victim to the all-consuming allure of money, the citizens of Dublin are absorbed with petty sums as a result of their poverty. About 15 percent of Dublin’s working population was unemployed when Joyce wrote his stories, and life in Dublin was relatively bleak, even beyond economic terms. With nearly a third of the city’s population living in cramped, one-room flats without running water or electricity, a person born in Dublin around the turn of the 19<sup>th</sup> century had a 21 percent chance of dying before the age of 5 years—a risk nearly 50 percent greater than that prevailing in other areas of Ireland during the same period (Ó Gráda 228).

Although money determines the parameters of most characters’ worlds in *Dubliners*, the only salary named in precise terms throughout the collection is that earned by Eveline, a 19-year-old woman who works to supplement her family’s income with seven shillings — about 35 U. S. dollars — a week (Logan 1, *Dubliners* 21). Joyce’s deliberate failure to mention precise earnings in the stories illustrates the characters’ general refusal to descend to monetary details in an outward way, despite the driving force of money in their thoughts and decisions. Though their lives revolve around money, they pretend to be above such lower-class concerns as wage earnings. By mentioning Eveline’s wages, Joyce eliminates the illusion of class that the other characters are allowed to carry, however poorly. While pinning down Eveline’s status makes the young woman seem more honest and incapable of social deceit, it also makes her less powerful in the Dublin game of social bluffing. Revealing her salary, Joyce defines her low status and leaves no doubt that she — like her more pretentious Dublin peers — desperately needs the money she earns.

The moral underdevelopment of Joyce’s characters inhibits their ability to communicate effectively and to escape the confines of a culture defined by money. Nobody in *Dubliners* successfully communicates his or her feelings to another, as is evidenced by the rareness with which anyone can alter the mind or understanding of a companion. Mrs. Mooney might muscle Mr. Doran into marrying her daughter, and Mrs. Kearney might be able to haggle partial payment for her daughter’s services, but even these communicative dealings seem fraught with misunderstanding and mistrust. In the case of Mrs. Kearney, things end badly, and in the case of Mr. Doran, one suspects that they will — as Joyce’s

*Ulysses* illustrates when Doran, like his father-in-law, becomes a drunk. Money dwarfs all other relationships in *Dubliners* and consequently, these relationships develop in the stunted, dysfunctional form exhibited by Mooney, Kearney, Farrington, Lenehan and Corley.

If each Dubliner is doomed to become a money-driven, paralyzed adult with childlike morals, “Araby” gives readers a glimpse at the causes behind the pervasive moral stunting of children in Dublin. The story follows a pre-adolescent boy, whom Joyce modeled somewhat after himself, through an encounter with the adult world. The narrator is undeniably different from most Dubliners, possessing an imagination that envisions “bodies glowing” in the street at night and draws out “a ballad about the troubles in our native land” amid the songs of shop boys (*Dubliners* 15-6). Seeming somewhat ignorant of money and its all-encompassing value in his world, the boy — who might be about twelve, as he is old enough to show interest in women but not quite old enough to know anything about them — promises to bring the object of his desire a token of his affection from the bazaar. Although he has no idea what he is promising or what it will require to live up to his offer, the boy perceives already that money puts the thrust behind the world’s turning. The boy gauges his ability to win the girl by his ability to bring her something, and not by a romantic encounter. His fantasy is an inversion of that of Lenehan, who imagines a romantic encounter that, in reality, results in Corley taking money from a woman, and this switch illustrates the boy’s more noble nature. The importance of money and possessions in the interaction nevertheless shapes the boy’s plan, even if he is not aware of the influences.

