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It only took a spike in the price of hydrocarbons for the world to be transformed beyond recognition. Oil producing nations that were struggling to keep their budgets in the red have emerged as global investors, and oil consuming nations that were highly skeptical of the Kyoto accord have begun professing a firm belief in the need to move away from dependence on fossil fuels. Nowhere, however, has the transformation been more breathtaking than in the case of Russia.

Just recall the dark days when Vladimir Putin was anointed to become first prime minister and then president of the Russian Federation. The lands that he assumed responsibility to rule over bore an eerie reminiscence of scorched earth.¹ The economy was at the tail end of a serious hyperdepression, its infrastructure was in a state of serious decay, and following the financial meltdown in August 1998, expectations had emerged that Russia was heading for a sovereign default.

In the spring of 1999, *The Economist* quipped that having aspired for years to become a member of the G7 club of the richest industrialized nations, Russia was now looking at membership in a less glamorous P7 club of pariah nations where it would have joined the ranks of countries like Sudan, Liberia, Congo and Somalia, “poor, war-ridden places, some barely existing as states,” which had borrowed money from the IMF and failed to repay their debts.²

The subsequent transformation from economic basket case to success story has proceeded at breakneck speed, and the times when dependence on credits and favors from the West conditioned Russian behavior now seem long past. To political elites in Moscow, the return to a position of international power and respect has been

¹ Meier, Andrew (2004), *Black Earth: Russia after the Fall*, London: HarperCollins.

² *The Economist*, February 6, 1999, p. 21.

nothing short of intoxicating. In a recent *Carnegie Foundation Policy Brief*, Dmitri Trenin captures the change of scene: “Anyone listening to Russian officials is impressed by their self-confidence, and even triumphalism. As the Russians see it, Russia is up, the United States is down, and Europe is out.”³

Trenin, symptomatically, does not even mention China, which for some reason seems to be completely off the Russian radar screens. Although the big neighbor to the east has a track record of annual growth rates of 8-10 percent since 1978, Moscow appears curiously convinced that there is nothing to be learned from this example. Perhaps there is a lingering mindset here, viewing China as a poor Third World nation that once copied now-defunct central planning from Moscow. Perhaps it is the absence of free market rhetoric that makes China seem an unsuitable mentor for Russian reformers. Whatever the reason, it is, however, hard not to conclude that Moscow ignores the Chinese example at its own peril.

The bottom line is that from Moscow’s point of view, Russia’s long-standing obsession with catching up with the West now seems to be finally within reach. While the US has shot itself in the foot, if not worse, with its Iraq adventure, the Kremlin has used its energy policy to lock a veritable stranglehold on Europe. The European Union that only yesteryear spoke to Moscow with such apparent authority has now been reduced to a mere market place for Russian gas, provided on conditions that are laid down not by Brussels but by the Kremlin.

Three questions emerge, to be dealt with in turn in the following. First and foremost we have to ask whether the self-assurance that is currently being projected by Moscow rests on solid foundations, i.e. if Russia really is – in any reasonable sense – about to catch up with the West. While some achievements are unquestionable, the rhetoric is also laced with statements that make the listener wonder what is going on. When, for example, the admiral in charge of the Russian navy claims that rearmament plans call for the construction of six new aircraft carriers, one may reasonably wonder where this is going to happen. The only place in the old Soviet Union that was large enough was the Nikolaev yard, which is now in Ukraine.

Secondly, we must ask how the success story, if such indeed it is, has been achieved. Are we now witnessing the outcome of a finally successful transformation

³ Trenin, Dmitri (2007), “Russia’s Strategic Choices,” *Carnegie Foundation Policy Brief*, no. 50, May, p. 1.

to rules-based market economy, as some pundits would have it, or is it just another case of forced resource mobilization that will be followed by yet another slump, as has been the case so many times before in Russian history?⁴

Thirdly, we have the question of sustainability. Will the Russian economy continue logging impressive growth rates, or will the current spurt simply run out of steam? The latter is predicated not on whether the price and supply of hydrocarbons can be maintained, but rather on whether the new system that is emerging is both *politically* feasible, in the sense of avoiding paralyzing internecine struggles over the distribution of rents, and *economically* feasible, in the sense of being credibly committed to upholding property rights and the sanctity of contracts in general.

The acid test of sustainability will hinge on whether the institutional makeup of Putin's Russia is conducive to such broad-based entrepreneurship and innovation from below that constitutes a *sine qua non* for achieving a competitive edge on global markets. The obvious alternative is that of regressing to an ever-greater dependence on exports of raw materials,⁵ which embody little value added and generate little demand either for qualified human capital or for such sophisticated institutions that are entailed in what Mancur Olson refers to as "market augmenting government" and as "property rights intensive production."⁶

Let us begin by taking a closer look at the imagery of success that tends to surround presentations of Russian economic development under Putin.

A Hollow Success Story

⁴ Gerschenkron, Alexander (1962), *Economic Backwardness in Historical Perspective*, Cambridge, MA: Harvard University Press.

⁵ It is important to note that the official image of a rapidly modernizing economy with a vibrant service sector rests on distorted statistics concerning the role of the energy complex. Via elaborate transfer pricing schemes, the oil companies have succeeded in booking much of their activity as transport services rather than as extraction. If the numbers are recomputed according to patterns prevailing in Western oil companies, the share of the Russian energy complex in GDP increases from officially reported nine percent to 25 percent. (World Bank (2004), *Russian Economic Report*, no. 7, at www.worldbank.org.ru.) This, moreover, still does not take into account that much energy is sold domestically at prices that are well below the world market level. Any further expansion in the role of the extractive sector must thus be viewed as very serious.

