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PRIVATIZATION AND CRIME: THE POST-SOVIET EXPERIENCE*

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Introduction

Russia has embarked on a more ambitious and more rapid process of privatization than the other CIS countries. This privatization entails the privatization of real estate, as well as small and large enterprises. All aspects of this privatization program have been highly criminalized. At present,¹ Russian organized crime controls over 40,000 privatized enterprises including 400 banks and 47 exchanges.

The criminalization of the privatization process has occurred by the laundering of criminal capital into the legitimate economy, and numerous legal violations that have occurred in the privatization process. According to Ministry of Interior specialists, not one case of privatization studied has occurred without violations of the law.² These violations include the falsification of documents, violence used against individuals seeking to acquire property and the murder of individuals by hired hit-men to acquire choice real estate. The data on privatization far understates the problem because many activities which would be outlawed in the regulation of privatization in other societies are not explicitly prohibited in Russia.

In Russia, such a significant percentage of the economy has now been privatized that the criminalization of the privatization process can only be addressed in limited areas³. But the lessons learned from the Russian experience can be applied elsewhere in the CIS as the successor states privatize industry, the consumer sector and real estate.

American assistance in the remaining parts of the privatization process must take adequate precautions to prevent United States government complicity in the illegal acquisition of private property by members of the former Party elite (Nomenklatura) and organized crime members. The AID guidelines developed for the hundreds of millions of dollars awarded to assist the privatization process contained no provisions requiring the contractors to guard against criminal infiltration of the privatization process. Assistance programs from the World Bank and IMF for Russia and other successor states have also chosen to ignore the prevalence of organized crime and the problems of its infiltration into the banking sector and other key areas of these countries' economies.

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The recent work, The Sicilian Mafia: The Business of Private Protection, makes a compelling case for why such attention must be paid to the privatization process. The author, D. Gambetta, concludes that contemporary Russia "bears a striking resemblance to nineteenth-century Sicily"⁴ because organized crime proliferated at the time that land and property were redistributed. Once the mafia achieved economic control, it has been very difficult for the Italian state to assert its control over these areas.

Property redistribution is again underway in Italy because the state is privatizing some of the forty percent of the economy which it holds. Leading law enforcement personnel and economists have focused on means to prevent the privatization of legitimate state businesses to organized crime⁵. Despite these warning signs from the Italian experience, and the concerns expressed by many CIS specialists, privatization in Russia and some other successor states has been planned without sufficient attention to the organized crime problem⁶.

Privatization and the Development of the Russian State

The future development of Russian society and its economy will be determined by the redistribution of the resources of the Soviet state. The privatization process will determine the future distribution of wealth in Russian society and the citizens' perceptions of capitalism and of democracy. Russia, unlike China, tried to simultaneously create a free market and a democratic society. Therefore, citizens have been unable to determine whether their present criminalized economy is a result of the difficulties in creating capitalism or of forming democratic institutions. The inability of the present state to promote an orderly and non-violent transition to a democratic market economy may promote a citizen backlash in which an authoritarian, right-wing government which promises law and order may be voted into office.

Distribution of Wealth

Privatization has been dubbed the pri-hvatizatsiya (the great grab) because the valuable resources of the former Soviet state are being redistributed to a small share of the Russian population. At present there is a 28 fold difference between the wealth of the richest ten percent of the Russian population and the poorest ten percent.⁷ This distribution of wealth is similar to what is seen in some of the countries of Latin America and is certainly not that different from what existed in the pre-revolutionary period in Russia. But this striking discrepancy in wealth is a shock to a population that was accustomed to an ideological commitment to equality, and despite the collapse of Communism, continues to retain the socialist ideal of economic equality.

In 1993 all Russian citizens obtained vouchers which let them acquire the assets of the former Soviet state, but this has provided citizens only token participation in the market economy. Instead, vast wealth has been accumulated by a few, many of whom were able to amass vast fortunes in the final days of the Soviet Union as a result of their positions in the state bureaucracy or in the underground economy. The holders of this wealth, therefore, represent an unusual alliance of former Party bureaucrats, organized criminals and dishonest businessmen. This so-called "gangster industrial complex"⁸ is as oblivious of the needs of the citizens as the former Soviet nomenklatura (party elite). Moreover, the brazen display of wealth by the unusual coalition of the new financial elite is often accompanied by an equally visible display of force. Therefore, Russian citizens equate the emergence of private property with the growth of organized crime.