Perhaps the boy might have avoided — or might still avoid — the stunted, money-driven morals of his elders. His uncle arrives home late, talking to himself and giving off signs of drunkenness that the boy “could interpret” (*Dubliners* 18). Not yet old enough to throw his money into pints like his elders, the narrator has not really encountered the ultimate test that seems to catch every other Dublin man in its grasp — the temptation of alcohol. Money issues thwart his hopes anyhow, when he finds he does not have the monetary backing to play in the adult world. He lacks enough money to purchase anything, and he seems to arrive in the reality of the scene, in which he is a young boy in a shop totally out of his league, with harsh abruptness.

His setback may send him forth to seek out more money to meet his needs — a drive found in characters ranging from the gallants to Farrington — or it might simply send him back into the vivid,

childlike wonderland from which he has scarcely emerged. Judging from his view as he leaves the bazaar, “gazing up into the darkness . . . like a creature driven and derided by vanity,” the narrator does not seem likely to fall into the money pit quite yet (*Dubliners* 19). His experience instead serves as a contrast to the adult world, accentuating the backwardness in which a child has a better handle on money and morals than the adults around him.

Giving off a figurative sense of emptiness through its failure to provide moral motivation, the economy in Joyce’s time had recently taken on a literal “emptiness” when the gold coin was abandoned in favor of banknotes and bills, which were meaningless scraps of paper outside of the context of wealth that they represented (Osteen 155). Less than a century before *Dubliners* was written, bank notes began to replace more valuable coins because of an economic crisis in the British economy (Lewis 4). To a man who held money in such low esteem as Joyce, the valueless paper currency — worth only what the government said it was worth — provided a sharp reminder of the foolish, lofty attachments many Irish placed in simple, relatively unimportant objects designated to represent wealth.

The value of power, represented by economic success and the appearance of social prestige in James Joyce’s Ireland, comes through in the struggles of Joyce’s characters in *Dubliners*. No character can escape the control money exerts over the lives of the people in Ireland. Driven by the forces of poverty and impotence, the Irish people suffer from twisted values and immature, paralyzed relationships, as represented in Joyce’s work. Though Joyce may have engaged in behaviors that appear, on the surface, to resemble the money-grubbing tendencies of his *Dubliners* characters, his work remained his unequivocal goal, while money generally represented the means by which he could pursue it. The *Dubliners* often seem doomed to live and die in the backward system pervasive in Dublin, but Joyce’s career and literary success illustrate the possibility for a limited escape from the intense power of money and moral economy.

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**Fishing for Sovereignty:  
Norway's European Voyage**

**Brian C. Andersen**

## INTRODUCTION

The European Union (EU), even before it became an official entity, has always had a unique relationship with its Nordic neighbors<sup>1</sup>. After the atrocities of World War II, Europeans sought to find ways in which to make war among them close to impossible. A proposed solution was the intertwining of their coal and steel industries, particularly that of the two major continental powers, France and Germany. Along with the Benelux countries<sup>2</sup> and Italy, they created the European Coal and Steel Community (ECSC) in 1951. By the end of the 1950s, the European Communities were in existence, including the ECSC, the European Economic Community (EEC)<sup>3</sup>, and Euratom<sup>4</sup>. The Nordic states, however, were initially not part of these organizations, though with time, most of the Nordic states have chosen to join the European Communities. Norway presents an interesting case because it still remains outside, but nonetheless possesses very unique ties with it, namely through the European Free Trade Association (EFTA) and the European Economic Area (EEA). After briefly outlining the history of Norway, EFTA and EEA, this paper will explore some of the particular influences of the EEA on Norway and the limits imposed by it, the Norwegian perspective of Europe, and finally look into the future with the possibility of eventual Norwegian accession to the EU.

## HISTORICAL BACKGROUND

Historical context must be taken into account when exploring Norwegian relations with the rest of Europe. The Nordic countries were not the only ones who did not join the Common Market created through the EEC. The intended goal of the EEC was first to create an economic union of its member states that would later lead to political union. Many European states did not initially take very well to this idea. Norway, in particular, saw no benefits of an eventual political union with the rest of Europe due to a perceived loss in sovereignty. Also, Norway, like many other countries in the area, had been occupied by

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<sup>1</sup> The term "Nordic neighbors" refers to the Scandinavian countries of Denmark, Finland, Norway, and Sweden. Austria is also sometimes including with this grouping.

