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POLICY PAPER SERIES

**«RUSSIAN COMPETITIVENESS: 'RULE OF MEN',
RENT-SEEKING, PREDATION AND STRUCTURAL
MILITARIZATION»**

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Introduction

Russia's is competitively deficient judged from the standpoints of micro-theory, Paretian efficiency, Keynesian full employment, rulers' sovereignty and constrained "virtual" potential.¹ This is most conspicuous in its capital under-utilization, mass involuntary unemployment (including the category of "discouraged workers"),² substandard productivity, low per capita consumption, capital flight, and export ineffectiveness (particularly civilian manufactures). The textbook cures are well known. Competitiveness, understood both as the desire and ability to survive and prosper in the free market can be enhanced by expanding privatization, strengthening property rights, improving information, know how, entrepreneurship, corporate governance, technology and infrastructure, and by eliminating private and public barriers to entry.³ Vladimir Putin's administration knows this, and has endorsed the requisite technical reforms, with some visible success. But systemic constraints have prevented rapid progress. Competitiveness continues to be severely impaired by the "rule of men," rent-seeking, predation and structural militarization. This paper explains why Russia is unlikely to make substantial headway in improving competitiveness, even though Putin's advisors know that Pareto-efficient free enterprise is best.⁴ It focuses on the systemic sources of Russia's non-competitiveness, and discusses their embeddedness.

¹ Clifford Gaddy, *The Price of the Past: Russia's Struggle with a Legacy of a Militarized Economy*, Brookings Institution Press, Washington D.C., 1996. Andrei Nesterenko, "Markets Between Soviet Legacy and Globalization: Neoinstitutionalist Perspectives on Transformation," in Klaus Segbers, ed., *Explaining Post-Soviet Patchworks: Pathways From The Past To The Global*, Vol.2, Aldershot, Ashgate, 2001, pp.78-103. By the mid-1990s more than half of public property was privatized, but many of these companies aren't truly private because their formal owners cannot exercise management and earn profit, p.97. Unlike industry, finance and services, where large-scale denationalization has been accomplished, agricultural land remains under the control of collective farms. Cf. Anders Aslund, *Building Capitalism: The Transformation of the Former Soviet Bloc*, Cambridge University Press, Cambridge, 2001. Maxim Boyko, Andrei Shleifer and R. Vishny, *Privatizing Russia*, MIT Press, Cambridge, MA, 1995. Joseph Blasi, *Ownership, Governance and Restructuring*, Rutgers University School of Management and Labor Relations, New Jersey, 1994. Raj Desai and Itzhak Goldberg, "Stakeholders, Governance, and the Russian Enterprise Dilemma," *Finance and Development*, Vol.37, No.2, pp.14-18. Aleksander Radygin, "Spontaneous Privatization: Motivations, Forms and Stages," *Studies on Soviet Economic Development*, Vol.3, No.5, pp.341-347. Pekka Sutela, "Insider Privatization in Russia: Speculations on Systemic Change," *Europe-Asia Studies*, Vol.46, No.3, pp.417-435. Cf. Alexandr Radygin, "The Corporate Securities Market: Bridgehead or Barrier to Globalization?" in Klaus Segbers, ed., *Explaining Post-Soviet Patchworks*, pp. 193-226. John Earle, "After Voucher Privatization: The Structure of Corporate Ownership in Russian Manufacturing Industry," Center for Economic Policy Research Discussion Paper No.1736. John Earle, and Saul Estrin, "Worker Ownership in Transition," in Roman Frydman, Cheryl Gray, and Andrezej Rapaczynski, eds., *Corporate Governance in Central Europe and Russia*, Vol.2, Budapest, Central European University Press, pp.1-61.

² Steven Rosefielde, "The Civilian Labor Force and Unemployment in the Russian Federation," *Europe-Asia Studies*, Vol. 52, No. 8, December 2000, pp. 1433-1447.

³ Robert Cottrell, "Russia's Rising Tycoons," *Johnson's Russia List*, No. 6388, 8/6/2002. According to Peter Boone and Denis Rodionov 85 percent of Russia's non-government companies are controlled by eight shareholder groups, classified by value. Cottrell interprets this as chaebolization, and believes it augurs well for re-industrialization.

⁴ Lavrov, Litwack and Sutherland, like Vladimir Putin have called for the end of all these abuses and deficiencies, but as under communism the gap between rhetoric and reality remains immense. See A. Lavrov, T. Litwack, D. Sutherland, *Fiscal Federalist Relations in Russia: A Case for Sub-national Autonomy*, OECD, 2001. Cf. Steven Rosefielde and Natalia Vennikova, "Fiscal Federalism in Russia" *A Critique of the OECD Proposals*, *Cambridge Journal of Economics*, forthcoming 2003. On the "virtual" sub-economy see Clifford Gaddy, *The Price of the Past: Russia's Struggle with a Legacy of a Militarized Economy*, 1996, and Clifford Gaddy and Barry Ickes, *Russia's Virtual Economy*, Brookings Institution Press, Washington, D.C., 2002. On "predation" see Stefan Hedlund, *Russia's "Market" Economy: A Bad Case of Predatory Capitalism*, UCL Press, London, 2000. Some believe that the Washington Consensus strategy of integrating Russia into the WTO or the European Union may offer a method for correcting its easternness. See Eric Brunat, "After the Economic Rebound in Russia - The Importance of a Pro-Active

Rule of men

The "rule of law" often serves as a convenient shorthand for Paretian general competition. It means that people are empowered to pursue their own desires restricted only by a voluntary social compact. If they utility seek and are rational, then "lawful" contracting leads directly to the neoclassical ideal. The "rule of men" is the converse. It refers to the "authoritarian" condition where some individuals have the power to dispense with free enterprise, or the social democratic compact, flouting the consent of the governed, or imposing their own self-serving "laws."

Vladimir Putin, the Yeltsin "family," oligarchs, mafiosi, the security community, and a myriad of others individuals in post-communist Russia have the ability to place their self interest above society's "Paretian will." It follows ipso facto that the competitiveness of the new system must be sub-optimal. Only the magnitude of under-competitiveness is in question. There is no single metric to calibrate the chilling effect of the Kremlin's "rule of men," but the dimensions are huge judged by the arbitrariness with which the people's (state's) assets were mis-appropriated in the nineties.⁵ Contracts mean little. They are non-reciprocal tactical instruments used by the strong to obligate the weak, and corruption is pandemic. The courts don't provide victims with relief because they serve the powerful,⁶ and property rights are often dysfunctional and tenuous.

Property rights, entrepreneurship, and business under these conditions are insecure, exacerbating under-competitiveness both by the fear and the reality of the rule of men. This repression goes well beyond textbook micro theory where monopolists and oligopolists manipulate supply to influence prices and obtain excess profits. It relies on legerdemain, physical coercion and theft, and is intensely Paretian inferior.

