

Russia's Economic Future
Asian Perceptions and Cultural Misperceptions

Steven Rosefielde
Professor of Economics
Chapel Hill

Paper prepared for the Hosei/Tokyo University
International Comparative Studies Conference:
Rethinking International History from an Asian
Perspective
September 16-19, 2004

First Draft

Session 3: Asian Perceptions of the West
September 18

ABSTRACT

Contemporary Asians view Russia through an array of communalist, liberal and socialist cultural filters. They see some things accurately, but not the inner logic of the Russian economic system. Many mistakenly believe together with western specialists like Andrei Shleifer and Daniel Treisman that American style reforms have transformed Russia into a "normal country." Close scrutiny however reveals that the institutions borrowed were hijacked by the federation's "Muscovite" culture to serve the ends of a veiled authoritarian martial police state. This paper explains how the Muscovite economic mechanism has worked for the last 500 hundred years, and why Asians (and westerners) have trouble grasping Russia's political economic future.

JEL CLASSIFICATIONS: P16, P30, P52

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INTRODUCTION

Contemporary Asians perceive Russia through a variety of cultural lens. There are indigenous Confucian, Buddhist, Shinto and communalist influences, often overlaid with western enlightenment perspectives including socialism. For economic comparativists these diverse outlooks are reducible into three ideal utility optimizing types.

The most familiar for western and Asian scholars alike is the individualist utility optimization or PAB model elaborated by Vilfredo Pareto, Kenneth Arrow and Abram Bergson (Bergson, 1938, 1948, 1954, 1966, 1967, 1976; Samuelson, 1977, 1981; Arrow, 1963, 1981). It encompasses both democratic free enterprise and social democracy, teaching that if economies abide strictly by PAB axioms, then outcomes are likely to be favorable from the standpoint of the people's sovereign preferences. Charitable PAB systems, stressing social justice, and relying on government programs take the form of EU-type welfare states; while more entrepreneurial societies veer closer to the American norm.

Lenin's concept of a natural economy without private property, business and entrepreneurship, responsive to the will of the vanguard of the proletariat through requisition and planning provides the basis for a very different ideal where the state paternalistically protects the people from themselves, and market exploitation (Rosefielde, 2006; Rosefielde and Hedlund, 2006).

And finally, there is an Asian communalist ideal, abstracted by Masahiko Aoki (Aoki and Patrick, 1995; Aoki and Kim, 1995; Aoki and Saxonhouse, 2000) whereby consensus building and communal welfare displace individualistic competition. The model has many of the formal virtues of PAB, but economic participants in Aoki's conception are more prepared to work cooperatively, and sacrifice their narrow self interest for the group, community and nation (Rosefielde, 2002).

Asian scholars have applied all three standards to appraising Russia's past, present and future, whereas westerners have been concerned more with the PAB and natural economy norms.

No Asian scholar today considers Russia ideal, or expects a "virtuous" Leninist restoration. Everyone recognizes that the post-Soviet Russian experience has been blemished, and is concerned more about its future than the past.

Asian perceptions are sober and pragmatic (Tomiyama 2004; Mizobata, 2004a,b,c). Comparatively few scholars in Japan, China and South Korea believe as Andrei Shleifer and Daniel Treisman do that Russia has already become a "normal" country, well advanced along the path toward western democratic free enterprise (Gavrilenko and Kuboniwa, 1997). Asian's are less enthralled by the rhetoric of globalization, given their own exceptionalism, and often hold Russian political economic culture in low regard.

This mix of attitudes at once more tolerant of systemic diversity than the western norm, and chary of Russian national character reflects the realism of Asian "public culture" (the cultural factors governing personal conduct and governance in the public domain), but doesn't provide a sound basis for grasping the forces forging Russia's economic future, or anticipating the consequent challenges for Asia. Like the west, Asian public culture inclines scholars to see Russia "as they like it," and not as it really is. They see many things right, but could do even better by discerning the laws governing Russia's cultural abnormalities.

RUSSIA WITHOUT CULTURAL FILTRATION

The Soviet Union as Asians partly understand was an authoritarian society, governed by the Communist Party which relied heavily on the KGB (Komitet Gosudarstvennoi Bezopasnosti) and possessed

the world's largest military industrial complex in 1984, the year Mikhail Gorbachev became the head of state.¹ Its production capacities were several times greater; its arsenal double, and defense burden sextuple America's. This enormous burden together with the "command economy" took a heavy toll on per capita consumption, depressing it to a level 10 to 20 percent of the American standard. These indicators weren't Goskomstat's or the U.S. Central Intelligence Agency's (CIA). The defense burden estimates are Vitaly Shlykov's, (former deputy chairman of the Russian Defense Council), the U.S. Defense Intelligence Agency's (DIA) and the author's based on corrected CIA adjusted factor cost data. The Soviet defense burden reported by Big Brother was half America's, while the living standard was much closer to the U.S. norm. A Soviet collapse was unthinkable on Big Brother's numbers, but proceeded quickly once the inner Party group grew weary of its own Orwellian game (Rosefield and Hedlund, 2006). Soviet authoritarianism began crumbling when Gorbachev took the helm in the fourth year of the eighties. Seven years later Felix Edmundovich Dzerzhinsky's statue was removed from Lubyanka square (the USSR's first

¹ Alexander Zinoviev dismisses this view as "Russophobia," See "Trumphant Vengeance," *Johnson's Russia List*, No. 8276, Article 15, July 1, 2004. George Orwell, *Nineteen Eighty-Four*, Martin Secker & Warburg, Ltd., London 1949. Richard Pipes, "Flight From Freedom: What Russians Think and Want," *Foreign Affairs*, May-June 2004. Evgeny Gavrilov, "Economic Growth As A Way To Freedom," *Johnson's Russia List*, No. 8273, Article 1, June 29, 2004 cites a Levada Center opinion poll supporting Pipes' analysis. Cf. Alexander Lukin, "Pipes Can't See the Trees for the Forest," *Moscow Times*, July 21, 2004. James Billington, *Russia in Search of Itself*, Woodrow Wilson Center, Washington DC, 2004. Also see Joshua Rubenstein, "Review of Russia in Search of Itself," *Wall Street Journal*, April 20, 2004. Rubenstein quotes Billington: "Russia is moving toward some original Russian variant of a corporatist state ruled by a dictator, adorned with Slavophile rhetoric, and representing, in effect, fascism with a friendly face." On rent granting and rent seeking see Anne Krueger, "The Political Economy of Rent-Seeking Society," *American Economic Review*, Vol.64, No.3, 1974, pp.291-303. Peter Boone and D. Rodionov, "Rent Seeking in Russia and the CIS," Paper presented at the 10th Anniversary Conference of the EBRD, London, December 2001. Joel Hellman, "Winners Take All: The Politics of Partial Reform in Post-Communist Nations," *World Politics*, Vol.50, No.2, pp.203-234. Leonid Polischuk and Alexei Savvatev, "Spontaneous (non) Emergence of Property Rights," *Economics of Transition*, Vol.12, No.1, pp.103-127. CIA, *Global Trends 2015 on Russia*, reprinted in *Johnson's Russia List*, No.8192, Article 3, May 2, 2004. Aleksandr Gol'tz, "Glavnoe prepiatstvie voennoi reformy - rossiiskii militarizm," (The Main Barrier to Military Reform - Russian Militarism," *Pro et Contra*, Vol.8, No.3, 2004 (carnegie.ru). For a detailed examination of Stalin's red holocaust see Steven Rosefield, *Red Holocaust: The Economics of Disutopia*, unpublished manuscript, June, 2004. Although mass homicide was a distinctive attribute of Stalin's reign starting with forced collectivization in 1929, a replay is unlikely because the scope of the secret police's mission has been pared, terror is no longer a preferred disciplinary method, and there is no Stalin clone on the horizon.

secret police chief), and the G-7 confidently awaited Russia's speedy transition to democratic free enterprise.²

2004

Andrei Shleifer and Daniel Treisman believe that the G-7 including Japan wasn't mistaken.³

² Orwell coined the term "Newspeak" to describe the creation of a public language that lacked words needed for a clear perception of people's existential plight. The term also has the extended meaning of false and deliberately misleading assertion. Many authors use the cognate "Soviet speak" to convey the same meaning tailored to the Soviet lexicon. Much of what purports to be objective analysis of post-Soviet reality is "Russian speak." See Anders Aslund, *How Russia Became a Market Economy*, The Brookings Institution, Washington, DC, 1995; Olivier Blanchard, *The Economics of Post-Communist Transition*, Clarendon Press, Oxford, 1997. Willem Buiter, "From Production to Accumulation," *Economics of Transition*, Vol. 8, No.3, 2000, pp. 603-622; Stanley Fischer and Alan Gelb, "The Process of Socialist Economic Transformation," *Journal of Economic Perspectives*, Vol.5 No.4, 1991, pp.91-101. Timothy Frye, "Markets, Democracy and New Private Business in Russia," *Post-Soviet Affairs*, Vol .19, No.1, 2004, pp.24-45. Paul Kubicek, ed., *The European Union and Democratization*, Routledge, London 2003. Joseph Stiglitz, "Whither Reform: Ten Years of Transition," *The World Bank Economic Review*, September 1999. Oleh Havrylyshyn, "Unchartered Waters, Pirate Raids, and Safe Havens: A Parsimonious Model and Transition Progress," paper presented at the BOFIT/CEFIR Workshop on Transition Economics, Helsinki, Finland, April 2-3, 2004. Peter Rutland, "Russian Society: A Brake on Reform?" *Johnson's Russia List*, No.8217, Article 5, May 21, 2004. Rutland reports that a nationwide survey on "Rich and Poor in Russia" by the Institute for Complex Social Research portrays a society that is deeply troubled and far from ready to support Putin's ambitious reform agenda.

