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Comparative Oligarchy: Russia, Ukraine and the United States

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Abstract

The incidence of oligarchs is one of the most significant political problems after communism. An appropriate policy towards them has become a pressing issue for both Russia and Ukraine and addressing this matter will greatly influence the future economic systems of these countries. The paper examines the nature of oligarchs and the reasons for their emergence. Similarities with the great new businessmen in America of the 1850s, the so called "robber barons", are drawn. The paper also discusses common reactions to oligarchs and the ways to treat the oligarch problem. Finally, it reviews a number of policy and political options; and promotes making oligarchs pay a compensation for benefits they have enjoyed, in return guaranteeing them their property rights.



Oligarchs have become one of the big political problems after communism, and one of the big policy questions in both Russia and Ukraine is what to do with the oligarchs. No doubt, this question will greatly influence the future economic systems of these countries. In order to design a suitable policy for oligarchs, we need to examine what oligarchs actually are, why they have arisen, and what people react against.

1. What Is an Oligarch?

“Oligarch” is an old and popular concept. It arose as a label for contemporaneous businessmen simultaneously in Russia and Ukraine around 1994, and the main features of oligarchs in the two countries were very similar¹. The popular meaning of an “oligarch” is a very wealthy and politically well-connected businessman, a billionaire, or nearly so, who is the main owner of a conglomerate and has close ties with the President. In traditional parlance, an “oligarchy” implies the rule of a limited group of people. It might be more appropriate to call the oligarchs plutocrats, because their power is focused on money. Joel Hellman (1998) has coined the phrase “state capture” to characterize the relationship between big businessmen and the state in a country such as Ukraine, because the big businessmen influenced the state by all kinds of means.

Oligarchs are by no means anything unique to Russia and Ukraine. Andrei Shleifer (2005) has rightly pointed out that oligarchs are typical of most middle-income countries. Much of the discussion about economic populism in Latin America circles around the entrenched power of oligarchs (Dornbusch and Edwards, 1991). People talk about oligarchs also in other countries in the former Soviet Union, notably in Kazakhstan and Georgia, but hardly in the very poor countries Kyrgyzstan and Tajikistan, and not at all in lingering socialist economies, that is, Turkmenistan, Belarus and Uzbekistan.

The historically most prominent example is the “robber barons” in the United States. The *New York Times* referred to the new big businessmen in America as “robber barons” in the 1850s, alluding to the knights who lived in castles along the Rhine and extorted fees for passage, who were the original oligarchs. This label stuck. The robber barons were identified as the men who built great industrial and transportation empires in the late 19th century in the U.S. (Steele Gordon, 2004, pp. 211-2).

In fact, the oligarchs in Russia and Ukraine have displayed much greater similarities with the American robber barons than is usually understood, because time has healed and beautified in America. The argument of this paper is that we can better understand the Russian and Ukrainian oligarchs, if we compare them with the American robber barons. In all these countries, big businessmen have responded rationally to a peculiar set of economic, legal and political conditions that were in place in all three countries in the relevant period.

2. The Economics of Oligarchy

The outstanding economic characteristic of the oligarchs or robber barons is great wealth, and their number is limited. Bradford de Long (2002, p.179) suggests that a present-day billionaire would be a good proxy for a “robber baron.” John Steele Gordon (2004, p. 207) aptly quotes US President Herbert Hoover: “The trouble with capitalism is capitalists. They’re too damn greedy.”

¹ See two excellent studies of the Russian oligarchs, Chrystia Freeland, *Sale of the Century: Russia's Wild Ride from Communism to Capitalism*, New York: Crown Business, 2000; David Hoffman, *The Oligarchs*, New York: Public Affairs, 2002.

One fundamental cause of this generation and concentration of wealth was the sudden achievement of great economies of scale in certain industries, especially metals, oil and railways. The super-rich emerge in countries with large markets and rapid structural change, notably in the US during industrialization after the Civil War and in Russia and Ukraine after communism.