The rule of men is imbedded in the Russian culture and constitution, and consequently is "systemic."⁷ It can be modified by policy, but this is more easily said than done because Russians are accustomed to "double think," routinely acting at variance with the ideals they profess. Mikhail Gorbachev couldn't contain his rhetorical enthusiasm for democracy, radical economic reform and new thinking, while expecting his functionaries to act as he really intended. Most of Putin's reforms accordingly remain dead letter law, creating an enormous barrier to improved competitive reform, despite his welcome statements of principle.⁸

Rent seeking

Rents are incomes derived from leasing fixed factors of production like land. They are defined more narrowly in general competitive theory as the premium paid to superior types of otherwise homogenous factors including "quasi-rents" imputed to skilled labor, and more broadly in popular usage as unearned income acquired through non-competitive contracting, leasing and crony

Policy," Russian Economic Trends, Vol. 11, No. 3, 2002, pp. 16-26; Eric Brunat, "La croissance de l'économie russe peut-elle être durable?", in Francois Géré et Arnaud Blin (sous la dir.de), Puissance et Influences, annuaire géopolitique & géostratégique 2002-2003, Editions Charles Léopold Mayer et Descartes & Cie, Paris, pp. 55-74; Ivan Samson, "The Common European Economic Space Between Russia and the EU: An Institutional Anchor for Accelerating Russian Reform," Russian Economic Trends, Vol. 11, No. 3.

⁵ Martha Brill Olcott "Reforming Russia's Tycoons," *Foreign Policy*, Vol. 130, May/June 2002, pp. 66-75.

⁶ S. A. Pashin, "Chelovek v rossiiskom pravovom prostranstve," *Moskovskaia vysshaia shkola sotsial'nykh i Shabanova*, "Institutsional'nye izmereniia i nepravovye praktiki," in the same journal, pp. 319-27.

⁷ Stefan Hedlund, *A People With A Troubled History*, unpublished manuscript, 2002. Stefan Hedlund, "Can They Go Back and Fix It?: Reflections on Some Historical Roots of Russia's Economic Troubles," *Acta Slavica Iaponica*, forthcoming 2002.

⁸ George Breslauer, *Johnson's Russia List*, 2/27/02.

transfers. Rent-seeking in the first two senses isn't anti-competitive. It is a normal market phenomenon in a universe where qualitative diversity and indivisibilities abound. Privileged contracting, leasing and crony transfers are another matter. They are a sub-case of the "rule of men" where governments, non-governmental authorities, and powerful businessmen can acquire unearned income by networking, and exclusion. The "loans for shares" scandal,⁹ and the leasing of Russia's natural resources to processors on terms tantamount to free transfers,¹⁰ are only the most egregious examples. Rent-seeking in this dysfunctional sense is ubiquitous in Moscow and throughout the regions.¹¹ It is particularly pernicious because it perverts entrepreneurial initiative, diverting the nation's constructive energies from legitimate business and investment to the pursuit of sinecures. Rent-seeking doesn't eliminate competition entirely, it only suppresses free entry in lucrative activities, leaving people to compete as they like where rents, and above normal profits cannot be easily obtained.

The impulse to anti-competitive rent-see isn't uniquely Russian. But it is especially virulent due to culture and authoritarian tradition in the land of Rus. It can be exorcised, but chronic denial makes this unlikely.

Predation

The rule of men doesn't have to be malevolent. Aristotle believed that governance by a "philosopher king" like his pupil Alexander the Great would be better than democratic free enterprise. His optimism rested on the premise that it was rational to do good, and a wise ruler therefore was bound to devote himself to national prosperity. Russia for the last 800 years has shown that a good philosopher king is hard to find. Its autocrats, and sovereigns in the technical economic sense have preferred to plunder and exploit the people, while prattling about utopia. Predation in post-communist Russia has been most visibly associated with asset-seizing, asset-stripping, rent-seeking, embezzlement, extortion, racketeering, swindling, prostitution and other forms of servitude and subjugation.¹² These activities are intrinsically anti-competitive, and subversive to the development of a well functioning market.

However, optimists aren't easily daunted. Some conceive predation to be self-correcting, while others envision predators spontaneously metamorphosing into captains of industry, using

⁹ Chrystia Freeland, *Sale of the Century: Russia's Wild Ride From Communism to Capitalism*, Crown Business, New York, 2000; David Hoffman, *The Oligarchs: Wealth and Power in the New Russia*, Public Affairs, New York, 2002; Paul Klebnikov, "The Oligarch Who Came in from the Cold," *Forbes*, March 18, 2002, and Klebnikov, *Godfather of the Kremlin: Boris Berezovsky and the Looting of Russia*, Harcourt, New York, 2000, Martha Brill Olcott, "Reforming Russia's Tycoons."

¹⁰ Bulat Stolyarov, "The Kremlin Wants the Natural Resources," *Vedomosti*, July 16, 2002 (Johnson's Russia List, #6272, July 26, 2002). The presidential administration has submitted a new bill to the cabinet which could mean that oligarchs controlling natural resources will be deprived of their licenses and the mineral wealth their companies extract will become the property of the state. Yevgeny Gavrilov, chief economist at Toika-Dialog opposing the action said "In Arab states, where the state owns the produced raw materials and companies are just concessionaires, shares of these companies are not listed on stock exchanges, and the securities market is not viewed as an instrument of attracting investment. If the government implements Kozak's proposals (I do not think it will) it will mean more than bidding farewell to the securities market. We will have to build an entirely different economy." Kozak's proposals were withdrawn 8/15/02, (*Johnson's Russia List*).

¹¹ Anders Aslund, Also Aslund, *Building Capitalism: The Transformation of the Former Soviet Bloc*, Cambridge UP, London 2002. Anders Aslund, "Russia's Collapse," *Foreign Affairs*, 78, No.5 (September/October 1999), pp.64-77.

¹² Stefan Hedlund, *Russia's "Market" Economy: A Bad Case of Predatory Capitalism*. Clifford Gaddy and Barry Ickes, *Russia's Virtual Economy*.

their power to enrich themselves further through legitimate entrepreneurship at home and abroad. It could happen. But in contemplating the possibilities it is useful to bear in mind that a good deal of Russian predation is only tangentially motivated by wealth maximization, and is often psychologically disordered. Russian predators frequently seem more concerned with power, intimidation and revenge than material prosperity, further dimming prospects for improved competitiveness.

Virtuality

One of the most conspicuous characteristics associated with rent-seeking and predation is resource demobilization. Both not only discourage their victims' entrepreneurship, they diminish the effort of victimizers and suppress competition. This behavior stands in stark contrast to Soviet arrangements, particularly under Joseph Stalin when the rule of men was synonymous with resource mobilization and overfull employment. Postwar Soviet leaders also suppressed competition to foster communist legitimacy through collectivist economic development, modernization, and military might. The physical systems management regime they relied on, often called the command economy substituted plans, directives, incentives and "communist enthusiasm" for libertarian utility seeking.¹³ Its residue survives in what Clifford Gaddy and Barry Ickes call "Russia's Virtual Economy," productive networks which continue to function outside the demand responsive, consumer sovereign paradigm, and thus circumscribe the scope of Russian competitiveness by withholding materials and assets from the marketplace.¹⁴ Other things equal these foregone competitive opportunities might be of subsidiary concern. But there is a little understood subset of the virtual subsystem that could be easily reinvigorated, and threatens to diminish the limited competitive scope of Russia's illiberal markets. It only awaits the re-prioritization of its mission, with the concomitant reallocation of resources from the market to physically managed military industrial activities.