<sup>2</sup> The Benelux countries include Belgium, The Netherlands, and Luxembourg.

<sup>3</sup> The EEC essentially was the creation in 1958 of a Common Market among the Benelux countries, France, Italy, and Germany.

<sup>4</sup> Euratom is the entity in charge of regulating nuclear energy in Europe.

Nazi Germany during World War II, so they highly valued their recently regained sovereignty. The United Kingdom (UK), which also was not part of EEC, proposed a Common Market among the non-EEC members, and in 1960 this proposal came to fruition. The European Free Trade Association (EFTA) was founded by the Stockholm Convention on 4 January 1960 with seven members: Austria, Denmark, Norway, Portugal, Sweden, Switzerland, and the UK.

Norway, like the other EFTA members, did not want to give up any form of their sovereignty. Norwegians much preferred the simple free trade area rather than any form of further union. As Sieglinde Gstöhl asserts, the Norwegians experienced over 500 years of foreign rule, and they were not willing to give up their newly acquired independence.<sup>5</sup> These forced unions throughout history as well as the later German occupation have led to a strong opposition to any outside interference in Norwegian affairs. After such a long and hard fight for independence and nation building, it is obvious that Norway would prefer the more intergovernmentally<sup>6</sup> structured EFTA to the EEC's stated goal of eventual political union. Norway's view of the European Communities probably equated to that of its view of Sweden controlling its foreign policy in the nineteenth century.

## FROM EFTA TO EEA

In order to better understand Norway's decision to join and remain in EFTA rather than the EEC/EU, it is helpful to understand the evolution of EFTA itself. The original focus in the 1960s was on free trade in industrial products among the EFTA Member States, which included the original seven and Finland, which joined in 1961. The 1970s brought several changes. Iceland joined in 1970, but the UK

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<sup>5</sup> In 1380, Norway was united with Denmark, but in practice was treated more as a Danish colony. This lasted until 1814 when Sweden acquired Norway under the Treaty of Kiel. Norway was left rather independent in its domestic affairs, but the militarily powerful Sweden dictated its foreign policy. By the late 1800s, tensions were high and war almost broke out between Sweden and Norway. The Norwegian parliament dissolved its union with Sweden in 1905. A plebiscite was held, and Norwegians approved the separation almost unanimously. A Danish prince was elected and crowned King of Norway in 1916. This newly found independence, however, would not last long. On 9 April 1940, German troops invaded Denmark and Norway. Denmark surrendered rather quickly, but the Norwegians continued to resist. Though the Nazis established a puppet government while the government-in-exile sat in London, Norwegian resistance continued throughout the war and made it difficult for a true Nazification of the country to take place. Finally in the fall of 1944 Norway was liberated.

and Denmark left and joined the EC in 1973. Norway had also applied for EC membership and was accepted, but withdrew its application as a result of the “no” vote in a referendum. The focus also shifted to the creation of a Free Trade Agreement with the EC, which was fully realized in 1977 when tariffs on industrial goods were removed. The EC began its project for developing a fully integrated internal market in the 1980s. In 1984 in Luxembourg, the first EFTA-EC ministerial meeting adopted a declaration on extended cooperation. Portugal left EFTA and joined the EC in 1986. Then Commission President Jacques Delors proposed the European Economic Area (EEA) to institutionalize and structure trade arrangements in 1989. Formal negotiations for EEA began in June 1990 and the EEA Agreement was signed in Oporto, Portugal on 2 May 1992. It entered into force on 1 January 1994 without the participation of Switzerland, which voted against EEA Membership. Austria, Finland, and Sweden joined the EU in 1995, and Liechtenstein joined EEA. This leaves Norway in a very unique spot. It is still an EFTA Member State along with Iceland, Liechtenstein, and Switzerland and one of the three EEA members,<sup>7</sup> but still not a member of the EU.