An additional economic characteristic is the presence of rent, which is often difficult to distinguish from economies of scale. Most of the original US robber barons made their money in railways, which easily generate monopoly rents. Other robber barons focused on the natural rents of resource industries, John D. Rockefeller on oil and Andrew Carnegie on steel². Today, the Russian oligarchs are typically preoccupied with oil and metals³, while six of the biggest Ukrainian oligarchic groups concentrate on steel⁴. Free distribution of state assets, notably land around the railways, was also an important cause of enrichment in the U.S., and that was of course true of Russia and Ukraine.

The nature of oligarchs is also determined by the prevailing legal conditions. Well-functioning legal systems are a recent invention, and even within the West legal systems are subject to many flaws. Without strong corporate legislation and a strong judicial system, partners find it difficult to agree or to solve conflicts. Nor can principals (owners) control their agents (executives), so they are compelled to manage their companies themselves. Joint stock companies emerged in the 19th Century, but many western countries have adopted insider legislation only in the last two decades. As multiple scandals illustrate, corporate governance remains poor in the West. John Steele Gordon (2004, (pp. 207-8) has eloquently captured the state of law in the United States in the 1860s, which saw the rise of the robber barons.

Nowhere was...corruption more pervasive than in New York, and especially on Wall Street.... In 1868 the New York State Legislature actually passed a law the effect of which was to legalize bribery.... In 1868 the popular English *Fraser's Magazine* wrote that "in New York there is a custom among litigants as peculiar to that city, it is to be hoped, as it is supreme within it, of retaining a judge as well as a lawyer."

Thus, the current legal practices in Russia and Ukraine appear just about normal for this stage of legal development. Poor governance breeds poor corporate governance, impeding the evolution of financial markets. As a consequence, businessmen with concentrated ownership are more likely to be more successful than those having to deal with many minority shareholders. Moreover, businessmen rationally opt for vertical integration to avoid the hazards of arbitrary court judgments about contracts, that is, they prefer corporate hierarchies over markets (Williamson, 1975).

Hence, the combination of poor legal systems, large economies of scale and fast structural change naturally leads to the concentration of fortunes of the kind we have seen in oil, metals and railways in the United States in the 19th century as well as in Russia and Ukraine today. Therefore, it is difficult to see how a market economy could be introduced under these conditions without generating super-rich businessmen.

3. The Politics of Oligarchy

The key legal problem, however, is property rights. Hernando de Soto (2000) has importantly pointed out how the absence of property rights harm the poor in middle income countries and the developing world today. The rich are also governed by the same hazard. The difference is that they have

² J.P. Morgan was an odd man out in finance, and so was Jacob Astor in real estate (De Long, 2002).

³ In oil: Yukos, Lukoil, Surgut, TNK, Sibneft, in metals Rusal, SUAL, Norilsk Nickel, Severstal, Evrazholding, NLMK, MMK, and UMMK.

⁴ System Capital Management, Interpipe, Privat Group, Industrial Union of Donbass, Zaporozhstal, and Zavod imeni Ilichea.

the possibility to use politics as a means of reinsuring their shaky property rights. Admittedly, they also use politics to extract more state resources and to undermine the property rights of others, whose political assets are weaker than they used to be, but the fundamental problem is the weakness of their property rights to already acquired property. For the very rich, politics is foremost a means to further their business interests.

Politics offer a number of goods to buy. Starting at the top, businessmen buy presidential decisions, usually not from the President but from his family or closest aides. The difference between the administration of Ulysses Grant (1869-77) and Boris Yeltsin or Leonid Kuchma is less than people now want to recognize. Although the U.S. robber barons arose in the 1850s (Commodore Cornelius Vanderbilt), it was not until the early 1900s President Theodore Roosevelt effectively stood up against them.