Structural militarization

The danger arises from the military modernization program scheduled to begin in 2005,¹⁵ or some future variant thereof, and the opportunities it will provide the defense industrial complex to advance its hidden institutional agenda by demonstrating its ability not just to build weapons, but to

¹³ Some have recently argued that the vitality of the physical management system was sapped by "informalization". Vladimir Treml and Michael Alexiev, "The Growth of the Second Economy in the Soviet Union and Its Impact on the System," in Robert Campbell, ed., *The Postcommunist Economic Transformation: Essays in Honor of Gregory Grossman*, 1994. Gregory Grossman, "Subverted Sovereignty: Historic Role of the Soviet Underground," in Stephen Cohen, Andrew Schwartz and John Zysman, eds. *The Tunnel at the End of the Light: Privatization in Business Networks and Economic Transformation in Russia*, University of California International and Area Studies Series, No. 100, Berkeley, pp. 24-50. Steven Solnick, *Stealing the State: Control and Collapse in Soviet Institutions*, Harvard U.P., Cambridge, MA., 1998. Ronald Wintrobe, *The Political Economy of Dictatorship*, Cambridge U.P., Cambridge, 1998. For other theories see Alexander Dallin, "Causes of the Collapse of the USSR," *Post-Soviet Affairs*, Vol. 8, No. 4, pp. 279-302. Gertrude Schroeder, "Reflections on Economic Sovietology," *Post-Soviet Affairs*, Vol. 11, No. 3, 1995, pp. 197-234. Mark Harrison, "Coercion, Compliance and Collapse of the Command Economy," forthcoming in *Economic History Review*, 2002. Byung-Yeon Kim, Causes of Repressed Inflation in the Soviet Consumer Market: Retail Price Subsidies the Siphoning Effect, and the Budget Deficit," *Economic History Review*, Vol. 55, No. 1, pp. 105-127.

¹⁴ Clifford Gaddy and Barry Ickes, *Russia's Virtual Economy*, Brookings Institution.

¹⁵ Steven Rosefielde, "Back to the Future? Prospects for Russia's Military Industrial Revival," *Orbis*, Vol. 46, No. 3, Summer 2002, pp. 499-510. *Reformirovanie i razvitie oboronno-promyshlennogo kompleksa 2002-2006 Gody* (The Reform and Development of the Military-Industrial Complex 2002-2006), Pravitel'stva Rossiiskoi Federatsii, No. 713, October 2001, approved by decree of the Russian Federation October 11, 2001.

create civilian jobs and consumer necessities. Few appreciate the dimensions of the threat posed to Russia's competitiveness because Soviet secrecy and the controversies it spawned cloud the topic. A brief review is therefore essential.

The Soviet command economy was dominated by the production of military goods and services. The mechanisms employed to achieve these objectives were part of the command economy, but swiftly took on a life of their own. Tables 1 and 2 present value statistics, computed at ruble factor cost and dollars, providing a summary profile of Soviet defense activities. All figures are disputable. Vitaly Shlykov former deputy-chairman of the Russian Defense Council and academician Yuri Yaremenko both contend that Rosefielde's estimates are much too low, but have not provided definitive proof because the key data remain classified. Their judgment applies both to the size of Soviet forces, and their rates of growth.¹⁶ They independently estimate that defense absorbed roughly 30 percent of the nation's resources during the last few decades of Soviet power. This figure, and the CIA's much lower estimate serve as useful benchmarks for gauging domestic resource allocation,¹⁷ and consequently the dimensions of structural militarization, without the further complication of evaluating their comparative worth, or "burden" - the opportunity costs of guns in terms of foregone butter. They indicate that the regime deemed it reasonable to devote between 15 to 30 percent of the country's resources to military security, computed at ruble factor cost, but not that the other 70 to 85 percent were reserved for civilian purposes.¹⁸ Shlykov insists that the leadership authorized allocation of non-defense resources to the civilian sector, not for consumers private welfare, but as working capital to maintain the security effort. To drive the point home, he suggested tongue in cheek that the entire economy was structurally militarized; that civilian consumption was tolerated only to the extent that it served the larger cause of defense. This rhetorical exaggeration clarifies what structural militarization is supposed to mean. The term doesn't simply imply that Moscow's military expenditures were prodigious. It suggests that the entire productive mechanism was heavily yoked to the task of defense.

The military industrial complex (voenno-promyshlennyi kompleks, or VPK) from this perspective lead a double life. It was simultaneously an agent of the state and principal promoting its own agenda. Shlykov maintains that neither the state, nor the VPK sought to optimize national security. The leadership instead was constantly preparing for the worst case, and unforeseen contingencies beyond that, while the VPK dreamed up projects to accommodate them, and expand its privileges. The military industrial complex steadfastly pressed for ever greater shares of the nation's resources, and subordination of lower priority claimants. Its privileged access, and priority requisitioning were codified in the law, enabling it to operate as a semi-independent empire within the larger physical management and planning system. The VPK wasn't consciously anti-consumerist, or anti-socialist, but in opposing the diversion of funds to inessential civilian purposes, it inured structural militarization.¹⁹

¹⁶ Rosefielde, "Back to the Future," and Vitaly Shlykov, *Chto pogubilo Sovetskii Soiuz?: Amerikanskaya razvedka o Sovetskikh voennykh raskhodakh*, Voennyi vestnik, Vol. 8, Moscow, April 2001.

¹⁷ Steven Rosefielde, *False Science: Underestimating the Soviet Arms Buildup*, Transaction, Rutgers, New Jersey, 1987, Table 14.2, p. 201.

¹⁸ For a systematic discussion of value issues see "Steven Rosefielde," *The Riddle of Postwar Russian Economic Growth: Statistics Lied and Were Misconstrued*, resubmitted to *Europe-Asia Studies*, August 2002.

¹⁹ Lennart Samuelson has written two recent studies on the Soviet "mobilization economy" based on extensive archival sources: *Plans for Stalin's War Machine, Tukhachevskii and Military-Economic Planning, 1925-1941*, Macmillan Press Ltd. (Center for Russian and East European Studies, University of Birmingham), 2000; *Rod koloss pa larvfotter, Rysslands Ekonomi i Skuggan av 1900-Talskrigen*, SNS Forlag, Stockholm 1999. He discovered that war preparedness planning was the dominant factor driving the five year plans under Stalin, and his successors. In his words, the Soviets planned not only for the worst case, but built up reserves beyond these requirements. This

Physical systems management

Many terms have been coined over the years to describe the Soviet productive mechanism. Gregory Grossman proposed "command," emphasizing the subordination of workers, managers, and consumers to communist directives and discipline.²⁰ Although the concept captured a salient aspect of the regime, and was sophisticatedly nuanced to encompass a wide range of behavioral possibilities including individual initiative, supervision, administration and planning, it too easily was misconstrued to mean a system of strict, centralized, micro-assignment where functionaries obediently fulfilled their duties. Alternative labels like "administrative," "centrally planned," "scientifically planned" and "optimally planned" systems similarly exaggerated the role that rational, authoritarian intentions played in determining productive outcomes, concealing the economy's muddled pragmatism.