The discrepancies in wealth can not be attributed exclusively to the criminalization of the privatization process. It is important to differentiate among three aspects of privatization: the inherent inequalities in redistributing state property; corruption; and organized crime.

Inequality and Privatization

Inherent inequalities in the distribution of property result from the fact that an individual's employment and residence in the Soviet period affects his access to property in the post-Soviet period. A citizen's knowledge or, more frequently, lack of knowledge, prevents him from acquiring property of potential value.

As companies have been privatized to their employees, individuals who work in enterprises with good prospects stand at a definite advantage. For example, an employee of Lukoil (a large state oil company) was able to obtain a share of a potentially lucrative business. Whereas a worker in a defense industry that cannot be successfully converted to civilian uses enjoyed no benefit from the privatization of his former place of employment. Top level employees of enterprises, state ministries and the military enjoyed such job related perquisites as country houses (dachas), choice apartments and cars. Now that the rental property stock of the former Soviet Union is being sold off to residents, individuals who reside in choice properties as a result of their employment or even that of their grandfather have the opportunity to buy them. In many cases these apartments and country homes are being sold at prices far below their market value. Therefore, the nomenklatura and the military elite that were beneficiaries of the Soviet state enjoy an advantage in the post-Soviet state. Yet this time they own the property rather than merely being its custodians.

Under voucher privatization, the State Committee on Property issued each citizen a privatization voucher worth 10,000 rubles. These vouchers could be invested in stock funds,

used at auctions of state property, or traded on the burgeoning state market.⁹ But these vouchers have not helped distribute the state's wealth equitably because most Soviet citizens lacked knowledge of the market and were incapable of making a sound investment decision. Many invested in criminalized funds which proceeded to lose their assets. For example in St. Petersburg a third of a million citizens lost 3.5 million rubles in five companies that were not properly licensed. Citizens took to the streets in protest.¹⁰

Only the small minority of Russian citizens with western experience and knowledge of the commercial world stand to benefit from this division of the state's resources. The limited regulation of the voucher markets, even in the absence of criminality, makes the property of Russian citizens precarious and compounds the problem of inequality in the post-Soviet state,

Many Russian citizens are so poor and so uninformed that they did not use their vouchers but sold them immediately. Vouchers traded on the secondary market between a low of 4,000 (approximately \$4) and a high of 14-15,000 rubles, some of this fluctuation is attributed to the machinations of bureaucrats and organized crime figures.

Few among the working class population have been able to acquire anything of value from the former Soviet state. The only exception may be the residents of such cities as St. Petersburg and Moscow who have been able to buy their apartments. Apart from these limited exceptions, most are entering the post-Soviet era with little property and little prospect of acquiring any.

Corruption and Privatization

The privatization process has provided the bureaucrats numerous new opportunities for corruption. As one popular news account reported, "The old bureaucrats dominate much of the privatization process, for example, often deciding who gets what at what price."¹¹ Whereas the Party elite only enjoyed control of the state's resources, they can now appropriate the state's property. In Russia, corrupt links were noted in many regions between governmental officials and territorial committees to promote privatization.¹² In some of the newly independent states, such as Kazakhstan, leading members of government are simply transferring ownership of state businesses to themselves, and then are exporting the assets abroad.

Numerous forms of corruption in the privatization process occurred that are not linked with organized crime. These include but are not limited to the following: underestimating the book value of the enterprise being privatized; managers of privatized firms paying themselves exorbitant salaries as a means of acquiring the company's capital; and civil servants working simultaneously in private firms in violation of the presidential decree on corruption.

In other CIS countries, particularly Russia, officials are acquiring and selling valuable state properties and businesses as if they were personal property. This includes appropriation and smuggling of timber, metals, oil and military equipment. For example, Ukrainian oil reserves were embezzled and sold at market prices. Most of this money was not returned to the former USSR but placed on deposit in foreign bank accounts.

Officials are also acquiring dachas and commercial real estate at below market value. They are also selling state property at artificially low prices to others after the receipt of significant bribes. The proceeds of these sales are then used to acquire other businesses or, as in the case of smuggled goods, the money is sent abroad for deposit in foreign banks or for the acquisition of foreign real estate¹³.

The entry of foreign investors has given officials the opportunity to capitalize on their positions either by selling information needed by businessmen or by selling trading rights and licenses as if they were their personal property. For example, foreign businessmen seeking to rent or buy real estate in Moscow were forced to pay large fees (the going rate was given at \$10,000) to city officials to have access to the lists of available property¹⁴.