The second kind of political goods on sale is legislation from the national parliament. The United States has not prohibited the purchasing of legislation, or lobbying, but on the contrary legalized this process and made it transparent. President Putin has complained that Yukos could block minor tax legislation directed against oil companies in Russia, but the United States cannot tax energy at all because of the strong corporate energy lobby. One of the causes of the strength of the corporate lobbies in parliament in the U.S., Russia and Ukraine is that parliamentary elections are dominated by one-man constituencies⁵. That means that individual candidates need to mobilize their campaign financing on their own, which is much easier to do if each contribution is relatively large or the candidate himself rich. The US Senate was even called a Club of Millionaires in the gilded age of the 1880s, which is true of the Ukrainian parliament today, and U.S. congressmen are still greatly dependent on their founders. The situation in the U.S. Congress is quite similar to the Russian Duma, where individual oligarchs finance a few parliamentarians in return for their attention to corporate interests. Ukraine stands out with the most oligarchic parliament possible after the March 2002 elections. It is commonly said that 300 out of the 450 deputies in the Supreme *Rada* are dollar millionaires, and until the Orange Revolution half the Supreme *Rada* was dominated by nine oligarchic factions, primarily representing the interests of business groups.

A third group of political goods for sale is government decisions. This is straightforward corruption. Several of the ministers of President Ulysses Grant's administration were direct beneficiaries of corrupt payments of railway companies (Steele Gordon, 2004, p. 219), and corruption of cabinet ministers has been a patent problem in the United States. With the American revolving doors between government and the private sector, conflicts of interests slightly detached in time have become almost impossible to prosecute. By contrast, in the 1990s it was amazing how little attention the Ukrainian and Russian oligarchs devoted to government posts. Ministers tended to stay with civil servants, some of whom were corrupt, but others were not. In Russia, the half-year appointments of Vladimir Potanin and Boris Berezovsky to senior government posts were exceptions. Russian businessmen prefer to buy services from the relevant officials or purchase public jobs for their helpers. At present, Russian ministerial posts are reportedly traded for prices in the range of \$10-\$30 million. The prices depend on post and to whom the payment is being made, while deputy ministerial posts are being traded in a closer range of \$8-\$10 million. The Russian administration has become more pervasively corrupt than ever before⁶. Again, Ukraine has been far more oligarchic than Russia. Two prime ministers in the 1990s, Yukhum Zviahivsky (1993-94) and Pavlo Lazarenko (1996-97), were major businessmen themselves (Åslund, 2000). Even so, the Ukrainian government remained dominated by civil servants until November 2002, when the country's first coalition government was formed under Prime Minister Viktor Yanukovich, and big businessmen moved from

⁵ Admittedly, only half the deputies in Russia and Ukraine are elected in that way, but many slots on party lists are bought by wealthy businessmen.

⁶ Interviews with insightful Russian businessmen, March 2005.

Parliament to top government jobs. Viktor Yushchenko promised to draw a sharp line between business and government, and his first government contains only two substantial businessmen (Yevhen Chervonenko and David Zhvania).

A fourth political good of great value is court decisions. The quote above about New York courts in the 1860s says it all about American courts at that time. In Russia and Ukraine, the utilization of courts has risen all the time, as law has evolved (Hendley et al., 1997). Alas, as courts have become more important, they have also become more corrupt, and the prices of court decisions have risen in parallel (Kaufman and Siegelbaum, 1996).

Media, the fourth estate, is a fifth kind of political good, although it is mostly private and only influences the government. In the United States, media owners have had a free hand for a long time. Publicity has long been traded freely in Russia and Ukraine, and this is completely legal. In Russia, media were dominated by the oligarchs Boris Berezovsky and Vladimir Gusinsky under President Yeltsin. President Vladimir Putin has gradually expanded government control and ownership over media, but the trade in publicity for commercial purposes is continuing as before, and you can buy price lists from public relations agencies in Moscow, specifying how much it costs to buy positive news reporting by various prominent TV personalities⁷. In Ukraine, oligarchs (primarily Viktor Medvedchuk and Viktor Pinchuk) bought up a lot of media, especially TV, before the presidential elections in October 1999, inspired by the Russian presidential elections of June 1996. Oligarch even assumed the meaning, owner of media⁸. The main media have so far stayed in the hands of a few oligarchs.

This discussion of the economic, legal and political conditions of oligarchy is meant to show that the Russian and Ukrainian oligarchs are by no means as atypical as is often argued. The oligarchs are responding rationally to the prevailing conditions in order to maximize an objective function combining profit and security. Most countries in the world are oligarchic. Just look at Sweden and Finland, which are similarly dominated by heavy industry with large economies of scale. The common argument that American robber barons were different because they invested and built new enterprises hardly holds up (Goldman, 2004). The U.S. robber barons mainly made their fortunes on railways, but through the free distribution of government land, as well as subsidized state financing, which were critical for the success of railways (de Long, 2002). Naturally, the first railways enjoyed great monopoly rents. Resources and rents are characteristic of oligarchs throughout the world. After the Russian and Ukrainian oligarchs had seized their enterprises, they have invested heavily by any standard (Shleifer 2005).