From the first day of Bolshevik power when private business, entrepreneurship and ownership were criminalized, Russian producers of every description were forced to improvise. The rules of the game fluctuated and evolved. After War Communism, some private and cooperative activities were tolerated, but once Stalin's industrialization drive commenced pragmatic muddling was paramount in the state sector. Leaders, planners, ministers and heads of main departments (glavki) could issue all the macro commands they wished, but "meso" and micro decisions making for the 27 million goods in the official nomenclature was beyond their capacity. It was the mechanisms and rules governing these productive processes, subject to limits imposed by macro financial restrictions, and resource allocation that conditioned the performance and potential of the Soviet system.²¹

The principal meso and micro choice-makers in this realm were "Red directors" (enterprise managers), their sub-ministerial supervisors, senior operatives of the inter-enterprise, inter-sectoral coordinative network (the material technical supply system, and state banking institutions) as well as research, design, and incentive bureaus. These functionaries were prohibited from engaging in private, for-profit activities outside the precincts of the state, but were allowed to act as Paretian utility seekers for themselves and their institutions, constrained by fiat ruble prices, state set wage rates and worker incentive schemes, budgetary restrictions, quotas, plan targets, prioritization and ministerial policy, guided in part by managerial bonus incentives, perks, and stratagems for personal

precautionary approach served the Soviet Union well during the Second World War, and Samuelson believes that it dominated the leadership's thinking thereafter. Initially, in the early thirties, planners strove to keep costs low by building military industrial production capacity without mass rearmament, but procurements escalated as the Second World War neared, and the influence of structural militarization became more pronounced. This left the Soviet Union saddled with a defense strategy which while appropriate against Hitler, quickly became obsolete against the west. Samuelson argues that for most of the post-war period, the Soviet Union had two distinct military industrial complexes; a nuclear one providing deterrence, and a mass conventional army that became progressively irrelevant, and sapped the nation's economic vitality. It is this second element which became obsolete. As an economic historian, Samuelson casts his analysis in a larger perspective tracing the origin of the mobilization model to the ideas of Ivan (Jan) Bloch in the 1890s. At first this Czarist advisor argued that nations which prepared properly for total war would win, but later foresaw a draw in which everyone lost. H.G. Wells condemned the trench combat of the First World War as "Bloch's War." Samuelson suggests that Stalin's victory in the Second World War vindicates Bloch's original view, but argues that the mobilization approach has subsequently become obsolete. Thus, the analysis of Putin's challenge investigated in this paper can be construed as an extension of the Bloch/Wells debate about the feasibility/futility of total war, and the imperatives of rational defense planning. It should also be observed that weapons producers preferred soft targets. It was the military-industrial planners who were obsessed with mobilization.

²⁰ Gregory Grossman, "Notes for a Theory of the Command Economy," *Soviet Studies*, Vol. No. 2, October 1963, pp. 103-123.

²¹ George Kleiner, *Mesoekonomika perekhodnovo perioda: Rynki, otrasli, predpriatiia*, Nauka, Moscow, 2001.

advancement. Red directors in this environment couldn't operate as entrepreneurs, had only a minor role in designing and selecting enterprise technologies, and couldn't alter established product characteristics. But they were "commanded" to harness the potential of their enterprises' productivity capacities, and coaxed to comply with bonuses tied to full and overfull factor employment, and "optimal" above quota product assortments in multi-product firms.²² Likewise, red directors were rewarded for introducing new and improved goods, directly and indirectly insofar as this facilitated satisfaction of plan targets, and increased production bonuses. And they never fretted about sales, because the state purchased everything produced, as long as goods weren't defective.

Another way to look at this matter is to recognize that Soviet "systems directors" used a medley of incentives, commands and punitive sanctions as surrogates for the Marshallian quantity adjustment mechanism regulating enterprise supply in the west. The principal difference between the two forms of control was demand responsiveness. In the USSR the micro-demands of workers, and most purchasers had little impact on employment, product characteristics and assortment choice, even though the supply mechanisms fostered overfull capacity utilization; whereas, in market economy causality was reversed. Competitive demand governed employment, product assortments and qualities, while physical capacity utilization was subsidiary.

The Soviet approach is best conceived of as "physical systems management." Contrary to a good deal of liberal theorizing, it turned out that markets were inessential to attaining and sustaining high levels of physical production. Private business, entrepreneurship and ownership were superfluous if the state were willing to sacrifice, accepting physical output instead of value as its maximand.

Physical systems management of course wasn't confined to enterprises. Productivity, and growth required other supporting services like education, science, RDT&E, design, engineering, infrastructure, inter-industrial allocation, retail distribution, foreign trade mechanisms including technology transfer and diffusion. Each of these activities was handled in the same way. Institutions were tasked to physically maximize, unconstrained by market demand and value. They were permitted to behave like Paretian rational actors, optimizing where they could including informal barter operations as long as they remained insulated from consumer sovereignty, and concealed their self-aggrandizement from public view.

The results of these improvisations are partly emblazoned and concealed in the official record.²³ Soviet physical systems management provided the USSR with "overfull" employment, overfull capacity utilization, and sustained physical productivity growth. The mechanism was generally applicable and could have served civil society, but was structurally militarized. It could have survived in perpetuity as a matter of principle, if the leadership had succeeded in combating its inner decay. This task however proved more difficult than most imagined because those closest to the reality, were most aware of the systems inherent futility. No matter how hard they strived, or how rapidly physically productivity increased the perceived quality of life showed little improvement, spawning cynicism and corruption. Some doubtlessly were gratified by the Soviet Union's military power, but even they must have had doubts as the threat from the west receded.

²² Steven Rosefielde and R.W. Pfouts, "Economic Optimization and Technical Efficiency in Soviet Enterprises Jointly Regulated by Plans and Incentives," *European Economic Review*, Vol. 32, No. 6, 1988, pp. 1285-99.

²³ Steven Rosefielde, "The Riddle of Postwar Russian Economic Growth: Statistics Lied and Were Misconstrued," to *Europe-Asia Studies*, forthcoming Vol. 55, No. 3, May 2003.

Shock therapy

In an ideal world, where mistakes can be instantly and costless corrected, reforming the Soviet physical management system was pointless. It had to be scuttled, and replaced with a supply mechanism responsive to consumer demand. And many like Stanislav Shatalin felt that even in an imperfect universe this was the only course, whether it took "five hundred days or five hundred years, as long the demolition effort rid Russia of communism!"²⁴ It is easy to understand the sentiment, but prudent people know that nihilism doesn't guarantee success, no matter how long destroyers are prepared to wait. Many argue that it would have been preferable to gradually dismantle structural militarism than to raze it, not only because shock therapy was crude and excessive, but because the system might metamorphosize instead of transitioning to generally competitive free enterprise.

The order of structural de-militarization could have been predicated on these concerns. The main priorities should have been 1) preventing resource control from falling into the wrong hands, 2) redirecting physical systems management toward civilian needs, 3) transforming physical into value based systems management, 4) market institution building, 5) purchase privatization, 6) lump sum compensatory dividends for those unable to participate in purchase privatization, and 7) the creation of competitive asset markets. This agenda is consonant with the approach advocated by the "Washington Consensus," but its focus and sequencing are radically different.²⁵ While, resuscitating private business, entrepreneurship, science and ownership are essential, they are phased in gradually after the resource base is protected from pillage, structural de-militarization is well underway, and worker welfare is protected. Likewise, equity isn't disregarded in the vainglorious pursuit of efficiency on the pretext that "omelettes cannot be made without breaking some eggs."

