

## CHAPTER ONE

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# The Russians Are Coming

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**I**MIGHT NEVER HAVE GONE to Russia had it not been for two phone calls, one fax, and a submarine.

The first call, in the summer of 1990, was from a friend who led a Boston-based research group called Defense and Disarmament. Together with the Soviet Academy of Sciences, his organization was sponsoring “Swords into Plowshares,” a conference at Harvard University focused on production conversion, military to civilian, in both the United States and the Soviet Union. Would I be interested in addressing that unusual assembly? I would indeed.

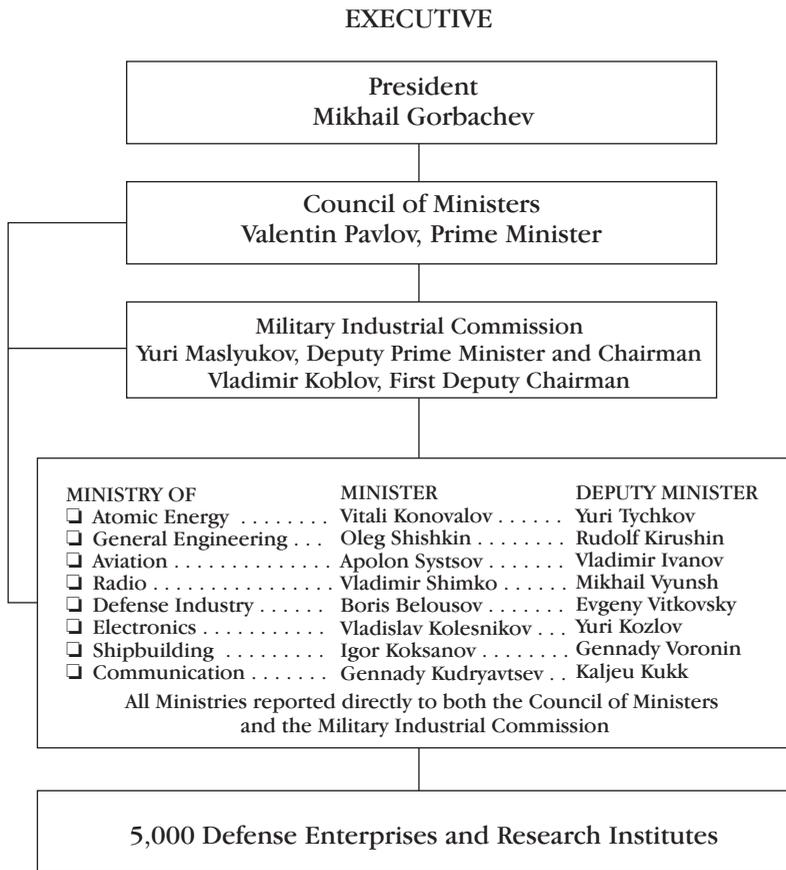
Harvard’s venerable red brick buildings and the placid Charles River seemed an appropriate setting for the subject. But I noticed an important disparity. The Soviets sent high-ranking government officials and senior managers of the factories that produced military hardware. The United States was represented by a sprinkling of middle-level managers from military-industrial companies like General Electric and Raytheon. That the American companies attached little importance or urgency to converting from military to civilian production was evidenced by the ranks of their representatives.

In their choice of delegation leader, the Soviets sent a very different signal. Vladimir Koblov was first deputy chairman, and soon to be chairman, of

the State Commission on Military Industrial Production of the Council of Ministers of the Union of Soviet Socialist Republics (U.S.S.R.) (the “State Commission”). The United States has no equivalent rank or job, but imagine that all of its defense contractors, from giants Boeing and McDonnell Douglas to the smallest independent contractor, were combined into a single organization supplemented by the Pentagon’s procurement bureaucracy. Someone equivalent to Koblov would be in charge, overseeing thousands of plants and offices, and millions of workers.