Foreign investment in such potentially lucrative natural resource companies as Lukoil and Neftegaz is limited to a small percentage of the company. Managers, in violation of the privatization regulations, have exploited their right to buy a significant percentage of the company and are reselling their shares at inflated prices to foreigners.

Joint ventures with foreign countries can also be exploited to the personal benefit of high-level bureaucrats. In Belarus, a state-owned instrument making plant was sold to a Swedish-Belarusian joint venture for a token price of 8 million rubles, when the Soviet government had acquired the plant for \$10.5 million. An official of the Belarussian Trade Committee and the plant manager were on the board of the joint venture.¹⁵

Officials sell export licenses and trading rights as if they were their personal property. The Vice-President of Kyrghyzstan, Felix Kulov, was accused in 1993 of arranging illegal export licenses for copper wire, aluminum and rare bronze artifacts.¹⁶

Conflict of interest is endemic in the privatization process. Individuals employed in the state bureaucracy also work on the board of municipal privatization boards. For example, an investigation of the Moscow State Property fund revealed that three members of the fund were directors of private real estate firms in direct violation of conflict of interest laws. Conflict of interest and overt corruption on the St. Petersburg State Property fund also led to the dismissal of several key personnel.¹⁷

A proposed law on corruption that would address many problems of abuse of position, including that in the banking sector, failed to be passed at the Federation Council level, the

upper level of parliament. The legislation was rejected, many observers believe, because of the corruption of many legislators and their close links to organized crime.¹⁸ Without this legislation the state has not been able to adequately address problems of corruption in the privatization process.¹⁹

Privatization and Organized Crime

The major means by which organized crime has entered into the privatization process is through voucher fraud; auctions for the acquisition of private property; commercial real estate; the banking industry; and the appropriation of the state's natural resources. Specialists in the field of privatization and crime believe that the most violations occur in the area of trade and residential real estate.²⁰

Few protections are in place. A law against fraud in the privatization process was introduced only in late 1993, after a significant share of Russian property had already been privatized. This presidential decree, intended to promote transparency, required directors of newly-privatized companies to publish shareholder registers detailing the quantity of shares owned by individual investors. The decree also required that firms register the company's charter capital, categories of shares, dividends, share transactions, stock splits and consolidations. But the decree still provided no protection from management which sold output at reduced prices to companies they own, reducing potential profits for shareholders.

Voucher Fraud and Auctions

Organized crime entered into voucher privatization and auctions in several ways. First, millions of extra vouchers were illegally produced which were retained by different organized crime groups for their own use. Second, the deliberate failure to cancel vouchers in order to reuse them enhanced the capabilities of organized crime groups to acquire more property. For example, a St. Petersburg official in the State Property Committee was arrested on charges of criminal negligence after discovering that city officials had canceled only 10 percent of the 8 million privatization vouchers used at auctions. These already used vouchers could then be recycled and used again. Third, organized crime personnel blocked access to auctions where property was being sold, or rigged auctions to ensure that they would purchase the desired property. At these auctions more than 60,000 small businesses and 6,000 big state firms have been sold to investors.²¹

The Russian press contains numerous examples of organized crime's role in this privatization process.

Before a public auction begins, the information is conveyed to everyone that an "authority" is interested in this piece of property, and that if anyone takes the risk of competing for it, he shouldn't complain later that he wasn't warned. Then a representative of the "authority" appears in the hall, escorted by 10 to 20 thugs...According to information from law enforcement agencies, as much as 70% of the real estate put up for sale at public auctions winds up in the hands of individuals who are agreed upon beforehand."²²

In Yaroslavl, "Trade establishments with respectable names are using coercive methods at privatization auctions to buy state property and real estate at low prices. Illustrative of this is a motor transport base with a large sports complex that was sold for 60 million (approximately \$60,000) and a noodle shop with imported equipment that went for 47 million.²³ Even more striking is the case of the reindeer restaurant in Zelenogorsk, along a heavily travelled international highway, which was sold at a closed bid for \$1 million rubles in October 1992, that was then the cost of a one bedroom apartment."²⁴