Implementation of this program would have been straight forward. Physical systems management including Gosplan, Gosnabsbyt, Gosbank and supervisory ministries would have been preserved initially, and then phased out by gradually circumscribing their authority as market institutions developed to take their place. Structural de-militarization should have commenced by reducing weapons, military construction and defense RDT&E procurement orders, while agreeing to purchase consumer goods produced by the VPK without limit, in accordance with prevailing practice. Had this been done, the VPK would have immediately pursued its interest by expanding civilian production, without serious complication because forty percent of the VPK production under communism was consumer goods. To further facilitate the process, VPK managers should have been granted wider discretion in running their firms, mimicking the rights of western firms as Deng Xiaoping subsequently did, without granting them formal ownership.²⁶ Ownership rights could then have been earned by setting "strike prices" at which the manager-worker group could buy those assets which had been devoted to civilian market operations. Firms should have been privatized in this way only when they demonstrated the competitive viability of their initiatives. These liberalizing and internal privatization programs could have been concurrently introduced outside the VPK, and supplemented with market institution building. As liberalization gained momentum, competition would slowly determine how control over resources should be reallocated

²⁴ Lecture, Duke University, November 1991.

²⁵ John Williamson, "Democracy and the Washington Consensus," *World Development*, Vol. 21, No. 8, pp. 1329-1336, August 1993.

²⁶ Deng's "The Regulations on Transforming the Management Mechanism of State-Owned Industrial Enterprises," issued July 1992 authorized 14 managerial control rights over: 1) production, 2) pricing, 3) sales, 4) procurement, 5) foreign trade, 6) investment, 7) use of retained funds, 8) disposal of assets, 9) mergers and acquisitions, 10) labor, 11) personnel management, 13) bonuses and 14) internal organization and the refusal to pay unauthorized charges by the government.

between the VPK and civilian consumer goods producers, with the pool of transferable resources expanding due to reduced state defense procurement. The rational allocation of ownership could have advanced *pari passu* by gradually expanding firm's right to buy and sell assets, including mergers and acquisitions. Throughout the process, the state would have had to remain vigilant against embezzlement and misappropriation of government assets. If these efforts succeeded to the degree they have in China, the Kremlin would have received ample funds from assets sales to compensate those who received less than average, or were left out entirely. Structural demilitarization in these ways would have avoided all the trauma created by Yeltsin's shock therapy, and the West's preoccupation with the monetarist "order of economic liberalization."²⁷ There would have been no oligarchs, mafia plague, or culture of corruption, and vested authoritarian interests opposed to popular sovereignty would have been diminished. Ironically, after the horses have left the corral, Vladimir Putin is now contemplating adopting aspects of this script.²⁸

Resource barons

Responsible structural de-militarization was never in the cards. None of the key participants understood the problematic. But liberals on Boris Yeltsin's team, and foreign advisors saw the Russian military as a symbol of communism, and wanted it eliminated, or more realistically reduced. Most wanted the VPK's military assets serving national defense converted, and the resources it controlled reallocated to civilian use, while an unscrupulous minority focused on seizing "prolong warfighting material reserves," diverting resources for their private use, and profiting from foreign weapons sales. In astonishing short order, the vultures prevailed. Defense material reserves worth tens of billions of dollars were illegally sold abroad, much of it to Asia, transshipped through ports on Japan's Nihon Kai, including Maizuru. The Russian Weapons Export Agency (Rosvoruzhnenia) became a lucrative sinecure, and control of the crown jewels, that is, Russia's mineral wealth was transferred from the VPK to Yeltsin's oligarchs.

Arms production plummeted roughly ninety percent in a couple of years, remaining at low levels to the present day. The production figures in Table 3 provide a clear impression of the debacle. Much of the deployed arsenal was decommissioned, dismantled and sold for scrap. This would have had a devastating impact on the military balance, had America not downsized reciprocally as indicated in Table 4. Moreover, the VPK suffered a double blow because its civilian production was also adversely effected by the diversion of previously subsidized resources to the oligarchs, and oligopolistic distribution practices that replaced Soviet era goods with expensive foreign imports. As a consequence the majority of the VPK's production capacities, both military and civilian are drastically underutilized, and are becoming increasing obsolete.

The evisceration of the VPK, however hasn't been accompanied by the efflorescence of liberalized civilian industry. Unlike the VPK, Russia's new oligarchic resource barons have preferred to confine their investments for the most part to natural resource extraction and processing sub-sectors domestically, and to purchasing real estate and other tangible assets abroad. The VPK's loss in this way has not become society's gain. Where a proper structural de-militarization strategy would have preserved full employment, reallocating resources to better use, Yeltsin's cronyism

²⁷ The Ronald McKinnon, *The Order of Economic Liberalization: Financial Control in the Transition to a Market Economy*, Johns Hopkins, Baltimore, MD, 1991.

²⁸ Bulat Stolyarov, "The Kremlin Wants the Natural Resources."

caused mass unemployment, resource demobilization and 3.4 million premature deaths for the benefit of the undeserving.²⁹

²⁹ Rosefielde, "The Civilian Labor Force and Unemployment in the Russian Federation," and Steven Rosefielde, "Premature Deaths: Russia's Radical Transition," *Europe-Asia Studies*, Vol. 53, No. 8, December 2001, pp. 1159-1176.

TABLE 1

Total Soviet and American Defense Activities 1976-1984
(Excluding Military Pensions and RDT& E Valued
in Billions of Constant 1978 Dollars)

	CIA		Soviet Rosefielde	Joint Chiefs of Staff	Official Soviet	US DOD
	(1)	(2)	(3)	(4)	(5)	(6)
1976	120.8	114.6	141.0	—	—	84.0
1977	123.2	117.0	147.8	—	—	85.9
1978	125.7	119.5	155.0	—	—	86.9
1979	128.2	122.0	162.6	159.8	—	91.4
1980	130.8	124.6	170.7	(168.2)	—	93.8
1981	133.3	127.1	177.8	177.1	—	99.6
1982	136.0	129.8	185.4	—	16.7	108.4
1983	(138.8)	(132.6)	193.3	—	—	116.1
1984	(141.5)	(135.3)	201.5	—	—	126.7
1976-84 Compound annual rate of growth (percent)	1,178.3	1,122.5	1,535.1			892.8
	2	2.1	4.6	5.3		5.3

Sources: Tables 13.10, R1 and A15; *Allocation of Resources in the Soviet Union and China—1983*, JEC, September 1983, p. 307; *Department of Defense (Outlays)*, computer printout, FY85; Organization of the Joint Chiefs of Staff, *Military Posture for FY85*, Washington, D.C., 1982, p. 16; British Broadcasting Corporation, *Summary of World Broadcasts (SU/7156/A1/4)*, October 14, 1982; International Institute for Strategic Studies, *The Military Balance 1984-1985*, p. 16; Council of Economic Advisors, *Economic Indicators*, December 1984, p. 2. *Allocation of Resources in the Soviet Union and China—1984*, JEC November 1984.