At the conference, some American speakers argued against converting military plants, maintaining that it could not be done for several rea-

SOVIET MILITARY INDUSTRIAL COMMISSION AND MINISTRIES

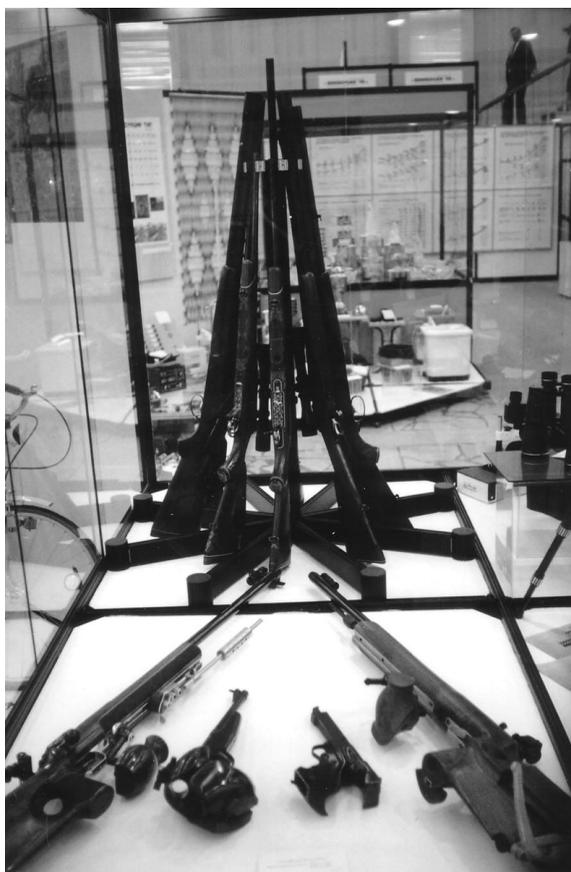


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7

sons, one of which was that unions would not agree to the necessary changes in job descriptions and pay scales. The Soviet speakers, by contrast, tended to ask: “Why not? If the world wants fewer weapons and more consumer goods, let’s oblige.”

The contrast surprised and appalled me. We Americans were supposedly responsive to markets, but here it was the Soviets showing flexibility. We argued for the status quo; they, for change. The Soviets had not come to Harvard to discuss long-term gross domestic product (GDP) growth; they wanted to know how to turn rifle factories into refrigerator



During later visits to the ministries and enterprises that reported to the State Commission, we would see weapons—powerful and plentiful—on exhibit, from rifles and handguns to tanks and Proton rockets. The importance of conversion seemed obvious.

plants *now*. Perhaps the difference in authority between the two delegations accounted for some of the difference in spirit. As the conference progressed, it became even clearer that the Soviets were top decision makers for their enterprises, whereas the middle-level Americans unquestioningly expressed their companies' policies.

My own speech suggested two simultaneous initiatives: privatization of Soviet enterprises and the creation of an investment fund that would allow aggressive American, European, and Japanese corporations to buy stakes in the privatized companies. Privatization would give the Soviet economy a shot in the arm, while the fund could pioneer new areas of profit and serve as a model for future investment in the Soviet Union.

Privatization is an old and simple concept, based on the conviction that private investors, rather than the state, should own a country's factories and farms. Just a few years before, this would have been dangerous even to hint at in the Soviet Union. But thanks to the new rules of Mikhail Gorbachev's administration, it was suddenly possible. Under privatization, Soviet workers who became part owners of enterprises would have a stake in their own productivity. In this way they would gain something tangible from the abandonment of communism. They would see that the transformation to free market capitalism would benefit the great majority of people, unlike the old system that primarily served the Communist Party and the state.

However, I cautioned, while the concept of privatization was simple, its execution would be devilishly difficult. A few precedents existed for privatizing an entire state-owned economy, but none large enough to be a model for the Soviet Union. When East Germany privatized its much smaller economy in 1990, it was able to adopt West Germany's laws and economic structures. Even so, it was—and remains—a Herculean task for the Germans. By contrast, the Soviet Union would be privatizing almost from scratch, and without an established economic power like West Germany to act as a parent in times of crisis.

Privatization would involve far more than declaring that workers are now plant owners. They might have all the job skills in the world, but Soviet workers had no financial capital. If enterprises were to modernize and expand, if their managers were to learn the techniques of marketing and international trade, the country would need to enact laws permitting enterprise ownership by other investors, too. Only foreign investors could contribute both the hard currency that privatization demanded and the business expertise necessary for recently emancipated companies to stand on their own and compete in a free market. The country

needed to create a legal framework in which foreign investors, individual and corporate, could feel comfortable.

The next morning my office telephone rang. It was Vladimir Koblov, who asked if I could meet individually with each member of the Soviet delegation later that day. My plan had apparently struck a responsive chord. They said it offered a more focused, specific vision than any other they had heard, and they wanted to hear more.

Desperate to stave off an economic free fall, the Soviets wanted all the help I could provide. I cleared my calendar and spent the afternoon in individual 15-minute sessions, answering questions on my investment fund proposal, about Batterymarch, and about how to create an environment attractive to foreign capital.