³ Andrei Shleifer and Daniel Treisman, "A Normal Country," *Foreign Affairs*, March/April, 2004 (<http://www.foreignaffairs.org/2004030.farsay83204/andrei-shleifer-daniel-treisman-a>). For a Japanese perspective see (Gavrilentov and Kuboniwa, 1997). Pekka Sutela cast doubt on this optimistic scenario by noting Russia's status as a quasi oil economy (petro economies usually are indolent and unjust), and by raising the specter of politically inspired economic disturbances associated with the impending post-Putin succession crisis. Seminar on Russian Military Politics and Strategy, National Defence College, Department of Strategic and Defense Studies, Helsinki, Finland, April 1, 2004. Yuri Fedorov (MGIMO), however doesn't believe Putin will step down (personal conversation, same conference). Also, cf. Iikka Korhonen, "Institutional Cure for Resource Curse?" paper presented at the BOFIT/CEFIR Workshop on Transition Economics, Helsinki, Finland, April 2-3, 2004. Korhonen argues from econometric evidence that democracy is a partial cure for the resource curse. But since Russia is authoritarian, Sutela's caveat stands. Stanley Fischer agrees with Shleifer and Treisman. See note 1. Steven Rosefielde, "An Abnormal Country," Discussion Papers 2004, No.6, Bank of Finland, Institute for Economics in Transition, Helsinki, Finland. Vladimir Shlapentokh, "Shleifer and Treisman's Economic Comparisons are Wrong," *Johnson's Russia List*, No.8091, Article 16, February 28, 2004. Theo Emergy, "Judge: Harvard Broke Contract with U.S.," *Johnson's Russia List*, No.8274, Article 7, June 29, 2004.

Harvard may have to repay millions of dollars to the government after a judge ruled that two of its employees advising Russian authorities on privatization violated conflict-of-interest rules. U.S. District Judge Douglas P. Woodlock's ruling came more than three years after federal prosecutors filed the complex civil case against Harvard, employees Andrei Shleifer and Jonathan Hay, and their spouses. The lawsuit arose out of work by the Harvard Institute for International Development in the 1990s to help the country shape its post-Communist government into a modern, capitalist system. The U.S. Agency for International Development gave Harvard about \$34 million for the "Russia Project." Hay and Shleifer were advising the country on restructuring its economy. At the same time, they and their families allegedly made several hundred thousand dollars in investments in companies Hay and Shleifer were

helping the Russian government regulate. The Justice Department alleged the investments violated the conflict-of-interest policy in the contract between Harvard and the agency. It asked for \$102 million from Harvard, three times the roughly \$34 million that the university institute billed US AID. But Woodlock found Harvard did not know its employees were violating the contract and cannot be made to pay triple damages Woodlock ruled, however, that Hay and Shleifer made false claims about their activities. He scheduled a July 19 hearing to discuss how much money the plaintiffs will have to pay. "We are pleased that the court did find in favor of the government against each of the defendants. The remaining issue is really the damages," U.S. Attorney Michael Sullivan said. The university said "in all likelihood any damages assessed against Harvard for the contract violation would be only a fraction of the damages originally sought by the government." Messages left with Shleifer's attorney and at his home were not immediately returned. Messages left for Hay's attorneys were not immediately returned. Marcella Bombardieri, "Harvard Professor, Employee Liable in Fraud Case. But \$102 Million Claim Against University Fails," Boston Globe, June 29, 2004, reprinted in *Johnson's Russia List*, No.8274, Article 8, June 29, 2004. A federal judge yesterday found that a star Harvard professor and another Harvard employee conspired to defraud the US government when they made personal investments in Russia while working on a federal contract to help that nation's transition to capitalism. Judge Douglas P. Woodlock also found that Harvard University breached its contract with the government, but he dismissed the government's most serious claim: that Harvard as an institution was responsible for knowingly deceiving the US Agency for International Development and could be liable for up to \$102 million. Federal prosecutors had asked Woodlock to levy punitive damages against Harvard under the False Claims Act, which would have held the university responsible for triple the \$34 million amount of the original contract. But Woodlock denied that request, meaning that the most money Harvard would have to pay would be the \$34 million, plus interest, that USAID paid for the contract after Andrei Shleifer and Jonathan Hay began investing in Russia's securities market and oil industry. The judge will hold a hearing on damages July 19. Shleifer, a Harvard economist, and Hay, a Harvard Law School graduate who also earned a math PhD in Moscow, were found to have violated the False Claims Act, and could face damages up to \$102 million. They were the top two officials of the now-defunct Harvard Institute of International Development. The Harvard project, which operated from 1992 to 1997, was one of the top foreign aid programs helping to overhaul the nation's economy, with Harvard officials hired by the government to give impartial advice to Russian officials. In its 2002 suit, the government argued that Hay's and Shleifer's personal investments were a conflict of interest, because the two men were designing laws and regulatory institutions for the Russian government at the same time they were investing money in certain businesses. That alleged violation of Harvard's contract tainted \$350 million in US projects, hurt Russia's economic development, and damaged US-Russian relations, the government said. The case is a civil lawsuit, and there are no criminal charges. Woodlock concluded that Harvard did not know that Hay and Shleifer were breaching the government contract. And he said the university had no reason to scrutinize its employees' activities without any information that a problem existed. However, the judge wrote, Harvard did breach its contract with US AID simply because its employee, Hay, violated the conflict-of-interest policy the university signed. Despite the mixed results of the decision, both sides portrayed it as a victory yesterday. "We're still in the process of completely analyzing the court's decision, but at this point we're pleased with the decision," said US Attorney Michael J. Sullivan, noting that Woodlock ruled in the government's favor on several claims. "The university regards the decision as consistent with the view we have expressed to the court from the beginning of the litigation," said Paul F. Ware, an outside attorney representing Harvard. "The court has found that the university was not engaged at any time in fraudulent conduct, and had no knowledge of any events involving other people which may have been the basis for the government's complaint." As for the finding that Harvard breached its contract, even that "was not a function of institutional conduct by Harvard," Ware said. Woodlock said he could not decide on some of the allegations against Shleifer, because the professor argued that as a consultant to the project he did not fall under the conflict-of-interest clause. That issue will have to go to a jury trial if it is not settled out of court. "We're pleased now that most of the claims in the case, and against Andrei Shleifer, have been dismissed," said Shleifer's attorney, Earl Nemser. "We expect the remaining claims will be disposed of favorably to him." There were several investments made by Shleifer and Hay at issue. Shleifer and Hay argued in one instance that they did not make the investment in question. Shleifer argued in another instance that the beneficiary of the investment was his wife. But Woodlock found they did intend to invest in Russian companies. Shleifer, a highly regarded economist and close friend of Harvard's president, Lawrence H. Summers, could not be reached yesterday. Nor could Hay, now an attorney in London. Summers, through a spokeswoman, declined to comment. The judge found the greatest fault with Hay, writing that he "was at least acting in reckless disregard" of his contractual obligations. Hay loaned money to his father for the purpose of an investment, the judge said. "I find this attempt to 'launder' the money through Hay's father and girlfriend ineffective," the judge wrote. Hay's attorney declined to comment, saying he hadn't had time to study the 100-page decision. Harvard has argued that even if found to have breached its contract, it doesn't owe any damages because the Russia project was a success. "Our belief regarding the project is that

However the Bush administration and many transitologists disagree. Marshall Goldman for example contends that Russia's transition has been pirated by oligarchs.⁴ Oleh Havrylyshyn concurs,⁵ but holds out hope that the state may still re-chart a course to an EU safe haven. Neither they, nor most Asians however have factored in Orwell. All are sensitive to Soviet-speak, but aren't paying sufficient attention to the footprints left by the military industrial complex and the security services. They don't know, or see little importance in the fact that there are 1700 Russian military industrial enterprise and organizations today just as there were in 1991; that Russia has three million men in arms, that according to the VPK (Voennyi Promyshlennyi Kompleks) weapons production has risen from 13.9 percent of the 1991 level in 1997 to 42.6 percent in 2003;⁶ and that Putin has authorized a full spectrum, fifth generation weapons modernization

[the institute] performed very valuable work in Russia, in creating and supporting institutions and infrastructure which is viable today," said Ware.

⁴ Marshall Goldman, *The Piratization of Russia: Russian Reform Goes Awry*, London: Routledge, 2003

⁵ Havrylyshyn, *Ibid.*, acknowledges that Russia's transition appears to have been temporarily pirated, but holds out hope that EU accession, or other well designed "commitment" enhancing policies will provide the leverage needed to complete the task.