Method:

- Column 1: The CIA postrevision figure reported in Table 13.10, column 1 is extrapolated to 1984 at 2 percent per annum in accordance with the testimony of Robert Gates, Deputy Director for Intelligence, CIA to the Joint Economic Committee of Congress. "Our latest dollar estimates show the same trend since they are based on the same estimates of quantities of Soviet weapons. The estimated dollar cost of Soviet defense activities grew at slightly less than 2 percent over the 1976-81 period, a percentage point below the long term average. Procurement costs in dollar terms did not grow during the 1976-81 period." *Allocation of Resources in the Soviet Union and China—1983*, p. 307.
- Column 2: The agency has adjusted the 1978 procurement series component of the CIA's Soviet defense spending statistics for learning in its 1982 series. An estimate of this learning discount is provided in Table A15 and the resulting learning adjusted procurement series is reported in Table R1, column 3. Total Soviet defense outlays adjusted for learning are computed by subtracting the procurement discount for each year 1976-84 from total outlays shown in column 1. The discount is 6.2 billion dollars, or 16.6 percent of the yearly figures listed in Table R1, column 2.
- Column 3: This series is computed by subtracting the CIA's weapons procurement estimates in Table 1, column 2, from its estimates of total Soviet defense outlays, Table R4, column 1, and then by adding back the author's Soviet weapons estimates reported in Table R1, column 4.
- Column 4: The JCS series valued in FY83 prices has been converted to calendar year 1978 prices in two steps. First, FY83 prices are deflated to a FY78 base using data provided in *Department of Defense (Outlays)*, computer printout, FY85, Table 6-11. Second, the FY78 statistics are transformed to calendar year estimates by deflating total defense expenditure inflation with the GNP deflator October 1, 1978 to December 31, 1978. The full deflator is $1.54/1.02 = 1.51$. See Council of Economic Advisors, *Economic Indicators*, December 1984, p. 2.
- Column 5: This statistic is merely the official Soviet defense budget figure routinely reported in *Narodnoe khozaiatvo* converted from rubles to dollars at the official exchange rate. It is cited in *The Military Balance 1984-1985* and attributed to the BBC without further elaboration.
- Column 6: This series measures total American defense expenditures less military pensions and RDT&E in accordance with the CIA's definition of total Soviet dollar defense outlays. They are taken from *Department of Defense (Outlays)*, computer printout, FY85, Table 6-11, and have been converted to a calendar year basis expressed in 1978 calendar year prices.

Table 2

**Total Soviet and American Defense Activities 1976-1984
(Including Military Pensions and RDT&E Valued
in Billions of Constant 1970 Rubles)**

	CIA (1)	Soviet Rosefielde (2)	U.S. DOD (3)
1976	53.3	69.2	36.3
1977	54.4	73.7	37.4
1978	55.5	78.6	37.8
1979	56.6	83.8	39.5
1980	57.7	89.4	40.8
1981	58.8	94.3	43.2
1982	60.0	99.5	46.8
1983	(61.2)	105.1	50.3
1984	(62.4)	110.9	54.9
1976-84 Compound annual rate of growth (percent)	519.9 2	804.5 6.	387 5.3

Sources: Tables 13.11, and R2; *Allocation of Resources in the Soviet Union and China-1983*, JEC, September 1983, p. 306; *Department of Defense (Outlays)*, computer printout, FY85, Table 6-11; *Survey of Current Business* January 1980, p. 40. *Allocation of Resources in the Soviet Union and China-1984*, JEC November 1984.

Method:

- Column 1: The CIA postrevision figure reported in Table 13.11, column 1 is extrapolated to 1984 at 2 percent per annum in accordance with the testimony of Robert Gates, Deputy Director for Intelligence, CIA to the Joint Economic Committee of Congress, "Total Soviet defense costs, measured in constant 1970 rubles, grew at an average annual rate of 4 to 5 percent during 1966-76 (about the same as reported in earlier estimates). Our new estimate, however, shows that like overall economic growth the rise in the total cost of defense since 1976 has been about 2 percent a year." *Allocation of Resources in the Soviet Union and China 1983*, p. 306.
- Column 2: The author's estimate of total Soviet defense expenditures is computed by subtracting the CIA's latest postrevision ruble procurement series (Table R2, column 3) from its total Soviet defense outlay series (Table R5, column 1) and then adding back the author's estimates of Soviet weapons procurement 1976-84 (Table R2, column 4).
- Column 3: Total American defense expenditures in rubles are calculated in three steps. First, the dollar series reported in Table R4, column 6, is adjusted to conform with the agency's ruble definition of Soviet defense spending by adding RDT&E and pension expenditures to the total. These data are obtained from the Office of Net Assessment, and have been converted to a calendar year basis. Defense related activities of the DOE, the Coast Guard and the selective service have been omitted; with the result that my U.S. series is slightly underestimated. Second, this series is deflated to a 1970 price base using DOD fiscal year statistics adjusted for inflation October 1, 1970 to December 31, 1978. The full deflator is $2.9791/1.0134 = 2.9398$. Third, the 1970 series is converted to rubles with the agency's implicit 1970 defense ruble-dollar ratio, .64. See Table 13.11, column 4 for a further explanation. The figures 1976-79 in Table 13.11, column 4 are based on CIA estimates of US defense spending which differ somewhat from the DOD statistics reported in Table R5.

Table 3

Real Gross Industrial Output of the Russian Federation 1991-2000

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
All Industry	100	82.0	70.4	55.7	53.9	51.7	52.7	50.1	54.1	62.1
Defense (MIC)	100	84.4	64.6	39.2	31.2	22.7	19.7	19.2	25.5	32.0
Civilian	100	99.6	85.6	52.6	41.3	29.1	28.7	26.5	34.1	41.0
Military	100	49.5	32.5	19.9	16.6	12.8	9.4	9.9	13.5	17.5

Sources: All Industry: *Economic Survey of Europe, United Nations, No.1, 2000, Table 13.4, p.227, Economic Survey of Europe, United Nations, No. 1, 2002, Table 8.4, p. 232.*

Defense Industry: Julian Cooper, "The Russian Military-Industrial Complex: Current Problems and Future Prospects," in Pentti Forsstrom, ed, *Russia's Potential in the 21st Century*, National Defense College, Series 2, No. 14, Helsinki, 2001, p. 43. The underlying data are taken from VPK publications.

Table 4
Russian and U.S. Military Equipment Arsenals:1998

TANKS	
RUSSIA	16,210
USA	8,369
AFV/APC	
RUSSIA	28,530
USA	27,627
ARTILLERY/MRLS	
RUSSIA	16,453
USA	7,225
COMBAT AIRCRAFT	
RUSSIA	2,868
USA	4,475
MAJOR SURFACE WARSHIPS	
RUSSIA	44
USA	134
ATTACK SUBMARINES	
RUSSIA	72
USA	66
STRATEGIC SUBMARINES	
RUSSIA	26
USA	18
STRATEGIC BALLISTIC MISSILES	
RUSSIA	180 SS-18 (10 MIRV) 188 SS-19 (6 MIRV) 92 SS-24 (10 MIRV) 360 SS-25 (1 WARHEAD)
USA	590 MINUTEMAN III 50 PEACEKEEPER MX 115 MINUTEMAN II SILOS (START ACCOUNTABLE)
STRATEGIC BOMBERS	
RUSSIA	28 TU95H (WITH ALCM) plus 5 in Ukraine 32 TU-95H16 (WITH ALCM) plus 20 in Ukraine 6 TU-160 (WITH ALCM) plus 19 in Ukraine
USA	95 B-1B 66 B-52H 13 B-2

Source: IISS, *The Military Balance 1998/99*, Oxford University Press, London 1999, pp.20-27, 108-112.