The next evening the entire Soviet delegation met at my home for further discussion. One of my guests, a burly, square-faced, dark-haired Russian, informed me that he had been in Boston before.

“Oh,” I replied, assuming he had been on a trade mission or something similar. “When was that?”

“About five years ago,” he allowed.

“Where did you stay?” I asked, anticipating the name of a downtown hotel.

“Nowhere,” he answered.

This was not the first time I was puzzled when talking to Soviets, and it would certainly not be the last. My guest grinned. He had “seen the city,” he said, from Boston Harbor—through the periscope of a submarine. “Swords into plowshares” hit close to home at that moment. Soviet submarines, whose nuclear weapons no Star Wars technology could stop, had been lurking in the waters near my home.

The Russians involved in the Plowshares project continued moving fast. Days later, I received a fax from the Soviet government inviting me to the U.S.S.R. to explain my ideas in detail. Before accepting, I again asked myself the hard question: Did I really believe Russia was a place where interesting profits could soon be made? I remembered some remarks by Graham Allison, former dean of Harvard’s John F. Kennedy School of Government and, later, a deputy secretary of defense in the Clinton administration. Given the wealth of natural and human resources in the Soviet Union, Graham told me, it had taken a truly evil genius, Joseph Stalin, to bring the country to its knees economically. For more than 70 years, that huge nation—three times the size of the United States—had experimented with a questionable economic system and failed miserably, squandering its wealth and misusing its human and material resources. Still, that failure, bitter as it was for the Russians, held

the promise of a new and better life—where Western capital and experience could be crucial.

I believed the potential of a free market Soviet economy was enormous, if only because of the nation's size. The country was simply too big to ignore. After China and India, it ranked third in world population, with almost 300 million citizens. Those millions wanted cars, appliances, well-made clothing, and decent housing, which Western companies could supply at affordable prices. If and when the free market revolution took place, the U.S.S.R. would provide a vital market for Western producers, and it offered a rich opportunity for Western investors.

The chronic shortage and shoddiness of Soviet consumer goods did not indicate ineptitude as much as it pointed to a lack of emphasis in these areas. For seven decades, the economy had been driven by concerns of national security, not by the demands of the marketplace. Influencing every economic decision was the Communists' determination to control all aspects of society. What the Soviets knew how to do, they often did very well. While their advanced weapons represented their exper-



By special invitation, I traveled to the Baikonur Cosmodrome in Kazakhstan and witnessed the December 2, 1990, launch of the Soyuz TM-11 mission, a historic joint mission with a private Japanese company. In this picture (not taken with a telephoto lens), the cosmonauts begin boarding for their mission to Mir.

tise in research, technology, and production, precious little of that knowledge and proficiency was used to stock retail shelves.

Likewise, political failure, as opposed to a lack of resources, accounted for the difficulty in feeding Soviet citizens. Prior to its breakup at the end of 1991, arable land composed 11 percent of the country, the same percentage as in China, but the Soviet Union was comprised of more than twice the land mass of China and only a quarter of the population.

Yes, there were spot shortages of fuel and other natural resources, but these, too, can be attributed to organizational shortcomings. The Soviet Union held 40 percent of the world's reserves of natural gas and almost 6 percent of the oil. (Its annual oil production in the early 1980s had been about one-sixth of the world's total.) The natural wealth was staggering. The country also had more timber, coal, iron ore, copper, zinc, nickel, lead, gold, and other precious metals than any other nation in the world.

The human talent was also extremely impressive. By any standard, the Soviet labor force was well-educated and highly trained. If early in the century only 10 percent of the population attended high school, by 1959 90 percent of Soviet workers had some high school training, and when Gorbachev came to power, nearly 100 percent had a high school education. By that time, high school attendance and the literacy rate in the Soviet Union were nearly identical to America's. The drive for educational achievement was growing because, coupled with Party membership, it was the principal route to upward social mobility. Higher education was also expanding. In 1990, 9 percent of the population had college degrees, compared to 2 percent in 1960. The technologically sophisticated defense systems were designed and perfected by one of the world's largest pools of 1.5 million basic-research scientists and engineers.

I concluded that a partnership with the West could involve many of those scientists and engineers in socially useful research and economically profitable development projects. The task was to identify the technologically advanced parts of the Soviet military establishment that could, after privatization and conversion, compete successfully in the world market. And, furthermore, this had to be done in a society immersed in the process of making the treacherous and unprecedented transition from communism to capitalism. I couldn't let a challenge of this magnitude slip by.

And so I left for Moscow in September 1990, thanks to two telephone calls, one fax, and a submarine.