⁶ Steven Rosefielde, *Russia in the 21st Century: The Prodigal Superpower*, Cambridge University Press, London, 2005. Julian Cooper, "The Economics of Russian Defense Policy," paper presented at the conference on Russia Under President Vladimir Putin: Toward the Second Term, European University Institute, Florence, April 22-23, 2004. Vitaly Shlykov considers the weapons production surge displayed in Cooper's VPK series bogus. Pavel Felgenhauer explains the disparity by weapons exports abroad. See Pavel Felgenhauer, "Billions Down the Drain," *Johnson's Russia List*, No.8232, Article 8, June 1, 2004. Felgenhauer implausibly alleges as well that many R&D programs in Russia are run simply to avoid taxes with no intent to ever produce anything in the end. Also, there are numerous reports that weapons procurement, maintenance, and readiness are in an acute state of disrepair. See for example Aleksandr Babakin, "Typhoon Subs have Fallen Victim to Big Business," *Nezavisimaya Gazeta*, May 26, 2004, reprinted in *Johnson's Russia List*, No.8224, Article 14, May 26, 2004. Vladimir Kuroyedov, Commander-in-Chief of the Navy is reported to have disbanded the 18th Submarine Division of the Northern Fleet at Zapadnaya Litsa in late April. One of the Typhoons was sent for dismantlement. Only ten missiles remain aboard the Severstal. The motive is said to be recovery of hundreds of tons of copper, lead, etc. Also see, "Russian Fleet Moving Towards Extinction," *Moscow News*, May 25, 2004, reprinted in *Johnson's Russia List*, #8222, May 25, 2004. Gennady Suchkov, a fleet admiral who was given a suspended sentence for negligence in a nuclear submarine sinking last year, said that some of Russia's most powerful strategic submarines, the Typhoons have been taken out of the arsenal for lack of nuclear missiles to equip them, and that the Russian military fleet will cease to exist by 2008. The problem he said is that the design institute hasn't even completed a prototype of the Bulava nuclear missile required by the Typhoon.

drive commencing in 2006, reaching the full stride in 2010. They don't adequately appreciate what the Soviet Union was, or how it has metamorphosized.

WHAT HAS CHANGED?

History never precisely repeats itself. Russia 2004 hasn't replicated USSR 1984, or USSR 1937. There have been too many fundamental changes. The Kremlin has decriminalized business, private property and entrepreneurship; legalized political pluralism, opened its borders, shed its communist ideology, and transferred natural resource processing wealth to pirates. This has created a strata of proprietors and businessmen who offer the state fresh opportunities, but pose great challenges. While they strengthen the economy, they don't wholly share the regime's martial police state agenda, assuring a tug of war between those whose futures are best served by a business friendly state, and those who desire to rein oligarchic aspirations. Russia 2084 will be shaped by the resolution of this struggle.

The outcome is uncertain.⁷ Nonetheless, as too few westerners and Asians sufficiently appreciate Vladimir Putin's actions clearly favor an Andropovian martial police state.⁸ The interesting issue therefore

⁷ Benoit Mandelbrot, *The Fractal Geometry of Nature*, 1982. The mathematical foundations for systems that combine strongly replicative patterns, with unpredictable breaks caused by turbulence was first developed by Mandelbrot. The concept is applicable to economic systems which may contain deterministic and non-deterministic elements, even if scientists were able to nano model systems behavior. Thus there is no contradiction in asserting that Russia 2084 is likely to replicate the Soviet Union 1984, and the recognition that such an outcome isn't inevitable.

⁸ Yuri Vladimirovich Andropov headed the KGB 1967-82, and served as General Secretary of the Communist Party for 15 months thereafter. He favored liberal reforms to reinvigorate the Soviet economy, and non-draconian secret police tactics. Pavel Baev, "Andropov's Legacy in Putin's Foreign Policy," *Johnson's Russia List*, No.8260, Article 12, June 19, 2004. Pavel Felgenhauer, "KGB: Big, Bad and Back?" *Moscow Times*, March 2003: After the collapse of communism, the KGB was broken up into five separate agencies, but it was not fully disbanded nor was the successor organizations' mode of operation seriously reformed. Now President Vladimir Putin, a former KGB operative, is reassembling the dreaded Soviet secret police...Everything will be concentrated in one big secret police agency: the authority to investigate suspected "foreign spies" and other wrongdoers the state does not like; and the ability to intrude deeply into the private lives of citizens using the most modern electronic means. It is typical that while announcing the recreation of a KGB-style super secret police, Putin did not propose the creation of any,

isn't "kto kovo" (kill or be killed), but how Putin's successors will rule. The Soviet example provides clues. The leadership will cling to Soviet speak calling authoritarianism democracy, servility personal liberty, control economic freedom, sinecures private property, and cheap labor poverty reduction.⁹ They won't need any coaching. Like Big Brother, they will know that capturing their adversary's language, and managing official statistics are the secret of societal control. As in Stalin's time there will be balloting and lively public debate without democracy or free expression. And many outsiders once again will be beguiled by the razzle-dazzle.

Pareto and Aoki optimal social welfare means nothing in this environment. The state prefers to

even superficial, public system for controlling its activities. Of course, an authoritarian state does not envisage any such controls...Now the FSB will also have its own massive armed force, the border guards - with more than 100,000 soldiers, armor, air force and a navy. Cf. Amy Knight, "A Modern Crime and Punishment: Who killed Russia's Leading Liberal?" *The Globe and Mail*, April 23, 2003, reprinted in *Johnson's Russia List* No.7153, Article 12, 2003. "Don't even think about it - that last week's murder of Sergei Yushenkov, Russian Duma deputy and co-chairman of the pro-democracy Liberal party, was politically inspired. Because when you start considering motives, it leads you straight to President Vladimir Putin's security police." Anna Badkhen, "Fear Returns to Russia: Peanut Butter and Sushi Give Way to a Campaign of 'Precision Terror'", *San Francisco Chronicle*, June 27, 2004, reprinted in *Johnson's Russia List*, No.8271, Article 3, June 27, 2004. "This is not the Great Terror of the 1930s," said Moscow historian Igor Dolutsky,...This is precision terror: Everybody doesn't go to prison, but the few who do are enough to scare everybody else." "The fear is back because the system is back. The system is built on fear...The Totalitarian state is being resurrected."

⁹ Nick Paton Walsh, "Russia's Poorest Face Huge Cuts in Benefits System Supporting Veteran, Disabled People and Pensioners to be swept Away as Moscow Reforms Aim to Cap Compensation," *The Guardian*, June 1, 2004, reprinted in *Johnson's Russia List*, No.8233, Article 1, June 1, 2004. "Number of Russian Homeless Children Nears Post-WW2 rates," *Johnson's Russia List*, No.8233, Article 2, June 1, 2004. There were 700,000 homeless children in Russia(2.3 percent of all children). Natalia Udonova, "Impoverished Russians," *Rodnaya Gazeta*, May 21, 2004, reprinted in *Johnson's Russia List*, No.8220, Article 9, May 24, 2004. Most analysts claim that there are many more poor in Russia than the government admits. According to researchers at the Russian Academy of Sciences, 65 percent of Russia's population are underprivileged and 35 percent have incomes below the subsistence minimum. One third of the new poor have college education, professional skills, and a lengthy work record. The minimum monthly wage is 600 rubles(20 dollars), whereas the subsistence minimum is over 2,400(80 dollars). According to Natalia Rimashevskaya "This phenomenon can only be described as hidden unemployment. If a full time worker is making less than the minimum subsistence level, this means that the worker isn't really working - merely being paid a benefit for the formality of being listed as employed. On the resurgence of Newspeak see Nick Paton Walsh, "The Kremlin's New Doublespeak," *The Guardian*, June 19, 2004, reprinted in *Johnson's Russia List*, No.8260, Article 2, June 19, 2004. Irina Skliarova and Ksenia Veretennikova, "The Social Pyramid," *Johnson's Russia List*, No. 8281, Article 2, July 5, 2004. The Duma approved replacing unfunded social benefits with monetary payments July 2, 2004. Cf. Anders Aslund, "Lonely at th Top," *Moscow Times*, July 13, 2004. Cf. Leon Aron, "Privatizing Pensions," *American Enterprise Institute, Russia Outlook*, July 1, 2004.

manage attitudes (altering individual utility functions), convincing the people that authoritarianism is preferable to Arrow democracy.¹⁰ To paraphrase Alexander Solzhenitsyn, Stalin's rule wasn't from each according to his ability, to each according to his needs. It was everything from each, to each according to his possibilities. Neither social justice, nor individual optimization are critical. People can be under or over remunerated. They can live undeservingly in squalor, or opulence as long as they perform their attitude managed missions.

During the Yeltsin years, the post-Soviet police state shriveled. Great sums were spent on creating an alternative political order without sufficient effect, prompting a gradual reversion to administrative control. Parsimony slowly displaced prodigality, just as it had after War Communism. Putin, Yeltsin's FSB (Federal'naya Sluzhba Bezopasnosti) chief and heir accelerated the process, seizing Boris Berezovsky's and Vladimir Gusinsky's assets, and establishing a new Federal Administrative mechanism to cost effectively tighten central control. Mikhail Khodorkovsky's arrest, the subordination of the Duma, the marginalization of opposition, and the packing of the bureaucracy with security service cadre furthered the process, setting the stage for the full restoration of a post-Soviet martial police state in either a stealthy or brazen, soft or hard form.

MUSCOVY

This drift back to the future is solidly rooted in the Kremlin's Muscovite traditions. Russian economic culture unlike its western or Japanese (but like imperial China) counterparts is predicated on

¹⁰ Kenneth Arrow, *Social Choice and Individual Values*, Wiley, New York, 2nd edition, 1963. Arrow demonstrates that balloting as a method of expressing popular demand for public goods is less efficient than perfect competition in private markets, but nonetheless is better than the alternatives.