The prime political complaint about oligarchs is their excessive wealth and the purportedly extraordinary inequality in Russia and Ukraine. The number of oligarchs is quite large in Russia, but part of the explanation is that they appear better at partnerships than their American brethren a century earlier, rendering several people rich out of one major enterprise. Yukos stands out as an example of loyal partnership breeding at least seven billionaires. The Ukrainians, by contrast, appear about as distrustful as their American forefathers. One important cause of these great fortunes in the United States, Russia and Ukraine is that these are rather large countries and thus their markets are huge. Therefore, the dominant businessmen in these countries easily become much richer than in smaller countries. The Gini coefficients for Russia and Ukraine are also similar to that of the United States, and far below the average of Latin America (World Bank, 2004).

Another common view is that oligarchs are disliked because they are parasites, not producing anything. In reality, however, the popular perception appears to be changing in the opposite way. The less rent-

⁷ A Russian peculiarity is that enterprises can also pay to avoid negative publicity, something that Gazprom has excelled in (Interview with Boris Fedorov in the spring of 2001).

⁸ I owe this observation to Olena Prytula.

seeking and the more productive oligarchs become, the more unpopular they become. This is particularly evident in Ukraine, where the oligarchs focused and made most their money on commodity trade until 2000. The all-dominant business was gas trade, and one of the gas oligarchs, Ihor Bakai, stated famously in an interview in 1998, “All really rich people in Ukraine have made their money on gas” (Timoshenko, 1998). Other sources of revenues were subsidized state credits, steel exports, oil trade, coal subsidies, agricultural and chemical exports, anything but production (Åslund, 2000). At the time of the Orange Revolution in 2004, Ukraine’s GDP was growing at a staggering pace of 12.4 percent, much of it steel produced in the oligarchs’ steel mills, and many other branches of industry were taking off in the oligarchs’ hands. The issue is really transparency. People do not react against billions of dollars are spirited out of the state treasury, because they do not see them. The oligarchs are becoming subject to much greater public criticism, when they no longer steal but produce, because the public do see factories, and then they draw their own conclusions about personal wealth.

Conversely, a standard view, much cherished by Western observers such as Joseph Stiglitz (2002) and Marshall Goldman (2004), is that privatization is key to the wealth of the oligarchs. Again, Ukraine illustrates particularly clearly that this was not the case. Until 2000, all oligarchs focused on gas trade and little else, and no privatization was required for that. Volumes have been written about the loans-for-shares privatizations in Russia⁹. To begin with, the oligarchs did not become oligarchs through these privatizations, but they were all known as oligarchs before. Moreover, most oligarchs did not participate in the loans-for-shares privatizations, so they did not the oligarchs. Unlike many other privatizations, money was actually paid, and even if the amounts were paltry in comparison with the potential values of the enterprises, they were larger than in virtually all other privatizations. Most of the enterprises involved in loans-for-shares did extremely well, notably Yukos and Sibneft, which led the revival of the Russian oil industry, and soon they paid as much taxes in one year as anybody possibly could have tried to sell these enterprises for in 1995. Thus, economically, the loans-for-shares privatizations in Russia were an unmitigated success, and soon these privatized companies generated more taxes in one year than anybody really thought they could be sold for in 1995. The state would have lost greatly, if it had kept them and privatized them later regardless of the sales price. It should be remembered that the old management both mismanaged these state properties and stole most of the proceeds. More broadly, it can be said that privatizations are much more detested than theft of money, because the objects of privatization, factories, can be seen with the bare eye. Also with privatization the problem is that it is too transparent so that ordinary people can see the wealth (Shleifer and Treisman, 2000; Åslund, 2002; Shleifer, 2005).