## THE EEA

According to the EEA Info Kit, “The aim of the EEA Agreement is to promote a continuous and balanced strengthening of trade and economic relations between the EEA States with equal conditions of competition and respect of the same rules” (EFTA Secretariat. [EEA Info Kit](#) 6). EEA has been in operation for almost ten years and is functioning well. The majority of the relevant legislation has been integrated into national law. The main thrust of the EEA Agreement is the extension of the EU Internal Market to the EFTA Member States who have chosen to participate in EEA. The same basic rules govern the EU Internal Market. These basic rules are outlined in the EEA Agreement and are known as the four freedoms. They consist of the free movement of goods,<sup>8</sup> persons,<sup>9</sup> services,<sup>10</sup> and capital.<sup>11</sup>

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<sup>6</sup> Intergovernmental – adj. – Being or occurring between two or more governments or divisions of a government. This is when the governments of states come together to make decisions rather than having a supranational body that has power to overrule national governments.

<sup>7</sup> EFTA includes the four aforementioned countries. EEA includes all but Switzerland – Iceland, Liechtenstein, and Norway.

<sup>8</sup> The basic idea behind the free movement of goods is to ensure that they are able to move freely across borders on equal conditions of competition and without the hindrance of customs duties. This applies to

Cooperation in other areas is also permitted in order to further facilitate the four freedoms. “The four freedoms are promoted and safeguarded by a range of horizontal measures that ensure the long-term viability of the Internal Market” (EFTA Secretariat. [EEA Info Kit 7](#)). Protocol 31 to the EEA Agreement provides the framework for cooperation in “flanking” areas such as the environment, research, and education. There are strict competition laws as well as restrictions on the use of state aid to guarantee the continued observance of the four freedoms.

Two things must be kept in mind. The EEA does not include common agricultural or fishery policies, though it has provided for easier trade in these areas. The EEA is also not a customs union.<sup>12</sup> Gstöhl asserts that the goal was, “to avoid economic discrimination and political satellization,” and “for Norway . . . the EEA seemed to promise a depoliticized version of EC membership” (Gstöhl 168). Due to the EEA Agreement, Norway was able to participate in the EC Internal Market without the full responsibilities or political integration expected of full EC Member States. Norway viewed this as gaining economic benefits without giving up any political sovereignty. There were no real supranational institutions,<sup>13</sup> so the population generally supported the EEA Agreement as well. It allowed Norway to still have at least some footing and influence with regard to the formation of policy, especially economic policy, in Europe, though without any direct influence such as voting rights.

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most goods and is established through one of two ways – either mutual recognition or harmonization. Mutual recognition entails that all parties accept the manufacturing and testing procedures of other parties. Harmonization entails the standardization of such procedures.

<sup>9</sup> The free movement of persons allows for nationals of any of the Member States to enter the territory of any other Member State for the purpose of working or finding work.

<sup>10</sup> The free movement of services is closely coupled with the free movement of persons and the right of establishment. Regardless of nationality, a person is allowed to provide services within the EEA.

<sup>11</sup> The free movement of capital provides the basis for the other three freedoms since they would be useless without capital. This allows funds to move without delay or extra costs, thereby further facilitating the other three freedoms.

<sup>12</sup> Customs Union – n. – An international association organized to eliminate customs restrictions on goods exchanged between member nations and to establish a uniform tariff policy toward nonmember nations.

<sup>13</sup> Supranational – adj. – Extending beyond or transcending established borders or spheres of influence held by separate nations. This entails national governments giving up some sovereignty to a higher body and allowing it to make decisions as opposed to an intergovernmental structure where governments of countries would come together to take decisions.