"pomestie" - rent-granting (the obverse of rent seeking) rather than inalienable property and the rule of contract law.,¹¹ Muscovy from Ivan the Great (1462-1505) onward has been a patrimonial society, where the ruler owned all he surveyed, and granted his supporters "kormlenie" feeding troughs in return for state service.¹² Czars could and did make gifts of private property, but they were revokable, without the right of judicial appeal. Property and the rule of contract law accordingly were always tenuous, raising serious problems of deceit, moral hazard and adverse selection. No one in Russia was secure. No one was protected by the rule of contract law, and therefore everyone had to erratically and fragmentedly optimize as best he or she could in an imponderable world. Investment, innovation and entrepreneurship were seriously hampered, encouraging the state to compensate for its backwardness with oversized land armies, secret police, and foreign technology transfers.

As might be expected the patrimonial rent granting system came under perpetual attack from would be "stationary bandits," seeking to transform rent into inalienable private property rights.¹³ Czars, like rent-granting bachelors sought to keep their paramours in a servile state, and rent-seeking courtesans strove to transform indulgences into inalienable property through marriage (the institution of the rule of law). Some succeeded, but not enough to serve as a prelude either to free enterprise under the rule of contract law, or democracy. Muscovy always was able to keep rent granting in command, and Pareto at bay through

¹¹ Boris Kagarlitsky, "Selling Out Russia's Forests," *Moscow Times*, July 1, 2004, reprinted in *Johnson's Russia List*, No. 8276, Article 8, July 1, 2004.

¹² Stefan Hedlund, *Russian Path Dependency* London: Routledge, 2005. Richard Pipes, *Property and Freedom*, New York: Alfred A. Knopf, 1999. Alexander Gerschenkron, *Economic Backwardness in Historical Perspective*, Harvard University Press, Cambridge, MA, 1961.

¹³ Mancur Olson, *Power and Prosperity: Outgrowing Capitalist and Communist Dictatorships*, Basic Books, New York, 2000.

political intrigue, the secret police and the army. It refused to serve Douglass North's role of credible enforcer for an autonomous society because sovereigns preferred autocracy to economic and political liberty.¹⁴ Russia and its people consequently remained backward, lagging developments in Europe and America, but survived nonetheless. The Soviet Union proved it was possible to produce enough to enrich the sovereign and his coterie, and achieve great power, within a rent granting structure of ministerial fiefdoms, enterprise overlords (managers) and Party oversight and intervention even in the worst case where the state criminalized business, entrepreneurship and private property. This benighted outcome was their optimum. It was callous, but from the winner's perspective best.

The system "worked" in its own inimitable way for more than half a millennium. Its properties throughout, including the communist epoch have been the same. Regardless of ideology, rent granting and servile rent seeking have provided a lavish existence for few, and a Spartan one for many, adorned by public opulence, a grand army and energetic secret police. The model is pliable. It permits the sovereign to defend his realms, survive in isolation, or seize targets of opportunity for conquest and plunder, relying on rent granting combined with markets, natural economy, plans, virtual sub-economies, and mixed arrangements. But it has an Achilles's heel. The Muscovite system is micro, and dynamically inferior to Pareto efficient profit seeking and Japanese communal utility optimization because it degrades efficiency, and impedes golden age optimal scientific and technical progress. It adds value, provides social discipline, sustains military superpower and can support modest improvements in living standards. But it cannot compete with American democratic free enterprise, European social democracy, or Japanese communal

¹⁴ Douglass North and Robert Thomas, *The Rise of the Western World*, Cambridge University Press, London, 1972.

liberalization statically and dynamically in optimizing social welfare. Russia's post-Soviet, market assisted, authoritarian system has a higher potential than its communist predecessor, but as the Kremlin has repeatedly discovered it is intrinsically inferior.

Muscovy has also proven resistant to fundamental reform. Russia's leaders always have been reluctant to explicitly acknowledge how Muscovy really works, preferring to deny the existence of trade-offs between rent granting and unfettered competition, and deferring hard choices.¹⁵ Czar Nicholas II was prepared to make token concessions to democracy, and experimented with economic liberalism, but still kept autocracy and rent granting in command. The Bolsheviks rid Russia of its Czars, but retained the core model behind a facade of central planning.¹⁶ And today, Vladimir Putin, Schleifer and Treisman proclaim that the federation is normal, diminishing the effectiveness of external pressure for enlightened westernization. A fear of anarchy girds authoritarian rent granting. Russians know in their bones that there is no rule of law to protect them from Hobbesian mayhem when patrimonial rulers are weak. They prefer Putin to Yeltsin, and like the Chinese fear democracy will degenerate into chaos, inclining them to choose Muscovy over a suspect unknown.

FORTRESS RUSSIA

In evaluating the likelihood of a soft Muscovite neo-Orwellian future, it is useful to recall that most

¹⁵ A good example of Russia's ability to simultaneously pursue to contradictory course is the government's double speak about privatization. While it claims the privatization will be completed in 2005-2007, the DUMA is writing legislation with Putin's approval that permits full re-nationalization without compensation. See "Russia plans to complete privatization in 2005-2007," *Johnson's Russia List*, No.8254, Article 12, June 16, 2004. Cf. "Plus Full Nationalization of the Whole Country," *Johnson's Russia List*, June 15, 2004.

¹⁶ Steven Rosefielde, *Russian Economics From Lenin to Putin*, Blackwell, London, 2005.

Sovietologists got the Soviet Union wrong. For complex reasons analyzed elsewhere,¹⁷ they failed to integrate the martial police state into their models, over estimating improvements in living standards, and drastically underestimating the burden of defense. Some supposed that socialist planning couldn't be as bad as it was, others that it would be saved by liberalization. It is wise to guard against similar wishful thinking today by focusing on the Paretian failings of the Muscovite order, instead of its superficial macroeconomic profile. Likewise, more attention needs to be paid to extremist rhetoric and confrontational behavior, not so much as a barometer of threat, but as an indicator of the martial police state reality behind the liberal Muscovite mask. A recent article by Mikhail Yuriev, former Duma Deputy Chairman and Yabloko party member entitled "Fortress Russia" is instructive.¹⁸

Yuriev blames "normalization" for impoverishing Russia, and dangerously reducing its material capacities. He contends that G-7 policies have been maliciously designed to subjugate the Kremlin, and

¹⁷ Steven Rosefielde, *Russia in the 21st Century: The Prodigal Superpower*, Cambridge University Press, London, 2005.

¹⁸ Mikhail Yuriev, "Krepost' Rossiia: Kontsepsiia dlia Prezidenta" (Fortress Russia: Strategic Concept for President Putin), *Novayagazeta*, No.17, March 15, 2004 (<http://2004.novayagazeta.ru/nomer/2004/17n7n17n-s44.shtml>). Yuriev was formerly deputy chairman of the Duma (beginning March 20, 1996), and a member of the Yabloko Party. See <http://www.biograph.comstar.ru-bank/yuriev.htm> For a debate on similar views see *Filosofsko-ekonomicheskoe uchyonoe sobranie, Akademiia gumanitarnykh nauk, Moskovskii Gosudarstvennyi Universitet imeny M.V.Lomonosova, Moscow*, 17-18, 2002. <http://eurasia.com.ru/mgu.html> David Holley, "Russia Sees U.S., Nato Actions as Reason to Watch Its Back: New Nuclear Arms and Alliance Expansion May Lead to Tougher Policy by Moscow," *Los Angeles Times*, March 26, 2004 (reprinted in *Johnson's Russia List*, No.8138, Article 1, March 26, 2004. "Estonia Might Face 'Caribbean Crisis': Estonia's Policy of Provocation Can Trigger a Serious Crisis Between Russia and the West," *Johnson's Russia List*, No.8138, Article 3, March 26, 2004. Andrei Zlobin, "Washington's Nuclear Barn: The United States Will Not Honor the Strategic Offensive Reductions," *Vremya Novostei*, March 26, 2004 (reprinted in *Johnson's Russia List*, No.8138, Article 4, March 26, 2004. Yevgeny Grigoriev, "Russia in the Tenacious Grip of NATO: The Treaty on Conventional Armed Forces in Europe Can be Given up for Lost," *Nezavisimoe Voennoe Obozrenie*, March 26, 2004 (reprinted in *Johnson's Russia List*, No.8138, Article 5, March 16, 2004). Dmitri Suslov, "The United States Will Get Bugged Down in the CIS: Uzbekistan, Tajikistan, and Kyrgyzstan Waiting for Rapid Response Forces US Military Infrastructure is Moving Closer to Russia's Borders," *Nezavisimaya Gazeta*, March 26, 2004 (reprinted in *Johnson's Russia List*, No.8138, Article 6, March 26, 2004). "Russian Defense Ministry to Launch 'Patriotic Channel,'" *Johnson's Russia List*, No.8138, Article 16, March 26, 2004.

will succeed unless Putin abandons Yeltsin's course. "If we do not close this gap or at least reduce it substantially, we are certain to lose our status as an independent country and separate civilization in the foreseeable future." Salvation requires Moscow to turn its back on an "open" economy and its face toward a "closed" one. This doesn't mean repressing domestic markets. Expelling foreigners and confiscating their assets under the banner of a Russia first ideology will be sufficient to make the superiority of the Russian way of life transparent. Accordingly, Russia should withdraw from all multilateral international relations, and base its bilateral relations on the "rejection of common human values, and in general, of everything but our own interest." The sum of these policies "will be known as the Fortress Russia strategy." Isolationism need not be permanent. It can be dispensed with in several decades. But in the interim, it will allow Russia "to win the next cold war and, if necessary, hot war."