Similarly, the popular reaction against the Russian oligarchs appears to have caught on around 2000 after several of the major oligarchs had decided to become fully legal and legitimate, pay taxes, declare their ownership and spend substantial amounts on charitable donations. In hindsight, it can be argued that this voluntary transparency was the most serious mistake the Russian oligarchs made.

In Ukraine, privatization was later and messier than in Russia (Yekhanurov, 2000), which only seems to have bolstered the power of the oligarchs. The excesses of the oligarchs delayed economic recovery much more in Ukraine than in Russia. In 2000, substantial economic policy changes occurred against the will of the oligarchs, which led to great economic growth. Although the oligarchs continued to reinforce their wealth for some time, the new competition of other emerging big businessmen challenged the very oligarchy (Åslund, 2001). The popular edge after the Orange Revolution is directed against the two leading oligarchs, Viktor Pinchuk and Rinat Akhmetov, who have made the transition from commodity trading to production, while the shadier oligarchs appear to escape the brunt of the critique. Pinchuk and Akhmetov possess large steel corporations, whose corporate structures appear both transparent and efficient.

⁹ The best is Freeland (2000) and Hoffman (2002). See also, Blasi et al. (1997).



Admittedly, they are the beneficiaries of the most disputed privatization in Ukraine, of the huge steelworks Kryvorizhstal, which was somewhat reminiscent of the loans-for-shares privatizations in Russia. It generated substantial revenue (\$800 million), and it was comparatively transparent, though not competitive. Pinchuk alleges plausibly that this privatization alone netted the state more than all other privatizations of steelworks in Ukraine.

There appears to be a negative correlation between economic utility and popular acclaim. Insider privatization, which predominated in the early transition, appears to be easily accepted however ineffective they were. If the first beneficiary wasted his funds, he is easily forgiven, or at least forgotten. If somebody buys a mismanaged privatized enterprise for a penny on the secondary market, nobody seems to complain. Nor do people seem to react if somebody takes over a well-managed company at a low price after having ordered out law enforcement agencies in lawless persecution.

The *sense morale* is not pretty. The more shady machinations oligarchs make their money on, the safer they are. The more productive they become, the more disliked they will be. The more transparent they are, the more condemned they will be. The more taxes they pay, the more exposed they become. Just look at Yukos. Admittedly, time heals wounds, and so does failure. Few are concerned about organized criminals who emigrated or state enterprise managers who lost their fortunes after having run their ill-gotten enterprises aground.

4. A Matter of Ideology

So what is the problem with oligarchs? There is a bit too much noise in the discussion about oligarchs, but the comparison with the United States helps to clarify the debate. The point is that people do not like successful capitalists, which is a purely ideological issue. This becomes plain if you look at some of the anti-oligarchic literature (Goldman, 2004; Stiglitz, 2002). Indeed, the United States government did not react against the robber barons in the 1860s and 1870s, when their excesses were worst, but under Theodore Roosevelt in the early 1900s, when populism had grown strong, although Andrew Carnegie was then giving away his wealth at an unprecedented speed.

In the end, however, the acceptance of large fortunes is a matter of ideology. If people are to accept that some are very rich, they must believe that great riches are permissible. The outstanding example of the acceptance of great riches of others under democratic conditions is the United States, and the United Kingdom comes a decent second, both largely embracing classical liberalism. In his book, *The Constitution of Freedom*, Friedrich Hayek (1960) has formulated this ideology, accepting both the formation of wealth and its inheritance.

Edward Luttwak (1999, pp. 17-21) has taken the argument quite a bit further, arguing that capitalism could succeed in the United States because of the country's intrinsic Calvinism. Religion compelled people to work hard and save. Americans see the desire to become rich as praiseworthy and success in doing so as a moral achievement. Wealth is an indication of virtuous life. Yet, puritanically, winners are not supposed to indulge in hedonism but to keep working hard to become even richer. Therefore, wealth does not become all that ostentatious. Conversely, people who did not make that much money were not equally virtuous, and had better be ashamed of themselves. Alas, "there are also plenty of non-Calvinists among the losers" (*ibid.*, p. 22), but those who did not understand better but stole were ruthlessly thrown into prison, landing the U.S. with one of the proportionately largest prison populations in the world.