## NORWAY IN THE EEA

Around the time that the negotiations for the EEA Agreement were taking place, Norwegian exports were essentially dependent on the EC. According to UN COMTRADE statistics cited by Gstöhl, about two-thirds of Norway's exports were destined for the EC. Much of this was in the form of energy-intensive products such as petroleum and natural gas. In fact, the same statistics note that about half of all petroleum exports and almost 100% of natural gas exports were destined for the EC. Such exports come from companies that are not easily able to relocate, so participation in the EEA seemed only natural in order to eliminate trade barriers. In areas particularly important to Norway's export-oriented industries, such as the fisheries sector, certain concessions such as elimination of quotas on certain species of fish were granted. The fisheries sector accounted for 6% of Norwegian exports in 1991 (Gstöhl 175). This was significant enough for Norway to want to protect this sector and was able to do so by limiting foreign investment in its fishing fleet. This was particularly important vis-à-vis the two important fishing EC members of Portugal and Spain. This allowed for the protection of key industries while still having access to the Internal Market. As Gstöhl says, "Several studies substantiated the claim that participation in the EEA would clearly increase national income in the long run, compared to a situation in which the Norwegian economy stayed outside the internal market" (175). Therefore, in addition to the low political risk of joining EEA, there were also substantial economic incentives.

The question then becomes: how has Norwegian membership in the EEA affected the country? According to Vice-Chairman of the EFTA Consultative Committee and Director of International Affairs in the Confederation of Norwegian Business and Industry (NHO) Jon Vea:

The EEA is Norway's umbilical cord to the EU. It is the most comprehensive and binding agreement Norway has ever entered into, and there is no doubt that for most of our industry, this agreement has been beneficial. With a few (important) exceptions, the agreement secures Norwegian industry full access to the EU's Internal Market – without question – our most important market. Through harmonized regulations, European standards and the principle of mutual recognition, and by way of common competition and state aid regulations, the EEA Agreement has given Norwegian industry almost equal conditions for competing with the Internal Market. (Baldvinsson 25)

Vea goes on to outline just how Norway's membership in EEA has been beneficial for its industry. He cites statistics showing higher employment rates, lower prices, better quality of goods and services, and many others. He points out that the biggest advantage for industry is the harmonization of standards and

the principle of the mutual recognition of national tests and certificates. This has made it much easier for trading within the Internal Market. In the sectors covered by the EEA Agreement, Veia asserts the effect has been positive overall, especially for small and medium-sized businesses. Exporting to the EU has never been easier. Norwegian industry has also benefited from its participation in the EU's various research programs from fisheries to communications technology.

The Internal Market is not without its own problems. Veia points out that barriers to trade do still exist, mainly with regard to mutual recognition. If a business wants to operate elsewhere in the EEA, standards often differ in the various Member States. An extension of this is the fact that some Member States are frequently slow to transpose legislation into national law, and sometimes even when legislation has been transposed into national law, it is not implemented and enforced uniformly. Another big problem is the general lack of knowledge about the Agreement itself, thereby not allowing businesses to take full advantage of the opportunities offered.

Norway's level of trade has also been positively affected in general by its membership in EEA. According to the Director-General of Statistics Norway Svein Longva, "The level of trade between Norway and the countries that now constitute the European Economic Area (EEA) has increased considerably in absolute numbers . . . since Norway as a member of the EEA gained access to the Internal Market in 1994" (Baldvinsson 30). Since joining the EEA, Norway has enjoyed a generally increasing trade surplus both overall and specifically with other EEA members. There was a slight decline from 1997 to 1998 due to a fall in oil prices. However, the generally higher prices of oil and gas, one of Norway's largest exports, have contributed to the country's increased trade balance. Longva points out that the value of such materials increased 136% between 1993 and 2002. Norway's exports of traditional goods such as machinery and manufactured goods as well as fish have slightly decreased since it joined EEA, but not significantly.