Yuriev, whose attitudes in many ways closely parallel those of the Genshtab (the Russian military General Staff), then goes on to display his ignorance of economic theory by "explaining" why autarky is best. His other arguments are similarly ill-founded and wouldn't deserve scholarly attention if the editor of *Novaya Gazeta* hadn't prefaced the article with the claim that an unpublished version of Yuriev's manifesto had caught Vladimir Putin's eye and been favorably received. A spate of stories supporting Yuriev's world view in the government controlled press released immediately after Putin's re-election is similarly discomfiting,¹⁹ raising the specter that Russia's velvet authoritarianism will be slowly replaced by a less

¹⁹ Yuriev is a member of the liberal Yabloko Party which has consistently favored democratic free enterprise and western global integration. But his Fortress Russia doctrine is more reminiscent of Vladimir Zhirinovskiy's rantings. Zhirinovskiy-Eidelshtein, as the leader of the Liberal Democratic Party of Russia since it founding in 1990 has variously urged the re-annexation of the Soviet Republics, defaulting on all external loans (2001), the abolition of Russia's federal system, and nuclear war with the west. (http://www.factindex.com/li/liberal_party_of_russia.html). Yuri Fedorov believes that Yuriev's article was commissioned by the siloviki in Putin's administration, is welcomed by the president. See note 3. There are many other examples of this type of thinking. See Alexander Dugin (<http://www.arctogaia.com>), but Yuriev's affiliation with Yabloko is exceptional.

permissive regime as the stresses of military modernization mount, and the shortcomings of the Muscovite model become evident. The illusions that Russia can restore its military competitiveness with free labor, and that prosperity is just around the corner will be shattered as output approaches the Soviet era full employment capacity bound. The growth miracle currently being heralded is merely a partial recovery from the 1989 benchmark, and will evaporate as full resource employment nears. Although Putin, like his predecessors will remain in denial, he will have to tighten the reigns or relinquish Muscovy.

POWER VERSUS PROSPERITY

If he responds true to form, he will choose power over prosperity, adopting Ivan the Great's tactical opportunism to preserve his power, while playing "positional" chess. He will focus on taking advantage of his adversaries' errors, rather than empowering democratic free enterprise. Stephen Blank has recently examined how the contemporary Muscovite power game works in "The 18th Brumaire of Vladimir Putin."²⁰ He characterizes Russia as a nation with a proclivity toward a weak state unable to effectuate its goals through a pliable and efficient governmental apparatus.²¹ State bureaucracies, the Duma and judiciary exist,²² but from

²⁰ Stephen Blank, "The 18th Brumaire of Vladimir Putin," paper prepared for the conference on Succession Crises in Russia, Boston University, Institute for the Study of Conflict, Ideology, and Policy, Boston, MA, April 20, 2004, pp.46-49. The General Staff is strongly hostile to NATO, and treaties that restrict its defenses against the west. Cf. Max Verbitz (pseudonym of a former Soviet Intelligence Officer), "New Russia (In an Old Trap), *Perspective*, Vol. XIV, No.3, March-April 2004, reprinted in *Johnson's Russia List*, No.8171, Article 11, April 17, 2004.

²¹ Cf. Peter Reddaway and Dmitri Glinski, *The Tragedy of Russia's Reforms: Market Bolshevism Against Democracy*, U.S. Institute of Peace, Press, Washington, DC, 2001, pp.84-85. "From the point of view of content, Yeltsin's system of rule was an amorphous type of pluralist autocracy. The consistently autocratic decisions emanating from the Kremlin were sabotaged on a daily basis, while the feudalization of the bureaucracy, the bacchanalia of special interests, and the general lawlessness revealed the increasing impotency of a state that was deprived of national roots and ignored or rejected by much of society."

²² Czar Nicholas II relied on rigged Duma election using what is know as the "June 3 (1907)" method. *Ibid*, p.3.

Ivan the Great forward have been governed by the logic of rent granting rather than serving as dependable instruments of totalitarian(or democratic) authority. Yeltsin accordingly is portrayed as a traditional Muscovite potentate who had the power to bestow and revoke the nation's patrimony (patrimonialism, synonymous here with rent granting), sustain his position by bestowing privileges to "servitors", and seize targets of opportunity, instead of pursuing an ideal economy, and efficiently harnessing its possibilities. Blank argues that the extreme impotence of Yeltsin's state was caused by the destruction of the Soviet command and control apparatus, and the willingness of insiders to steal what nominally was the people's means of production. He portrays Yeltsin's ascendancy as a series of "palace coup d'etats," first in 1991, and then successively in 1993 (more an usurpation of power), 1996 (more a usurpation of democracy), and 1999 (more a pre-emption of rival succession candidates), each intended to perpetuate his control over a weak state obsessed with coalition building and societal plunder.²³ The concepts of perestroika (Gorbachev's radical economic reform), perekhod (transition), demokratizatia (democratization), uskorenia (accelerated growth), and novoe myslenie (new thinking) which seemed to herald democratic free enterprise were merely window dressing.

The reality behind the rhetoric was a hydra-headed coalitional struggle to grab and secure the nation's wealth. The process, sanctioned by the rent granting sovereign began with "spontaneous privatizers" and then proceeded to Chubais's preferential treatment of managers, Shliefer's voucher privatization, the loans for shares scam, and perhaps to the massive defrauding of the IMF.²⁴ Riding the tempest was a full time job.

²³ Ibid., p.7. Cf. Vadim Volkov, *Violent Entrepreneurs: The Use of Force in Making of Russian Capitalism*, Cornell University Press, Ithaca, New York, 2002.

²⁴ Blank, Op. Cit, p.16. The IMF claims that reports that it was defrauded in 1998 are erroneous. See Interview with Aleksei Mozhin (Russia's executive director in the International Monetary Fund), "Aleksei Mozhin: It is Generally Impossible to Steal IMF Money," *Johnson's Russia List*, No.8185, Article 15, April 28, 2004."The absurdity of the message by American congressmen, who demanded that U.S. Secretary of State Colin Powell look into the disappearance of the IMF(International

Indulging one faction immediately sparked resentment among others. Yeltsin fended off the resulting threats by "gaining control of all means of violence inside Russia, overcoming independent operators and oligarchs who controlled state finances, and suppressing regional barons and oligarchs who withheld taxes from the regime, thereby undermining its domestic military, and international capabilities of action."²⁵ The military and security services in effect took over the traditional instruments of state building, force, taxation, budget expenditures, and the media to protect Yeltsin,²⁶ defang "stationary bandits", and suppress democracy. They succeeded in criminalizing the oligarchs' political and economic opposition by holding them responsible for prior misdemeanors. And finally, after the financial crisis of 1998, when he feared Primakov and Luzhkov would depose him,²⁷ Yeltsin struck a deal with his personal hatchet man, and FSB head, Vladimir Putin to

Monetary Fund) credit, is obvious." The original allegation is attributed to Deputy Ilyukhin (State Duma Committee on Security) in a letter dated 23 March 1999 addressed to the then Prosecutor General Skuratov asserts that 1.8 billion dollars, or nearly half the 4 billion dollar IMF transfer was stolen. Mozhin then explains why Ilyukhin's documents were faked. Yefim Barban, "Where's the Money, Roman? What Happened to the IMF Loan to Russia," *Johnson's Russia List*, Vol.8343, Article 22, August 26, 2004. Dominic Kennedy, the Times political reporter, gained access the report of Swiss authorities investigating the illegal transfer of IMF money to a secret web of slush funds in Switzerland controlled by President Yeltsin's inner circle. The IMF money was deposited in Roman Abramovich's Runicom SA account, and then moved to Gibraltar and the Ost-West Handelsbank. The general thrust of the articles runs counter to statements by the RF Central Bank and the IMF, both of which were satisfied with Price-Waterhouse's independent audit.

²⁵ Blank, *Op. Cit.*, p. 10.

²⁶ Guy Chazan, "Putin Orders Security Agency to Monitor Army's Allegiances, *Wall Street Journal*, February 16, 2000, p.A21. Yeltsin last three Prime Ministers all came from the "organs" of the KGB, or FSB: Sergei Stepashin, Vladimir Putin, and Evgeny Primakov. Alexander Korzhakov became General and head of Yeltsin's Presidential Security Service (Sluzhba Bezopasnosti Prezidenta, or SBP), which became a state within a state. Blank, *Op. Cit.*, p.19. It had the right to use the FSB surveillance and information gathering facilities, and actively utilized the capabilities for "kompromat." It also took monopoly control of the state's agency for exporting precious metals, Roskomdragmet.