Hillary Appel (2004) has compared privatization in the Czech Republic and Russia, and she has come to the conclusion that Vaclav Klaus wisely utilized classical liberal ideology fully to facilitate privatization.



Although the Russian privatizers were equally radical liberals, they decided that they were better off justify privatization in terms of concrete material benefits, advocating relevant shares for various groups of stakeholders (Boycko et al., 1995; Chubais, 1999). Alas, the Russian public felt cheated when their expected material benefits did not result, while the Czechs happily reelected Klaus, because he had not promised concrete benefits but an ideology, although the Czech Republic persistently underperformed in economic growth (see EBRD, 2004).

The fortunes of the Russian and Ukrainian oligarchs can hardly be accepted by the public, if people in these countries do not accept a truly capitalist ideology. The key to an understanding of what is going on now is that this is not a legal matter. The obvious point is that nothing could be done by law in a situation when laws were in disarray, the courts unreformed and the law enforcement ineffective at best but more likely corrupt (Gaidar, 2003). Therefore, both the state and the market had to fail in the transition, and the best that could be done was to guide society toward a normal situation (Shleifer and Vishny, 1998; Shleifer and Treisman, 2000).

The main enemy of liberalism is no longer socialism, even if many of its sentiments linger. Its place has been taken by populism. Much of the discussion about economic policy in Latin America in the 1970s and 1980s concerned populism. At that time, populism was primarily directed against the laws of macroeconomics (Dornbusch and Edwards, 1991). Now, the importance of macroeconomic stability has been greatly appreciated throughout the world, as the Washington consensus has effectively won. Instead, the new economic populism looks for redistribution through the undermining of existing property rights. As usual, populism is driven by a combination of forces, both those really suffering from the lack of justice and others who want to make their fortunes on a manipulation of a sound capitalist order.

5. Current Trends in Russia and Ukraine

Rather than being a real social, legal or economic problem, the oligarchs appear to have led the economic recovery in Russia and Ukraine. The more successful they become, and the higher the growth rate, the more disliked them become. The two main forces criticizing the oligarchs are emerging big businessmen, aspiring to seize their property, and populist politicians, just wanting to agitate people against some being richer than others. However, there is also a liberal concern, namely that the oligarchs are benefiting from privileges and that the playing field is not level. From this analytical vantage point, it appears easier to understand what is currently happening in Russia and Ukraine.

Russia under President Vladimir Putin has chosen a first option. One company, Yukos, has been singled out for confiscation through the arbitrary application of taxation, and its main owner has been jailed under great popular applause. As a result of tampering with both tax legislation and the judiciary, both the excellent tax reform and the judicial reform have been discredited, and the credibility of property rights has been undermined. Less noticed is what has happened to the rest of the big business world. The oligarchs have been forced to “reinsure” their property rights repeatedly with large and arbitrary amounts to Kremlin funds for various purportedly charitable purposes. Ironically, this arguably helps enrich the oligarchs, because smaller businessmen who encounter these practices of extortion tend to bail out and sell their up-and-coming enterprises to the established oligarchs who thus gain dynamic enterprises for very reasonable prices. Meanwhile the oligarchs also benefit from less competition. The natural expectation is that Russia’s high economic growth will tamper off. The drawback is social, because this is probably a significant cause of Russia’s economic growth being less than the average for the CIS for the last four years (EBRD, 2004).