Why then, did Norway not just join the EU? This question is quite complicated. As stated before, Norway viewed EEA as a strictly economic agreement without the political commitments required of full EU members. By joining EEA, Norway has been able to obtain the economic benefits of participation in the EU Internal Market without relinquishing any of its perceived political sovereignty.

## NORWAY'S VIEWS ON THE EEA AND Europe

The Norwegian government takes a generally positive approach to its relationship with the EU vis-à-vis EEA. In fact, in early 2002 it issued *The Coalition Government's European Policy Platform*, which puts forth some goals and possible courses of action to attain those goals. It seems, however, to be particularly geared toward the EU. The document states, "Although the EU will not have as broad a membership as pan-European forums such as the Council of Europe and the OSCE the cooperation within the EU is deeper and more comprehensive" (Kingdom of Norway 2.2.2). Right away Norway recognizes the preeminence of the EU in the region and realizes it is the premier organization. Norway also recognizes its own impotence in Europe as a non-EU Member State:

Since the EEA Agreement, EU cooperation has developed steadily. A number of EU decisions that are relevant for the internal market and thereby affect Norwegian interests fall outside the scope of the EEA Agreement because they have no legal basis in the agreement. Moreover, the EFTA/EEA countries have had difficulty in being allowed to participate in certain new EU committees and bodies of relevance to the EEA. The EEA Agreement does not allow Norway to participate directly in new cross-sectoral cooperation areas and forms of cooperation in the EU, such as the Lisbon Strategy. (Kingdom of Norway 2.3)

Norway essentially only has observer status in the EU institutions relevant to EEA and has no voting power. This makes it extremely difficult to exert any type of influence on the formulation of policies, which it is bound to transpose into its national law.

Many of the Norwegian government's goals are tied to the EU. They plan to give high priority to the administration of the EEA Agreement, which is the "cornerstone" of EU-Norway relations. They also hope to coordinate efforts in various other, non-economic areas such as foreign, security, and defense policy. These areas have become very important for several reasons. First is the recent creation of the EU Common Foreign and Security Policy (CFSP) and subsequently the European Security and Defense Policy (ESDP).<sup>14</sup> The EU has taken great measures to ensure common positions on as many foreign policy issues as possible as well as attempted to build up a common defense area. Norway has had no

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<sup>14</sup> CFSP came into existence on 1 November 1993 under the Maastricht Treaty, and according to the European Commission website, it is intended to help the EU "make its voice heard on the international stage, express its position on armed conflicts, human rights and any other subject linked to the fundamental principles and common values which form the basis of the European Union and which it is committed to defend." ESDP is an extension of CFSP and is intended to cover matters of EU security and possibly lead to a common defense.

say in these areas of development, yet it is often forced to acquiesce to the decisions of the EU without any say in those decisions. These issues are even more important to Norway because it is a NATO member and therefore has special interests in its security, unlike its neutral Scandinavian counterparts.<sup>15</sup> Norway also hopes to intensify its relationship with the EU by “seek[ing] to ensure close and fruitful cooperation with the country holding the presidency of the EU” (Kingdom of Norway 4.1). Other goals and courses of action include following the EU’s Lisbon Strategy of creating a more competitive European economy, linking Norway more closely to participation in EU projects, and being more informed on the Economic and Monetary Union (EMU). It seems, then, that the Norwegian government is seeking to link itself as closely as possible to the EU without actually becoming a member. This course of action, however, may not be very effective because no direct, concrete influence can be gained without full EU membership.