Voucher and Ruble Funds

The funds which were established for the purpose of privatizing state property were riddled with corruption. While the MMM fund, a pyramid scheme in which millions of citizens were deprived of their property is the most notorious example, it is hardly exceptional.²⁵ According to a former leading state prosecutor, not one of these funds was established without significant legal violations. Furthermore, many investment funds did not fulfill their obligations to their investors. Instead these funds were run for the personal enrichment of a small group while defrauding their shareholders. An international consumer watchdog said that the NeftaAlmazInvest fund had paid its advertised first annual return of 750 percent to only 12 of its many shareholders. Its investments include chemical plants and hotels but despite its name, it had no investments in oil or diamonds.²⁶

As a response to the MMM scandal, a June 1994 decree was issued "On the Protection of the Interests of Investors". It provided only a cursory response to the problem by mandating that all publicly offered securities be registered and a financial threshold was established for joint stock companies. "Joint stock companies created as a result of privatization of state and municipal enterprises are exempt from this requirement."²⁷ This loophole facilitates the criminalization of the privatization process.

Real Estate

Organized crime has entered actively into the privatization of the domestic and the commercial real estate market. Their methods to acquire apartments illicitly range from offering individuals a car and a tacit threat to evacuate their apartments, up to using hired killers to murder citizens with desirable apartments²⁸. Obshchaia Gazeta suggested in 1995 that as many as 30,000 individuals have been murdered for their apartments. In my discussion of this figure with the former head of criminal investigations for St. Petersburg, he believed that a high figure was accurate even though there had been only one case of prosecution for murder in St. Petersburg in an apartment privatization case.²⁹

The criminality is most concentrated in the commercial sector where the profits are highest. One complex case illustrates the very large potential profits. Moscow city officials sold the rights to auction off a building to five criminal organizations for about \$1500. "At the secondary auction, accessible to well-connected outsiders, if they paid heavy bribes, the property sold for 250 million rubles (\$250,000). Finally the building went on the market selling for 1.5 billion rubles (about \$1.5 million). The 1,000 fold appreciation in value took all of two months."³⁰

Although crime linked with real estate privatization is most visible in cities like Moscow and St. Petersburg where properties are at a premium, it is certainly not confined to that locale. Yaroslavl, a secondary city, has seen much investment of criminal capital in real estate. The explanation for this is its proximity to Moscow, a mere several hours by train.³¹

Once valuable commercial real estate is acquired by organized crime groups, it may be developed with the help of foreign assistance money from various international organizations. These buildings may then be rented to foreign concerns while the Russian owners deposit the rent overseas, often laundering the money through several banks.

Acquisition of firms

Organized crime groups, such as one led by Khomchuk in St. Petersburg, used intelligence, violent tactics and false documents from firms to acquire controlling blocks in 53 firms in St. Petersburg and Murmansk. Bureaucrats and bankers were bought off. His personnel would show up at a firm, state they were distributing humanitarian aid and obtain the addresses of retirees. The retired employees would then be intimidated or given a small sum of money and their shares would go into Khomchuk's possession. The heads of personnel departments of the firm, either through bribes or threats, would be forced to provide the lists of employees. The same tactics were used with them as with retirees. Management was offered special deals or, if intractable, were intimidated.

The cash used for this operation was obtained from the shadow economy. Khomchuk planned to sell the firms obtained through his strong-arm tactics, and acquire the controlling interest in the Northern Fisheries joint stock company in Murmansk.³²

Intimidation of managerial personnel in key positions by organized crime figures is particularly pronounced in the oil industry which provides Russia its most lucrative export commodity. In 1993, in connection with the privatization of oil firms, several directors of oil refineries in the Tuapse region were reportedly murdered.³³

Banking and Natural Resources

Organized crime has assumed a very significant share of the banking industry, and has appropriated a significant share of natural resources. The expansion of organized crime into these two areas has facilitated the mass export of capital from Russian and other CIS states, thereby undermining its financial stability³⁴. In 1992, as much as twenty percent of Russia's oil and one third of the metals mined were smuggled out of the country.³⁵ According to reliable estimates, between 50 and 100 billion dollars have been laundered out of Russia since the late 1980s.

Banking is so corrupted because, until Russian Central Bank officials raised capital requirements in 1994, it was easier to establish a bank than to buy a luxury auto³⁶. In the early 1990s there was an unprecedented expansion of organized crime into the banking sector³⁷. Many of the banks were initiated by privatizing former Communist Party money³⁸ to former Party officials and security police personnel.