²⁷ The Duma under Primakov initiated an impeachment process against Yeltsin. *Ibid.*, p.22. Blank sees and echo here of the Czarist past cites Baron A.P. Izvol'skii to the effect that despotism always bore the same fruits-- incoherence and irreconcilability, resulting in the Russo-Japanese War. *Ibid.*, p.23. Blank reports that Yeltsin had been forced to accept Primakov as Prime Minister in 1997, but by early 1999 it became apparent that he intended to destroy the oligarchs and the entire network of influence they had built in the presidential administration. Pavel Borodin had used the media to discredit Primakov's investigations, but the threat remained. NB. The stationary bandit model doesn't apply to the rent granting model because bandits are denied inalienable property rights.

have him assume the presidency in return for immunity from prosecution.²⁸

Once enthroned, Blank explains, Putin gradually increased the power of the security services without becoming captured by them,²⁹ while preventing oligarchs from orchestrating their own counter palace coup, or worse, pressing forward with democratization. Putin succeeded here by establishing new regional administrative bodies, removing obstreperous governors, prosecuting Yeltsin era media moguls like Boris Berezovsky, controlling the press, stacking the bureaucracy with former security service personnel, diminishing oligarchic access to the president, eradicating the electoral basis for liberal Duma opposition, and destroying Khodorkovsky for his political adventurism.³⁰ On the morrow of Putin's re-election triumph, the president has asserted his political hegemony over the bureaucracy, regional potentates, Duma, judiciary, security services, military and media. He also appears to have intimidated wayward-minded oligarchs. This doesn't amount to the creation of a strong state, pliable to his will, but momentum appears to be propelling events in that direction, raising anew the enduring Russia question, "chto delat'?" (What is to be done?)

What can Putin or his successors do with a strong state after it is attained that won't subvert the

²⁸ Tipped off by Swiss authorities in 1997, Primakov in 1999 mounted investigations against Yeltsin, headed by Procurator General Skuratov. Just as the process gathered steam, Putin's FSB lured Skuratov, or a man who resembled him into a room with two prostitutes and a concealed camera to compromise him (kompromat). Yeltsin then used the tape to try and fire Skuratov. When this failed, the family was prepared to sacrifice Berezovsky, but was worried about Borodin, and therefore authorized Putin to televise the Skuratov tape, this time culminating in his dismissal. Just before Yeltsin's impeachment vote on May 12, he fired Primakov and replaced him with his loyalist Sergei Stepashin. Then when this proved insufficient plans for a coup entitled Storm in Moscow were drawn dated June 26, and leaked to the press July 2, and then implemented by Putin, Stepashin successor. Putin orchestrated the creation of the Unity Party aimed at barring Luzhkov from either the premiership or the presidency. A kompromat campaign was launched against Luzhkov wife and associates, including Primakov, and Putin deftly manipulated Chechen affairs to bolster his image as a pillar of security. Blank, *Op.Cit.*, pp.33-36.

²⁹ Putin strengthened the pervasive monitoring of the Army by the FSB began by 1996 as Yeltsin's behest, by restoring the special departments of the FSB to spy on all the armed forces. Blank, *Op. Cit.*, p.10. The FSB also integrated II counter-intelligence units under its "unfied" centralized system.

³⁰ Blank likens Putin's "managed democracy" to the Czarist Third of June system, and following Max Weber calls it pseudo constitutionalism. *Ibid.*, p.17.

foundations of their authority? Western economists usually assume that he will establish the rule of law and democratic free enterprise, crafting strong laws protecting private property, and the sanctity of contract, where disputes will be impartially adjudicated by courts, and verdicts faithfully enforced by the executive. The role of the state will be reduced to the minimum in accordance with Adam Smith's recommendations to make consumers sovereign over private sector transactions. And correspondingly democracy will be installed to make the populus sovereign over the provision of government services. As Karl Marx might have scoffed, the *vozhd* is scripted to risk a return to the Yeltsin era insider free-for-all, presiding over the destruction of his own power, for the sake of a noble ideal. Perhaps one day a Muscovite ruler will prove to be a philosopher king. But having witnessed the Gorbachev debacle, he is more likely to spurn both democracy and free enterprise in favor of *siloviki* protected rent granting. If Russia democratizes, the *vozhd* will be beleaguered by Khodorkovskites. If he adopts competitive free enterprise, small businessmen may not be sufficiently strong to deter state capture by the security services. Either way, like the Soviet communists, Russia's Muscovite rulers are likely to insist on a visible role in state economic management and security.³¹

This suggests that the security services, the ministry of defense and the *genshtab* (the Russian Military General Staff) won't have a free hand, but will be inordinately influential.³² If the *vozhd* pursues a communist

³¹ Erik Berglof, "The New Political Economy of Putin's Russia: Dealing with the Limits to Top-Down Reform and Populist Temptations," paper presented at the FOI conference "Whither Russia," Stockholm, May 7, 2004. Yulia Latynina, "'Power Agency' Reform or Just Power Grab?" *Moscow Times*, April 28, 2004, reprinted in *Johnson's Russia List*, No.8185, April 28, 2004. "Newly appointed prosecutors demand half a million bucks from businessmen for 'registration,' explaining that they paid a million for their appointment and have to make good on their investment."

³² Few in the west appear to appreciate the power of the *genshtab*, which on occasion has acted in complete disregard of the Ministry of Defense and the President. For example, General Anatoly Kvashnin ordered the Pristina landings on his own initiative, and separately connived with the Duma to draft resolutions abrogating the CFE treaty. Blank, *Ibid.*, pp.39-40. Cf. Vitaly Shlykov, *Chto Pogubilo Sovetskii Soiuz? Genshtab i Ekonomika*, *Voennyi Vestnik*, No.8, Moscow, April 2001. Starting on January 24, 2004 Defense Minister Sergei Ivanov began a campaign to reduce the *genshtab*'s power, with Kvashnin as specific target when he told a gathering of the Academy of Military Sciences that the General Staff should be stripped of "noncore functions" because it had become too bogged down in "administrative routine" to focus on "strategy issues." He called

style economic modernization drive, they will steer it to military rearmament. If, he takes a hands off approach, allowing oligarchic domination of resources and utilities, the perpetuation of the "virtual" sub-economy and protectionism, then Fortress Russia could become an appealing complement,³³ allowing the "president" to placate most domestic constituencies, while currying nationalist support. Thus whether Putin is openly sympathetic to Yuriev's strategy as the Chechen War, and contemporary belligerent rhetoric suggest,³⁴ or prefers a veneer of liberality, gravity seems to favor a resurgence of Muscovite superpower under the FSB's watchful tutelage.³⁵ The coordinates are obscure, but the trajectory is unmistakable.

DEFENSE INDUSTRIAL COMPLEX(OPK)

This seems ominous, but does it really matter? Is superpower physically, and cost-effectively

or a single chain of command in the armed forces. This wish was formalized in a bill approved by the State Duma on June 11, 2004, but still must be signed by Putin. The bill drops the phrase "operational control" from the defense law of 1996, leaving the General Staff with strategic planning as its main responsibility. The change if effective could mean that the FSB in effect controls the army, since Ivanov is an old FSB buddy of Putin's. See Simon Saradzhyan, "Bill Hands Ivanov Full Control of the Army," *Moscow Times*, June 15, 2004, reprinted in *Johnson's Russia List*, No.8253, Article 12, June 15, 2004. Dale Herspring believes that the downgrading of the General Staff may allow Ivanov to push a Rumsfeld type reform stress RMA and mobility. See Dale Herspring, "MOD/General Staff," *Johnson's Russia List*, No.8258, Article 19, June 18, 2004; Herspring, "Russian Military Exercise," *Johnson's Russia List*, No8258, Article 20, June 17, 2004. "The current military exercise being carried out by the Russian military (Mobility -2004) marks a fundamental change in the Russian military... Its major goal has been the creation of mobile forces -- new operational-strategic units-- including airborne forces, naval infantry, light infantry units, military air transportation and helicopters." Kvashnin was sacked on July 19, 2004 and replaced by his deputy Yuri Baluyevsky. See Oleg Shchedrov, "Putin Shakes Up Top Brass, Generals' Heads Roll," *Johnson's Russia List*, No. 8297, July 19, 2004. Pavel Felgenhauer, "Kvashnin Won't be Missed," *Moscow Times*, July 20, 2004.

³³ Blank argues that Putin long ago displayed a willingness to play the nationalist card, linking him to promoting the aggressive prosecution of the Chechen war. *Ibid.*, p.13

³⁴ Blank interprets the Chechen War as the other side of the General Staff's anti-NATO mind set. *Ibid.*, pp.45-48. He reports a deal between Kvashnin and Putin giving the Genshtab carte blanche to occupy all Chechnya, exterminate terrorist, without operational controls from Moscow. Significantly, Putin has never recanted his statement that operational considerations alone would drive the conduct of the war. *Ibid.*, p.50.

³⁵ See note 31.

achievable in a mock liberal, or Fortress Russia economy? The answer to both questions is unequivocally yes. Russia retains approximately 40,000 nuclear warheads and has multiple capabilities for accurately delivering them to high value targets.³⁶ It possesses a larger arsenal, and has more men in uniform than the United States, judging from multiple intelligence sources.³⁷ It has no full spectrum rival other than America. These facts have been obscured for some observers by the drastic decline in Russian arms production (90 percent at the nadir in 1999), false manpower reports, and the obligatory understatement of defense costs.³⁸ Amateurs are easily misled into believing that diminished procurements translate into relatively smaller arsenals, and fail to take proper account of parallel reductions in western defense activities, especially in the EU. Russia's defense establishment doubtlessly was cocooning during the Yeltsin years, and sold off most of its prolong war fighting reserves. But idle machinery and equipment have been carefully moth balled, and can be easily reactivated.