#### **NORWAY IN THE EU?**

Membership in the EEA, however, only provided a limited influence. Therefore possible EC membership was considered another option. Norway submitted its second application on 25 November 1992. Accession negotiations proceeded rather quickly because much of the framework was already in place due to the EEA Agreement. The accession agreements were signed in Corfu, Greece on 24 June 1994. The Norwegian referendum on 28 November 1994, however, received a “no” vote of 52.2% with a voter turnout of 88.8%. The problem was not the political elites. Political elites perceived accession to the EU as something quite positive for Norway. While economic incentives were not so prevalent this time around since they were already gained through EEA, political incentives were. Norway’s highly profitable natural resource industries as well as its EEA membership allowed t a certain amount of economic freedom. Politically, however, it yielded very little influence. Norwegian political elites viewed EU membership as a way to preserve the welfare state because they believed it would result in a higher net product. Security issues were also at stake. Norway was an associate member of the Western

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<sup>15</sup> Finland and Sweden are officially neutral countries. Denmark is not.

European Union (WEU)<sup>16</sup>, therefore not allowing it a vote in decision-making. The political elites wanted to exercise influence in such areas like the CFSP.

The Norwegian population, however, was deeply divided over the issue of EU accession. They were divided along the same lines as they had been traditionally and as they were in the 1970s with the first referendum on EU accession. As Gstöhl points out, “The traditional linguistic, religious, rural-urban, and class-based cleavages combined again in a strong center-periphery conflict (Gstöhl 189).” Left-radicals, farmers, and fishermen made up the core of periphery opposition to EU membership based on many of the same issues that arose in 1972, namely agriculture, fisheries, and sovereignty. The main issue regarding agriculture pertains to the Common Agricultural Policy (CAP)<sup>17</sup> and where the subsidies were going. Much of this money goes to protect French farmers, but Norwegian farmers have several special needs, especially those in the arctic and sub-arctic regions. Norway wanted CAP to be restructured to include special subsidies for its arctic and sub-arctic farmers. The Common Fisheries Policy (CFP) was also an issue, especially considering Norway is the largest fishing nation in Europe. Norwegians did not want the possibility of giving up their exclusive twelve-mile fishing rights in the waters off its coast. They saw EU membership as infringing upon Norway’s right to self-governance. Though the referendum was extremely close, the grassroots opposition to membership prevailed in 1994 and prevented accession for a second time. The Norwegian population viewed joining the EU as relinquishing part of their sovereignty.

The “no” vote in 1994 was along many of the same lines as it was in 1972. The difference is that this time it was not so traumatizing. The government did not resign as it had in 1972,<sup>18</sup> but as Gstöhl puts it, “pursued a policy of ‘eager adjustment’ to the European Union (Gstöhl 197).” Norway participated in the Schengen agreements eliminating border controls as well as pushed for political discussions within the framework of EEA. So, while the government pushed for further integration, the Norwegian people

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<sup>16</sup> The WEU was an organization created in Western Europe in response to the possible post World War II threat of armed conflict with the Soviet Union. It could be viewed as the European counterpart to NATO.

<sup>17</sup> CAP is one of the EU’s most important policies. According to the Commission website, “it aims to ensure reasonable prices for Europe’s consumers and fair incomes for farmers, in particular by establishing common agricultural market organisations and by applying the principles of single prices, financial solidarity and Community preference.”

<sup>18</sup> The Prime Minister of Norway at the time, Trygve Bratteli turned the 1972 referendum into a vote of confidence for the government, and after the “no” vote in September of that year, the government resigned and a new, minority government made up of factioned parties took power.

resisted. Norway was unable to obtain full EU membership, but it still could work very closely with the Union through EEA.

Having applied twice and been accepted both times for membership in the EC/EU, Norway would more than likely not have a problem if it decided to apply again. The criteria for membership are known as the Copenhagen Criteria,<sup>19</sup> and Norway easily meets all of these. With the coming enlargement of the EU, there will be approximately 480 million people within EU compared to the 4.8 million in Norway. Commissioner for External Relations Christopher Patten points out that “it is natural that the relative attention to EEA matters will decrease (Patten).” He goes on to say, “In this light I think that accession to the EU might come to seem more desirable (Patten).” Norway, as shown in the government’s platform on European Policy, recognizes its limited influence. Christopher Patten also recognizes it when he points out that “in joining the EEA you gave up a part of your sovereignty to a common, greater structure. But you have very limited leverage on the formulation of policy in this greater structure (Patten).” Both sides recognize, at least to some degree, the limited influence Norway really has on the formation of policy, yet Norway still has chosen not to accede. Again, Christopher Patten articulates the general view of the EU on Norwegian accession: “Naturally, I would be all in favour of Norway’s full participation in the Union as I think it would bring both us and you great benefits (Patten).” This leaves the door open for eventual Norwegian accession to the EU.