The new Ukrainian government is contemplating a second option, to re-privatize enterprises that have been improperly privatized. In Ukraine, the dominant motive appears to be revenge against the oligarchs who supported the old regime. Another motive is the big businessmen around the new regime who want to seize the assets of the old oligarchs. Again, a third goal is to level the playing field. Clearly, the two first objectives contradict the third one, which is the legitimate goal. One idea is that the privatization will be annulled, compensation paid to the prior owner for his initial payment, and then the enterprises will be sold anew by the state at a competitive auction. The redistribution of property is often considered one of the characteristics of a revolution (Mau and Starodubrovskaya, 2001), but the revolution theoretician Charles Tilly (1973) has argued that redistribution of property always prevents the evolution of democracy. Only very recent privatizations can be reversed, because many enterprises have changed hands, and how will partial sales and investments be considered? Obviously, the oligarchs will resist, and the combination of their willingness to spend and a corrupt state makes it more likely than not that they will win. Nor is it likely that a new case-by-case privatization will be very successful, because they rarely are in weak postcommunist state (Havrylyshyn and McGettigan, 2000). In a revolutionary situation, many businessmen, not least respectable foreigners, are likely to stay out. In the case of Ukraine, however, the prior Ukrainian oligarchs might be replaced by Russian oligarchs, who are not marked by their cooperation with the old regime. The old owners will undoubtedly sue the state and court cases will be long-lasting. East Germany showed how harmful the unlimited legal pursuit of property rights through the courts can be, leaving millions of properties unused for years, although the East German courts were the least corrupt in the postcommunist region (Siebert, 1992). Property strife does reduce the propensity to invest, which is vital for economic growth. If not ranged in early on, this option might be more destabilizing than the Russian choice.

In neither Russia nor Ukraine, would the current thinking about reprivatization lead to reinforced property rights or a more level playing field. The state might extract more revenues, but the legal system is rather being undermined, and economic growth is likely to suffer.

6. What Should Be Done?

The question remains, what can and should be done to cure this problem with oligarchs? The criticism of the Russian and Ukrainian schemes does not imply that nothing should be done. According to the argument above, the oligarchs are natural results of the economic, legal and economic conditions that persist. If we want to change the oligarchs' status, we can pose demand upon them that they are prepared to accept, change their incentives or alter the economic, legal and political environment within which they operate. If the problem is that the oligarchs have paid to little to the state, that issue should be settled one-and-for-all, while their property rights should be reinforced.

The third and probably best option might be what the new Georgian regime attempted after the Rose Revolution. The government asked the incumbent owners of spuriously-privatized enterprises to pay up or at least make an additional contribution to the state. The oligarchs were invited one after the other to a group of top officials, and a price was conclusively agreed. As a result, the state treasury was filled up, and a stable settlement appears to have been accomplished. Judging from recent public statements from the Ukrainian oligarchs under attack (Viktor Pinchuk and Rinat Akhmetov), this is their preferred solution. They want to sit down with the responsible state officials and arrive at a final and definite deal, and then they allege that they are happy to pay what the government demands. This solution has several advantages. The oligarchs would be co-opted, as this would amount to a real compromise. The state would get substantial revenues, which would give it a strong case to the public. Therefore, it would become politically

possible to give the oligarchs amnesty for prior violations, and their property rights could hopefully be guaranteed by the state. Taxation is preferable to redistribution of property rights.

A fourth policy option would be to guarantee the oligarchs full property rights without asking them for any compensation. Obviously, this is the choice of the oligarchs, but it is hardly realistic in the current political climate. With their huge charitable donations primarily to the social sector, the Russian oligarchs are trying to develop this option. President Putin appears to toy with this fall-back position. Given the public outrage that became evident in the Ukrainian Orange Revolution, however, amnesty without some direct compensation to the state does not appear very plausible in Ukraine.

Whenever an amnesty has been decided, it should be sanctified by all possible means. Property rights are fundamental rights that should be guaranteed by the Constitution. If the state can effectively guarantee the property rights of the oligarchs, their demand for reinsuring their property rights through huge political expenditures diminishes. Then, state capture can cease and corruption can more easily be brought under control. Arguably, the privatization of more enterprises remains so attractive that an amnesty can only become effective after almost all major privatizations has been completed.

A fifth way of combating oligarchs is the social democratic approach, through progressive taxation. The problem is that it changes the economic system permanently and is likely to harm both entrepreneurship and economic growth for the foreseeable future. Bradford De Long (2002) points out that the United States hardly generated any billionaires from 1930 to 1980, because also in the U.S. social democracy was victorious. The outstanding feature of this period was high progressive taxation, which often exceeded 90 percent for the truly rich and peaked at 94 percent after World War II (Steel Gordon, 2004, p. 359). Thus, even under the generally liberal conditions of the United States, high progressive taxes on the very rich can stem the development of newly rich people. High progressive taxes almost define social democracy as distinct from a liberal market economy. To introduce them would be to through out the child with the bathwater. Fortunately, it is against the mood of our time, which is cherishes flat taxes. In addition, the oligarchs are more likely than not to evade or avoid such taxes by buying themselves sufficient legislative clout to stop such taxation, at least for themselves. Note that the wealthy aristocracy persists in many European countries with high progressive taxes, while new entrepreneurs are restrained.