Mobilization won't go smoothly. Many critical workers and skills have been lost; the population is decreasing, and prolonged war fighting reserves have been exhausted, but the most substantive impediments are in technology, training and readiness. The widening military technology gap is no small matter.³⁹ The

³⁶ Steven Rosefielde, *Russia in the 21st Century: Prodigal Superpower*, Cambridge University Press, London, 2005, Chapter 4.

³⁷ *Ibid.*, Chapters 3, 4, and 6.

³⁸ *Ibid.*, Chapter 6.

³⁹ *Ibid.*, Chapter 6. Wilhelm Unge, *The Russian Military-Industrial Complex in the 1990s: Conversion and Privatization in a Structurally Militarized Economy*, FOA-R-00-01701-SE, Swedish Defense Establishment, Stockholm, December 2000; Unge, *Den Ruskas Militartekniska Resursbasen* (Russian Military-Technological Capacity, FOR-4-0618-SE, Swedish Defense Establishment, October 2002. Roger Roffey, Wilhelm Unge, Jenny Cevstrom and Kristina Westerdahl, *Support to Threat Reduction of the Russian Biological Weapons Legacy -Conversion, Bio-defense and the Role of Biopreparat*, FOI-R-0841-SE, Swedish Defense Establishment, April 2003. Jan Knoph, "The State of Russian Armed Forces and their role in Russian Politics," paper presented at the seminar on "Russian Military Politics and Strategy," Finnish National Defense College, Helsinki, April 1-2, 2004.

Kremlin accordingly is working assiduously to leap frog more than a decade of obsolescence with new, fifth generation weapons. Its target for initiating mass production of these state of the arts, full spectrum systems is 2006, aiming a full scale production after 2009.⁴⁰ The precise dates are unimportant. The essential point looking toward 2084 is that the Genshtab, the Ministry of Defense, the Prime Minister (Kasyanov in this instance), and Vladimir Putin have declared their intention to do something about it.

Success here, as in other areas isn't assured, even if natural resource revenues are redirected from oligarchs to the Ministry of Defense. But there are no engineering, resource, or economic barriers blocking the Kremlin from resuscitating its superpower to the cold war norm.⁴¹ The Soviets proved that they could build and maintain a superpower military under central planning, and Russia should be able to perform at least as well under a mixed market regime, adjusted for territorial losses and diminished population, if society can bear the burden of defense, and the mock liberal system isn't too dysfunctional.

DEFENSE BURDEN: SLAVA'S PROBLEM

Soviet superpower was achieved and sustained by devoting an inordinate amount of resources to defense. This was the necessary consequence of central planning's inferiority (static and dynamic inefficiency

⁴⁰ *Reformirovanie i razvitie oboronno-promyshlennovokompleks 2002-2006 gody* (The Reform and Development of the Defense Industrial Complex 2003-2006. Vitaly Shlykov, "Russian Defense Industrial Complex After 9-11," paper presented at the conference on "Russian Security Policy and the War on Terrorism," U.S. Naval Postgraduate School, Monterey, California, June 4-5, 2002. *Aktual'nye Zadachi Razvitiia Vooruzhennykh Sil Rossiiskoi Federatsii*, (Priority Tasks of the Development of the Armed Forces of the Russian Federation), The Report of the Defense Ministry of the Russian Federation, October 2, 2003. <http://www.mil.ru/print/articles/article5005.shtml>

⁴¹ Some economists are concerned that military technological modernization possibilities are being impaired by the MOD's dependence on export production of weapons with fourth generation technologies. See D.P. Belousov and Maya L. Shukgal'ter, "Postkrizisnoe Razvitie Rossiiskovo Oboronno Kompleksa v 1999-2002gg" (The Crisis Development of the Russian Defense Complex 1999-2002), *Problemy Prognozirovaniia*, No.6, 2003, pp.61-75.

and under productivity),⁴² even though it did derive substantial economies of scale from mass weapons production.⁴³ The best estimate of the Soviet defense burden circa 1989 using the U.S. Defense Department's comprehensive definition of military activities, and the CIA's figures, corrected for its mishandling of learning curve adjustments is in the vicinity of 30 percent (of GNP). Academician Yuri Yaremenko who audited the secret data from the Central Executive Committee of the Communist Party informed the author in 1996 that his computations put the figure at 30 percent, but cautioned that inconsistent pricing practices made his result inexact. Vitaly Shlykov, a former GRU Colonel, VPK chief, and Deputy Chairman of the Russian Defense Council under Boris Yeltsin independently confirmed Yaremenko's estimate. However, here too there is considerable room for definitional ambiguity, and of course if the CIA's narrow estimate of defense activities is used a figure in the low twenties can be derived, again corrected for its learning curve blunder.⁴⁴

Vitaly Shlykov has explained that these high burdens of defense, between 22-30 percent, were caused by "structural militarization," that is, a supply mechanism which made it possible for the military to acquire and consume an enormous volume of resources, and the leadership's (genshtab's, Minister of Defense's, KGB's and Politburo's) strong demand for defense services driven by its conviction that it was wise to prepare for the worst case, and then add reserves for unforeseen contingencies. Consumer demand was irrelevant because administrative command planning was designed to disregard private (group) preferences, and there were no democratic mechanisms available to ordinary people for redressing grievances. The defense burden

⁴² Steven Rosefielde, *Russian Economics from Lenin to Putin*, Blackwell, London, 2005.

⁴³ Rosefielde, *Russia in the 21st Century*, Chapter 3. Steven Rosefielde, *False Science: Underestimating the Soviet Arms Buildup*, Transactions Press, Rutgers New Jersey, second edition, 1987. Rosefielde, "The Economic Foundations of Soviet National Security Strategy," *Orbis*, Vol. 30, No. 2, Summer 1986, pp. 317-30.

⁴⁴ Rosefielde, *Russia in the 21st Century*, Chapter 3.

in effect wasn't a burden at all from the leadership's perspective because it relegated consumer welfare to national security, and there were no possibilities for democratically over-ruling its authority.

The contemporary Russian defense burden using CIA and more comprehensive DOD definitions and methods is between 10 and 20 percent.⁴⁵ As during the Soviet period the official defense budgetary statistic means little, and should not be used for anything other than a base line. Structural militarization (in this instance the VPK's mobilization capacities, and ability to exert its defense priorities) apparently survived Yeltsin's re-prioritization, and the genshtab's loss of privileged access to the nation's natural resources. Moreover, Putin's military modernization program clearly demonstrates a willingness to contemplate a return to the Soviet notion of a "normal" defense burden. In the absence of democratic civilian control there is nothing stopping him or his successors from doing so. They will speak prudently about the need for cost efficiency, but the burden isn't theirs; it is Slava's (the generic Russian common man). Although *vozhds* profess concern for Slava, no one should be astonished if they are more interested in what their subjects can do for them, than what they can do for the people.

This attitude provides an opportunity for oligarchs in search of a democratic alliance. Affluent businessmen like Khodorkovsky could find it advantageous to campaign on a share the wealth platform, but the martial police state won't give them the opportunity.⁴⁶ It is far simpler to subordinate oligarchs and Slava

⁴⁵ *Ibid.*, Chapter 6.

⁴⁶ Mikhail Khodorkovsky, "The Crisis of Russian Liberalism," *Vedomosti*, March 29, 2004, reprinted in *Johnson's Russia List*, No.8142, Article 2, 2004. Ron Popeski, "Business Must Accept Putin, Share Wealth-Khodorkovsky," *Johnson's Russia List*, No.8142, Article 1, March 29, 2004. "Yabloko Agrees with Khodorkovsky's View of Russian Liberalism in Crisis," BBC monitoring, March 30, 2004, reprinted in *Johnson's Russia List*, No.8143, Article 1, March 30, 2004. Irina Nagornyykh, Natalia, Gevorkjan, Ilya Bulavinov, "The True author of Mikhail Khodorkovsky's Article?," *Kommersant*, March 30, 2004, reprinted in *Johnson's Russia List*, No.8144, Article 1, March 30, 2004. "Liberal Leader Nemtsov Doubts Authenticity of Khodorkovsky's Articles," *Johnson's Russia List*, No.8144, March 30, 2004.

alike to the dictates of Muscovy than to risk the loss of power for someone else's prosperity. Vozhds know that there is a steep tradeoff between butter and guns in a Pareto efficient economy, and as Shlykov has phrased it, are prepared only to offer margarine.⁴⁷ But they prefer guns and cavier and can have their way by compelling most of society to make do on a Spartan regime.

This is the contingency where the distinction between Shliefer-Treisman "normality" and Yuriev's "Fortress Russia" has traction. Any neo-classical theorist worth his salt knows that autarky is Pareto inferior. Free trade expands the choice set, allowing everyone to enhance his or her utility (second order adjustments aside). Consequently, "Fortress Russia" will reduce private consumption opportunities as Yuriev acknowledges, and Shliefer and Treisman doubtlessly understand. Muscovite rulers in 2084 however won't be daunted. When push comes to shove, they will embrace autarky and controls, sacrificing consumerism to Mars. "New Russians," oligarchs, engineers, managers and ordinary workers will be forced to restrain their material ambitions in the national interest. Military opportunity costs, given ruler's preferences, and wage controls will be reduced by managing demand to augment the social value of security. Thus while Yuriev's program is perverse from a Paretian standpoint, it provides a more accurate vision of Russia 2084 than the liberal, open, democratic free enterprise economy of Shleifer and Treisman's conjuring. As intended, it will allow succeeding generations of Muscovite rulers to more closely approximate Soviet burden levels, without foregoing whatever qualitative advantages are to be had from managed domestic markets. Although, the

⁴⁷ Production possibilities frontiers (with the exception of the true equilibrium point) are counterfactual equilibria where factors are paid the hypothetical value of their marginal products. Rent granting societies can do better by resorting to forced labor, and other forms of compulsory requisitioning. By doing so selectively, they can alter the shape the production feasibility frontier, allowing sovereigns to obtain more of some products than would otherwise be possible in free economies with lump sum transfers. Authoritarians therefore not only can impose their preferences, but can change "coercive" opportunity costs.

domestic markets Russia has are under-productive, they are probably better than what Fredrich von Hayek aptly called Bolshevik "planned chaos."