Much of the organized crime in different regions of Russia is based on the illegal privatization of raw materials. For example in Krasnoyarsk, wealth lies in the illegal privatization of woods and metal. In Ulyanovsk oblast', there was illegal acquisition of gold, silver, and platinum from the military industry.³⁹ Because of the close connections between the local political elites and those with access to these natural resources, there have been few prosecutions in any region.

Perceptions of Capitalism

Most Russian citizens have a very negative view of capitalism because the transition to a market is occurring simultaneously with the impoverishment of the population. According to a recent Academy of Sciences public opinion poll, two-thirds of citizens responded that "privatization is legalized theft" which benefits criminals⁴⁰.

The spread of disease, the rapid decline of the social safety net including child and medical care and the vast reduction in the buying power of state salaries has meant that much

of the population is living much worse than in the period preceding the transition to a market economy and the development of large scale private property. The primitive stages of post-Communist capitalist formation appear to be as hard on the mass of the Russian population as the conditions which inspired the Communist revolution.

The transition to capitalism has been less painful in Eastern Europe than in the former Soviet Union. First, these societies had fewer years of socialism. Second, significant private economic activity existed in Hungary and Poland before the collapse of Communism. In these countries the illicit economies could be legalized with the collapse of Communism, whereas Russia's underground economy was legally prosecuted even after the collapse of the Soviet state.⁴¹

In many Eastern European countries, unlike in the USSR successor states, the bureaucratic structures, and to a lesser degree the control apparatus, is still functioning. But in Russia, the state apparatus collapsed along with the Communist Party. In Russia, organized crime has replaced the dysfunctional state.

Foreign observers and many of Russia's newly rich compare themselves to the 19th century robber barons of the United States. That comparison is too facile. The robber barons were involved in the creation of industries and the development of capital--the construction of railroads, steel mills and heavy industry--even though they did it by ruthless means. Whereas the Russian rich are not creating property but merely dividing up the remains of the Soviet state.

Annelise Anderson has pointed out the fallacy of this analogy in her paper "The Red Mafia". In the United States there was a respect for the rule of law and the United States was heir to the well developed property laws of Great Britain. No gangs emerged as primitive states. Banks were privately owned and state regulated. In conclusion she remarks,

There is little support for the view that the fraud, violence, and development of mafias in Russia are simply an early stage of capitalism. They have no counterpart in the early history of the United States, and have arisen instead from the legacy of the Communist era: the legacy of excessive bureaucratic regulation, massive illegal markets, and, with the demise of the Communist Party, a vacuum of power engendered by confusion in the legal code and unsureness about what should and should not be legal.

These conditions are not an early stage of capitalism but an early stage of organized crime, when gangs abound, compete for territories and markets, and are especially violent.⁴²

In Eastern Europe where the old-style black market is evolving into legitimate business, the new economic elite does not need to rely on force as do their Russian counterparts. Unlike in Eastern Europe, "Economic liberalization in Russia is not leading to the old-style black market evolving into legitimate business, but to the new, legitimate businesses being sucked into the old black market."⁴³

Conclusion

The symbiotic relationship which exists between organized crime and the leadership has affected citizens' perception of democracy. Although Yeltsin has not been cited for corruption or dealings with organized crime, charges have been levelled at many of his closest associates, including A. Rutskoi and V. Chernomyrdin.

The corruption of the law enforcement structures and the intimidation of members of the judiciary by the gangster capitalists has made the achievement of the rule of law, an early objective of the Gorbachev era a remote possibility.

The United States government should not launch the next phase of our privatization assistance without ensuring that attention is paid to the threat of organized crime and corruption. Continuing to ignore the criminalization of the privatization process merely permits the further transfer of capital to the gangster capitalists and deprives citizens of the property that, as Boris Yeltsin and John Locke concur, is the best protection of the citizenry against state authoritarianism.

Unless American assistance includes controls over the criminalization of the privatization process, it will be subsidizing organized crime and contributing to a most unequal distribution of property. We will be complicit in what many CIS citizens call "the criminal revolution." Unless assistance funds for privatization provide sufficient controls for investment funds, banks, the privatization of valuable real estate and protections for citizens at privatization auctions, American aid can worsen the economic situation for the majority of citizens of the successor states.

The bureaucrats and organized crime personnel, enriched from the criminalized privatization process, export billions to western banks. Increased social and economic instability will result. More alarmingly, some citizens seek authoritarian solutions to the present criminalized situation⁴⁴.

NOTES

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