Not only the demand for corruption needs to be reduced, but also the supply. The means for the combat of corruption are many (Rose-Ackerman, 1999). The range of reforms of the public sector is great, but much can be accomplished through political reforms. The problem is the one-man constituencies, which are most easily bought by rich businessmen. Legislation on campaign financing has proven toothless in Russia and Ukraine, while transition to proportional elections for parties is likely to be a more effective cure. A party with a large number of members of parliament and a political program cannot easily switch positions without logic, although, it is no guarantee, as Vladimir Zhirinovsky's LDPR successfully has shown, and corruption in campaign financing often occurs in Western countries.

Another vital political reform to reduce both corruption and the power of the oligarchs is to move from a presidential system to a parliamentary system. At present, the borderline between free and half-free countries in Eastern Europe goes approximately along the line between presidential systems and parliamentary rule (Freedom House 2005). It is easy to understand why. The oligarchs have thrived in collusion with the President and his closest advisors in a sphere that has been unregulated, nontransparent and unaccountable. Theoretically, such controls can be introduced in a presidential system, as is the case in the United States, but that is a very difficult system to construct.

Media freedom and pluralist ownership of media is another vital condition for the checking of corruption and thus the power of oligarchs, because unpredictable media reporting does expose a great many scandals.



7. Conclusions: Make a Deal with the Oligarchs and Preach Capitalism

Ironically, the key problem of our time is the generators of an unprecedented boom in Russia and Ukraine. In the mid-1990s, young local people took on the challenge to transform the seemingly moribund Soviet smokestacks. They succeeded beyond any expectation, and especially in Ukraine revitalized old steelworks have driven the economic recovery. Soon, some new owners became conspicuously rich, especially as only economies of scale were great, rents ample, and only enterprises with concentrated ownership made it. Since their property rights were weak, the new entrepreneurs, commonly called oligarchs, reinsured their property rights by buying politicians, judges and other officials, what is called corruption or state capture.

Both Russian and Ukrainian politics are driven by a popular urge to defeat corruption, identified with oligarchs. The United States faced the same dilemma, how to quell the excesses of the new big businessmen, in the Gilded Age in the late 19th century, when Andrew Carnegie made a fortune on steel and John Rockefeller on oil. Russia under Putin has instigated confiscation through taxation of the biggest oligarchs and extorted the rest with periodic payments. Ukraine is considering a large scheme of re-privatization, which might destabilize both politics and economics, not to mention law.

The problems with these schemes are that they are driven by the wrong ideology, a populist dislike of the rich plus a desire by rising businessmen to grab the assets of the old oligarchs. Neither should be encouraged. Yet, there is a liberal argument for the leveling of the playing field, doing away with their current privileges and possibly making them pay up for some past benefits. In return their property rights would be guaranteed. The new government in Georgia has done exactly that. It has negotiated with the oligarchs and forced them to pay a certain amount to the state, but then guaranteed their property rights. This deal should be made one and for all, while the introduction of high marginal income taxes would impede not only the evolution of old oligarchs but probably preserve the old ones and brake economic growth.

The essence of the oligarch discussion, however, is ideology. The emergence of oligarchs must be understood as a natural consequence of the prevailing economic, legal and political conditions. To overcome this discussion the public need to accept the fundamental principles of capitalism. Yet, the oligarchs need to be disciplined. If the state is able to guarantee property rights to big businessmen, their need to capture the state with large political payments will plummet. The supply of available political services can also be reduced through the introduction of proportional elections, parliamentary systems and media freedom. Then, a normal legal system, which can discipline the oligarchs, can evolve.

In the end, no political solution is likely to hold if it is not supported by a strong ideological base. If people cannot be convinced that they need capitalism for their own good, they are not likely to accept the perseverance of the super-rich.

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