None of this of course means that Russian markets are efficient, or the new Muscovite economic system is stable. Yuriev's scheme can only degrade static productivity, and its impact on stability is moot. Just as during the cold war, Moscow will have to "perspire" profusely to compensate for its deficient "inspiration."⁴⁸ Although, business, entrepreneurship and private property have been decriminalized, Russian markets still labor under the burden of insecure property rights, the rule of men, predation, monopoly power, and managerial delusions of adequacy, compounded by the fragmented, and capricious visible hand of state administration and organized crime. Russia's economic prospects, after the recovery bubble bursts, consequently are lackluster.⁴⁹ And of course, as is widely appreciated, negative demographic, educational and health trends make matters worse. It could well be that when the smoke clears, Putin will find that "Fortress Russia" is the only game in town, even if he were inclined toward a more liberal solution.

PRESENT DANGER

Moscow's preference for a full spectrum military is driven by the intrinsic inferiority of its economic system, its appropriable mineral wealth, Kremlin fears and complexes, the threat array, the unreliability of rent granting military organizations, and other legitimate security concerns. These special factors, including aspirations for superpower favor the maintenance of large nuclear forces based on land, air and sea. They

⁴⁸ Cf. Paul Krugman, "The Myth of Asia's Miracle," *Foreign Affairs*, Vol.73, pp.67-78.

⁴⁹ Petr Netreba, "IMF Reveals The Enemy of the Russian Economy," *Kommersant*, June 28, 2004, reprinted in *Johnson's Russia List*, No. 8272, Article 9, June 28, 2004. "Russia needs broad-based and sustained reform to improve the investment climate."

entail space based defense and the exotic technologies that accompany it, as well as zigzag ballistic missiles to defeat America's national ballistic missile defense, and its own thinly disguised S400 anti-ballistic missile system.⁵⁰ The genshtab's preference for Blochian armies equipped with tanks, artillery, and tactical nuclear weapons, validated in its eyes by World War II, together with frontier air defense and tactical air support constitute another expensive obligation, although Vladimir Kuroyedov prefers a downsized navy.⁵¹ And of course there is a need for specialized anti-terrorist forces, and defenses against China.

The preponderant part of these forces only makes sense as deterrents against America, NATO and the EU, and then only so because Russia refuses to westernize. If it integrated into the global economy and joined the EU and NATO, strategic and conventional forces could be substantially pared. The interesting question therefore isn't what kind of military the Kremlin will acquire in the near term, but how it will be employed.

Anything is possible, but Muscovy has always exhibited two tendencies. Distrusting the reliability of its forces with good cause, the Kremlin has shied away from direct military confrontation with strong powers, although it often tests its adversary's will by probing for weak spots (Cuban missile crisis). A surprise ground attack against NATO, or an out-of-the-blue nuclear strike against America or China are very remote

⁵⁰ William T. Lee, "The ABM Treaty Charade: A Study in Elite Illusion and Delusion," Washington, D.C.: Comparative Strategy, April-June 2000; Lee, "ABM Treaty Myth and Reality," unpublished note, June 27, 2001, and Lee, "Putin's Radars Aren't Rusty," *Wall Street Journal*, August 28, 2001.

⁵¹ "C-in-C Says Navy Needs 300 Ships," *Johnson's Russia List*, No.8191, Article 10, May 1, 2004. Vladimir Kuroyedov, Command-in-Chief declared that the navy would be well-off with a combination of corvettes with a displacement of 1,400-1,800 tons and frigates. The overall number of ships would equal 30 percent of the Soviet Navy in 1991. The new navy will employ high tech systems, and have a more sophisticated infrastructure.

contingencies.⁵² Likewise, the Soviet Union's acquiescence to Baltic, Eastern and Central European independence among other things suggests that the benefits of occupation and spheres of influence disappointed the leadership, and won't be coveted again in the near future.

The other tendency is to conquer weak, backward societies with relatively small populations and ample natural resources. Rent granting societies find plunder preferable to productive labor, backward countries attractive places to post rent seeking domestic servitors.

The combination of these tendencies makes Central Asia and the Caucuses the prime targets for employing military power,⁵³ if the objective isn't achieved by other methods as it was during the twenties. Ukraine, Belarus, Lithuania, Georgia and Trans-Dnestria are also at risk, but Muscovy is blocked beyond this for the foreseeable future. The uses of Muscovy's martial police state seem circumscribed, and its force structure misaligned. And of course, it is Slava, not the Czars who will have to pay the piper. Muscovy can endure, but it cannot exploit others enough to keep pace with the west and China.

CULTURAL DISSONANCE: INSCRUTABLE MUSCOVY

It is widely acknowledged that culture shapes political-economic behavior and influences domestic and foreign perceptions. No one therefore should be surprised that Russians, Westerners and Asians interpret

⁵² Evan S. Medeiros, "Analyzing China's Defense Industries and the Implications for Chinese Military Modernization," testimony presented to the U.S.-China Economic and Security Review Commission on February 6, 2004. www.rand.org Bobo Lo, "The Long Sunset of Strategic Partnership: Russia's Evolving China Policy," *International Affairs*, Vol. 80, No.2, 2004, pp.295-309. Olga Saurova, "Russian Journal Warns About Chinese Threat," *Johnson's Russia List*, Vol.8256, No.2, June 17, 2004. Russia authorities in the Far East have been issuing Russian passports to Chinese in exchange for bribes, allowing the Chinese to buy land and other property. Five percent of the Irkutsk population is said to be Chinese

⁵³ Harley Balzer, "A Black Hole in Eurasia?: 'New' Security Issues and the Decline of Great Powers," paper presented at the annual meeting of the International Studies Association, Montreal, Canada, March 17-20, 2004. "Vladimir Putin's speech at a Security Council Session (on the CIS)," *Johnson's Russia List*, No. 8298, Article 8, July 19, 2004.

Russian political-economy differently, portraying it in their own parochial terms. There isn't any defense against such biases, other than learning. The west, and Russia steadfastly have sought to depict Russia as a society in transition from Muscovy to westernization since the Enlightenment in the eighteenth century, and haven't been daunted by repeated failure. This refusal to learn is a telltale sign of wishful thinking. Asian scholars insofar as their perceptions have differed from their non-Asian colleagues and have gone beyond their own culture driven biases have been insightful. They tend to assess foreign relations pragmatically. For example, while the Japanese agreed to give Boris Yeltsin two billion dollars worth of transition assistance in the mid nineties as their contribution to the G-7 initiative, not a single yen was disbursed because the Russians wouldn't agree to MOF's (Ministry of Finance) performance conditions. This pragmatism however wasn't matched in modeling Russia's political economic future. It should have been apparent, even in the early nineties, that post-Soviet catastroika shock would pass, with Russia reverting to the status of a Muscovite superpower unwilling to negotiate a favorable deal on the northern islands (Rosefielde, 1994). Yet MOFA (Ministry of Foreign Affairs) preferred to temporize. There was a chance that all four islands could have been ransomed for a few billion dollars, coupled with discrete bribes to the Yeltsin clan, but MOFA's concepts didn't allow it to perceive the opportunity. And it isn't clear now that the Koizumi administration has absorbed the lesson in its current oil negotiations with the Kremlin. While misperceptions don't always matter, they often do, behooving scholars of all backgrounds to scrupulously monitor their own cultural filters.

CONCLUSION

Many advocates of PAB, natural socialist economy, and Aoki optimization theory know that human behavior is more complex than its axioms postulate, but nonetheless contend that their approaches are superior and deserve to be emulated. The same reasoning based on past American performance, and concepts like bounded rationality make it seem that transitioning countries should emulate democratic free enterprise, European Union social democracy, or Japanese market communalism without concern for the particularities of their public cultures.

A thorough review of Russia's warped post-Soviet marketization process however proves that there are ample grounds for caution. Contrary to Sheifer's and Treisman's characterization, Russia remains an abnormal country, in many ways as abhorrent as its Soviet and Czarist predecessors because the aspects of PAB Yeltsin and Putin adopted were hijacked by Muscovite culture. The majority of the Russian people are far worse off than they would have been if American public culture were somehow substituted for the Muscovite alternative. Despite all its conspicuous shortcomings, American public culture isn't authoritarian, and doesn't have the extremely inegalitarian and unjust features of Russia's veiled martial police state. It offers superior opportunity, entrepreneurship, property rights protection, and fairer outcomes under the rule of law. Its micro and macroeconomic regulators are less corrupt, and more concerned with social welfare. There is more effective social activism, and personal freedom. And despite Putin's rhetoric about Russia's unbounded economic prospects, living standards in Muscovy for the vast majority are more likely to fall further behind the West's and Asia's than to converge.

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