Defense industrial complex

The success achieved by liberals in cutting defense production, and cronies in misappropriating the VPK's resources has indisputably reduced the arms procurement share of GDP.³⁰ In some subsectors the decline has been especially severe. The ammunition industry and conventional arms manufacture for example are only operating at 6.9 and 13.6 percent respectively of capacity.³¹ But this hasn't translated into a proportional structural de-militarization of the VPK's domain because its asset base remains largely intact. The defense industrial complex (*oboronno-promyshlennyi kompleks* or OPK) as the VPK is now called consists of 1700 enterprises and organizations, located in 72 regions, "officially" employing more than 2 million workers, and producing 27 percent of the nation's machinery, and 35 percent of its machinery exports.³² 129 of these entities are "city building enterprises," that is, defense industrial towns where the OPK is the sole employer.³³ The total number of OPK enterprises and organizations has been constant for a decade, but some liberalization has been achieved in ownership and managerial autonomy. At the start of the post-communist epoch, the VPK was wholly state owned. Today 43 percent remains government-owned, 29 percent is mixed state-private stock companies, and 28 percent is fully privately owned. All serve the market in varying degrees, but retain a collective interest in promoting government patronage, and can be quickly commandeered if state procurement orders revive.

Full structural demilitarization could be accomplished by allowing profit seeking to determine product mixes in the competitive market place; disbanding the OPK, and diminishing the state's implicit preemptive control rights. Judging by the collapse in weapons procurement orders, and partial privatization it might seem reasonable to suppose that this is the current trajectory. But recent government pronouncements including the official program for The Reform and Development of the Defense Industrial Complex 2002-2006 signed by Prime Minister Mikhail Kasyanov in October 2001 appear to be moving in the opposite direction toward re-consolidation of state authority, driven in part by the aging of OPK's capital stock, underemployment, low pay and poor enterprise finances.³⁴

The plan envisions downsizing the OKP by civilianizing some 1200 enterprises and institutions, stripping them of their military assets including intellectual property, and transferring this capital to 500 amalgamated entities called "system-building integrated structures." This rearrangement will increase the military focus of the OPK by divesting its civilian activities, beneficially reducing structural militarization in this regard, but will strengthen the defense lobby and augment state ownership. The program calls for the government to have controlling stock of the lead companies (design bureaus) of the "system-building integrated structures," This will be

³⁰ See Table 3. The situation with respect to total defense activities is more ambiguous. Although, military manpower officially has been drastically pared to 1 million, Vladimir Putin has acknowledged that the real figure is roughly 3 million, in line with Soviet era billeting adjusted for the post-Soviet territorial changes.

³¹ 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, p.3.

³² The employment figure is too low, and the machinery data probably too high, but for the purposes at hand the official numbers provide an adequate impression of scale.

³³ *Reformirovanie i razvitiie oboronno-promyshlennovo kompleksa 2002-2006 gody* (The Reform and Development of the Defense Industrial Complex 2002-2006). Cf. Vitaly Shlykov, "Russian Defense Industrial Complex After 9-11."

³⁴ 95.4 percent of OPK machinery is older than five years, pay is two thirds of civilian industry, and 18 percent of weapons producers are operating at a loss. See Shlykov, "Russian Defense Industrial Complex After 9/11," p.3.

accomplished by arbitrarily valuing the state's intellectual property at 100 percent of the lead companies' stock, a tactic that will terminate the traditional Soviet separation of design from production and create integrated entities capable of designing, producing, marketing (exporting), and servicing OPK products. State shares in non-lead companies will be put in trust with the design bureaus.

The Kremlin intends to use ownership as its primary control instrument, keeping its requisitioning powers in the background, and minimizing budgetary subsidies at a time when state weapons procurement programs are a pale shadow of the Soviet past. Ilya Klebanov, former deputy Prime Minister, and now Minister for Industry, Science and Technology, the architect of the OPK reform program hopes in this way to reestablish state administrative governance over domestic military industrial activities, while creating new entities that can seize a larger share of the global arms market.³⁵ He contends that this is unavoidable because private owners in the OPK prosper at the state's expense by exporting weapons and technologies they haven't created, without productively reinvesting the proceeds.³⁶

Table 5
Defense Industrial Organization: The Scheme for 2005-2006

Type of Equipment	Number of Integrated Structures
Aviation equipment	5-7
Missile and space equipment	9-10
Radio equipment and control systems	7-9
Communication and telecommunication equipment	2-3
Electronic equipment	2
Precision guided munitions	2-3
Tanks and artillery	2-3
Optics and electronics (laser) equipment	1-3
Ammunition and special chemistry	6-8
Shipbuilding	3-5
Shipbuilding equipment	3-5
Total	42-58

Source: 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 Post-graduate School, Monterey, California, June 4-5, 2002, pp.13-14.

To facilitate the development of fifth generation weapon systems, the OPK reform program envisions a two prong strategy. During the first phase 2002-2004 this task will be assigned to lead companies and the integrated structures they oversee. But thereafter, superior diversified research and production complexes capable of producing globally competitive military and consumer goods will be developed, a concept reminiscent of Gorbachev's schemes in the late eighties. Table 5 provides a preliminary list of these new structures.

The specific tasks that will be assigned to these new integrated structures have been formulated by the Security Council in the State Armaments Program for 2001-2010 and approved by President Vladimir Putin on January 20, 2002, but this forty three volume document with 12 "approvable" sub-programs is classified. Colonel General Alexei Moskovsky has provided a few

³⁵ Shlykov, Ibid., p.6. Klebanov claims that Russia's defense needs are too pressing to wait for the OPK to successfully privatize according to the American pattern.

³⁶ Even if Klebanov is right, the government need not effectively renationalize to capture part of weapons export rents. It can always tax.

glimpses into its contents in an interview published in *Krasnaya Zvezda*, February 19, 2002. The State Armaments program covers nuclear forces, space systems, aviation and air defense, conventional armaments, command and control, basic military research and equipment destined for other "power structures" (interior troops, border guards, FSB, etc.). Forty percent of budgeted funds are to be allocated to research and development 2000-2005, quadruple the share in the preceding plan. The actual figure for 2001 was forty one percent, with 48 percent of funding devoted to serial weapons production. After 2005 a tidal change is contemplated, with R&D dropping to 15 percent, and serial production expanding to 65-70 percent as Russia seriously turns its attention to military modernization.³⁷ A fifth generation fighter under development at "Sukhoi" will be part of this expansion, with mass production commencing in 2009.³⁸

As with all programatic documents, the feasibility of these schemes deserves to be regarded with skepticism. Vitaly Shlykov, doubts that they can be achieved within the current fiscal framework, noting that the government implausibly expects 55-60 percent of the funding to be provided from OPK profits, although he understands that these goals could be easily reached if Putin returned to the Soviet era strategy of "pushek i maslo" (guns and margarine).³⁹ Klebanov's demotion on February 18, 2002 likewise calls the Putin administration's commitment to the OPK reform program into question.⁴⁰ Nonetheless, it seems clear that momentum is not in the direction of structural demilitarization, but toward a gradual reassertion of state authority and control that on balance will be anti-competitive. If Russian competitiveness improves, it will be despite the OPK and not because of its liberalization.