## CONCLUSION

Norway’s accession to the EU could have occurred twice, yet it has not due to the two “no” votes in the referenda; the people perceived accession as a loss of sovereignty. Norway underwent intense negotiations in the early 1990s to obtain various special arrangements in the event it acceded in 1994. It received various concessions in areas it deemed important. Norwegians would have been able to retain

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<sup>19</sup> According to the European Commission, the Copenhagen Criteria are:  
stability of institutions guaranteeing democracy, the rule of law, human rights and respect for and protection of minorities;  
the existence of a functioning market economy as well as the capacity to cope with competitive pressure and market forces within the Union;  
the ability to take on the obligations of membership including adherence to the aims of political, economic & monetary union.

their exclusive fishing rights in the waters twelve miles off the coast and national control of the natural resources would have been retained as well. This retained control of natural resources was extremely important, especially in the area of petroleum and natural gas. The CAP was also structured to include the special needs of Norwegian farmers. Even though Norway negotiated such a special deal that would have addressed most of the concerns of the Norwegian people in joining the EU, the referendum still produced a “no” vote. It is obvious, then, that the economic incentives and special concessions granted by the EU were not enough to outweigh the real concern of the Norwegian people – the giving up of sovereignty. Sovereignty was still at the heart of the matter. They did not need or desire to give up any of their national sovereignty in order to gain economically or to gain influence within the EU decision-making apparatus. Norwegians still hold their sovereignty in high regard.

The question then becomes, what does the future hold? This question is really two-fold. First the coming enlargement of the EU must be addressed because it will void current bilateral trade agreements EFTA has with the acceding Member States and integrate them into the EEA. As of 1 May 2004, EEA will have 28 members instead of the current 18. The EFTA EEA states will have access to a larger Internal Market, but will also be required to provide various forms of aid to the acceding countries.<sup>20</sup> However, Norway will still be left in its precarious situation of being unable to exercise any direct influence on decision-making.

Secondly the question of eventual Norwegian accession to the EU is still left unanswered. As reported by the Norwegian Embassy in the United States, public opinion now generally supports Norwegian accession to the EU. The government, however, does not see this as possible until at least after the 2005 general elections. With the enlargement of the EU, Norway is becoming increasingly isolated from the rest of Europe, yet it is often still bound by policies (through EEA) that it had no vote in formulating. The Norwegian public realizes this. In fact, the Embassy reported that

According to a poll conducted by the Norwegian research group Opinion on behalf of Norwegian media group NRK and Aftenposten, as many as two-thirds of the population would have voted “yes” if an election was held today: Sixty-seven per cent of those who have made up their mind on the issue would have voted “yes”, whileas 29 per cent would have rejected the suggestion. 14 per cent of the population have not yet made up their mind, according to the poll. (News of Norway)

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<sup>20</sup> There are also provisions to provide aid to Greece, Portugal, and Spain since they are also relatively poorer countries.

So, while it seems that attitudes are changing, Norway may not be ready just yet for EU membership. The case in the first two attempts at accession was government enthusiasm, but popular discontent. Now the tables seem to have slightly turned. The public is showing more and more support of EU membership, while the government's enthusiasm has slightly waned, probably due to its desire to keep power after the upcoming elections. Will Norway eventually accede to the EU? At some point, it very well may. The real question is when and under what conditions? Only time can answer that question.

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