Privilege preserving growth

Whither Russia? Will competition under the rule of law lead to "golden age" modernization, unsullied by the rule of men, predation, rent seeking, asset grabbing, physical systems management and structural militarization, or will productive relations develop aberrantly? The optimistic alternative doesn't require comment. All roads lead to Pareto. But analysts have a weaker appreciation of privilege preserving growth possibilities. Some suppose that the competitive "mom and pop" sector will grow more rapidly than the privileged productive component as physically managed and structurally militarized activities shrink, and entrepreneurial rivalry intensifies. Learning by doing, technology transfer and foreign investment could accelerate the process. The rule of men however makes this scenario implausible because the cost of success in small business is predation, which deters market efficient initiative and economies of scale. Growth under current arrangements is conceivable, but severely constrained. Rent-seeking, asset grabbing, monopoly and predation are usually thought of as parasitic activities focused more on exploitation than growth, but can foster development under appropriate circumstances. If unearned profits are invested domestically, or returns on foreign assets are repatriated the productivity of privileged undertakings could rise, benefitting owners directly and people more generally to the extent that enhanced product characteristics and supplies are responsive to competitive demand. Russia's domestic investment however has been wretched and capital continues to flow out with few signs of

³⁷ Shlykov, "Russian Security Policy and the War on Terrorism," pp.15-17.

³⁸ Ibid., p.18. Sukhoi was awarded the contract April 26, 2002.

³⁹ Vitaly Shlykov, *Chto pogubilo Sovetskii Soiuz: Amerikanskaya razvedka o Sovetskikh voennykh razkhodakh*. *Voennyi vestnik*, No. 8, Moscow, April 2001. Shlykov uses the term "guns and margarine" to underscore the point that high levels of weapons procurement were achieved during the Soviet era by compelling consumers to accept Spartan living standards.

⁴⁰ Ibid., p.19.

sustained repatriation. Although there has been much chatter about globalization and industrial export competitiveness Russian successes have been few and far between.

Prospects for growth in civilian physically managed activities are even bleaker. The state refuses to serve as purchaser of last recourse for rust belt consumer goods, and is unwilling to provide financing or guarantees for modernizing Soviet era plant, machinery and equipment. Nor are leaders contemplating large scale public works projects that could indirectly revitalize this moribund sector. If the physical management component of Russia's productive mechanism is rejuvenated, the most likely source will be military modernization. This can no longer be accomplished in a twinkling of an eye, even if the state returns to the Soviet "pushek i maslo" strategy, but the mentality remains and could support rapid weapons growth for decades. The dynamic prospects of Russia's post communist privilege preserving market thus are unpromising unless Putin decides to emulate Peter the Great.⁴¹

Chasing rainbows

Hopes for faster growth rest on Russia's economic evolution. The system could mutate. Oligarchs could become enlightened entrepreneurs. Financial industrial groups could keiretsu-ize, or chaebolize. The state following China could initiate ambitious public works programs, or it could emulate west European social democracy. The casual embrace of any of these stratagems however is trifling, unless it is supported by adequate cultural and institutional reform. Pareto efficient systems require the rule of contract law, while Japanese and Korean institutions necessitate communal or Confucian obligation incompatible with Russia's mores. Just as the Swedish and Yugoslav models couldn't be adapted to Soviet conditions, enthusiasms for contemporary non-Paretian utopia are futile. Chasing other cultures rainbows isn't a surrogate for designing a globally competitive third way, or westernizing. Among a host of factors impairing Russia's ability to borrow institutions from abroad, two warrant brief comment. First, "overseas" Russians display scant loyalty to the motherland. It seems improbable that Russia's expatriates could form an ethnic bridge to the global marketplace or capitalize the federation's catch up. Second, Russia's industrialists lack a commitment to satisfying consumer preferences at home or abroad, and hence haven't a prayer of outcompeting Japanese keiretsu, Korean chaebols or the Chinese. Unlike its Asian neighbors industrial export growth is no more an option for the Kremlin than Soviet computopia. Chasing rainbows while indulging in Byzantine intrigue is an ancient Russian past time that shows no signs of fading; behavior that consigns it to being a backwater for the foreseeable future.⁴²

⁴¹ Steven Rosefielde, "Keins i Petr I: put' k ekonomicheskomu blagopoluchiiu i bezopasnosti Rossii," *Ekonomicheskaja Nauka Sovremennoi Rossii*, Vol. 5, No. 1, 2002, pp. 104-120.

⁴² Johnson's Russia List #6407, 26 August, 2002. Peter Boone and Denis Rodionov, "Reformed Rent-Seekers Promoting Reform?" Boone and Radionov argued based on a survey of 64 of Russia's largest firms that a single shareholder group now controls 97 percent of privatized enterprises by revenue and conclude that they will lead the way to prosperity for themselves and small businesses.

Engagement

Competitiveness isn't a pancea. It isn't a substitute of the rule for law, and cannot cure what ails Russia. Since savvy western policymakers must know that, competitiveness is more a tactic promoting transition than a blueprint for enhancing the prevailing system's performance. Perhaps Putin can be coaxed into curbing anti-competitive cronyism and state economic management. But transitologists shouldn't bet on it. Few cultures can best Russia when it comes to free form gaming and intrigue. Thanking foreigners for their sage advice and behaving conversely is a way of life, and it is as difficult to believe that competitiveness will weaken Russia's rule of men as to expect that leopards will change their spots.

Conclusion

There is a gulf between Russia's economic promise and its prospects. The nation possesses the resources and know how to become a great and prosperous western power, but a culture that cannot abide Paretian success. It cannot easily purge itself of the rule of men, pathological intrigue or the delusionary pursuit of rainbows, and must suffer the consequences. Advocacy of competitiveness from this perspective can only be beneficial if accompanied by an unceasing campaign against the rule of men. There is no benign variant of the rule of men within the Russian cultural matrix that can achieve the growth and development possibilities of the Japanese, South Koreans, or contemporary Chinese models. Russia's privileged can live lavishly under the prevailing regime, but the economy must underperform, rendering the Federation militarily vulnerable.⁴³ As this reality sinks in, no one should be surprised if Moscow chooses to structurally remilitarize rather than persevere with transition.

⁴³ Vitaly Golovachyov, "Splendor and Poverty of the Regions," www.trud.ru/01_Today/07/2002070230601.htm. Vyachaslov Bobkov, Director of the All-Russian Center of Living Standards, reports that 40.1 percent of Russians are "poor," living below the subsistence minimum; 20.1 are marginal above subsistence; 33.4 percent have incomes above the minimum consumption budget, and 6.4 percent exceed the high budget standard.

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