⁶ Olson, Mancur (2000), *Power and Prosperity: Outgrowing Communist and Capitalist Dictatorships*, New York: Basic Books, pp. x, 186.

The main item that is being advanced in support of the success story holds that since Putin took over as master of the Kremlin, the Russian economy has been growing at a steady 6-7 percent annual clip. To the extent that official Russian statistics on GDP growth may be accepted as credible,⁷ this does represent a dramatic change of scene. The more serious question, however, concerns what the implications are.

There are two important pitfalls here, both of which tend to be disregarded when pundits set about generating happy talk. One is that a track record of economic growth that looks so good in a perspective starting in 2000, comes across as much less so if the perspective is extended to start in 1990.⁸ The other concerns the fact that economic growth must be defined not in terms of GDP actually produced but in the growth of production *possibilities*, i.e. in capacity installed rather than capacity utilized. Both have important implications for the sustainability of current trends.

If we begin with the question of performance as measured by GDP, it is imperative to note that 2006 marked the year when the Russian economy finally returned to the level of GDP that had been achieved *before* the launch of systemic change. The rather less inspiring image that is conveyed by this longer time perspective is that of a hyperdepression followed by an economic boom. Accepting that the success under Putin has just barely managed to compensate for a drop in GDP by around 40 percent under Yeltsin, it comes across as rather logical that Yegor Gaidar, the architect and manager of shock therapy, has chosen recently to speak of “recovery growth.”⁹

If we add to this considerably more sober account of Russian performance that economic growth in the 1980’s was flat, we may conclude that Russia can presently look back at a quarter century of roughly zero economic growth. This is surely not something to be lightly walked away from, and it does provide a stark background to any form of Sino-Russian comparison. The real cause for concern,

⁷ According to the Russian economist Grigory Khanin, official growth statistics are overstated by on average three percent per annum. For the period 1999-2003, the accumulated growth should thus be 23 percent, rather than the officially reported 38 percent. (Khanin, Gregory (2006), “Economic Growth and the Mobilization Model,” in: Michael Ellman (ed.), *Russia’s Oil and Natural Gas*, London: Anthem Press, p. 153.) It might be mentioned here that during the time of Gorbachev’s glasnost and perestroika, Khanin was considered a leading authority on Soviet growth data. The credibility that he achieved then makes it hard to dismiss his present claims out of hand. This, however, is not the place to engage in the numbers game.

⁸ As Khanin notes, it is a general problem that “the overwhelming majority of researchers make forecasts of Russian long-term economic development based on the results of the last few years,” and that “these forecasts are based on purely economic factors, without taking account of the human potential and moral condition of the society” (ibid., p. 151).

⁹ Gaidar, Yegor (2005), “Recovery Growth as a Stage of Post-Socialist Transition?,” *Studies and Analysis* no. 292, Warsaw: Center for Social and Economic Research.

however, will emerge only when we proceed to the second of our two pitfalls, namely that of a serious degradation of the country's capital stock.

The main problem with the Russian economy over the years that have passed since the collapse of central planning is related to the fact that during the 1990's, fixed capital investment tumbled to levels where there was massive disinvestment. The causes behind this sorry state of affairs were related to the predatory strategies that emerged when state control was relaxed, and when there were no norms in place to block massive looting of state assets.¹⁰ As the time horizon for economic decision making was being radically shortened, the effect was a veritable collapse in fixed capital investment,¹¹ which in turn led to a rapid aging of the capital stock. Over the years 1990-98, the average age of Russian capital stock increased by nearly one year per annum.¹²

While this represented a heavy burden that would have to be carried by policy makers in the Putin regime, there was no inherent impossibility here. A substantial increase in fixed capital investment could have rejuvenated the economy, and made it possible for Russian entrepreneurs to venture forth on global markets with competitive products. Based merely on a casual glance at numbers on fixed capital investment in the Russian economy over the past few years, the image – albeit uneven – again is rather impressive.¹³ The question, however, is whether it is in any way, form or shape sufficient.

By way of illustration, we may consider the track record of the German and Japanese economies following the end of WWII. In addition to a high rate of fixed capital investment, which facilitated rebuilding damaged infrastructure and production facilities, their respective recovery strategies also placed heavy emphasis on technological progress and on building cutting edge human capital. The successes

¹⁰ Goldman, Marshall (2003), *Pirating Russia: Russian Reform Goes Awry*, London: Routledge.

¹¹ The drop in 1992 was precipitous, at 37.1 percent, followed by drops of 21.1 percent in 1993 and 29.3 percent in 1994. Although the rate of descent subsequently slowed, investment growth remained negative up until the crash in 1998. (See further EBRD (1998), *Transition Report Update*, London: EBRD, p. 63.)

¹² During the 1990's, the average age of Russian capital stock increased from 10.8 to 17.9 years. More specifically, the share of the Russian capital stock that was less than five years old, and could thus be considered modern, dropped from 29.4 to a mere 3.9 percent, while that being older than 20 years and thus clearly obsolete increased from 15.0 to 34.9 percent. (Evgeny Gavrilov (2000), "Savings, Capital Flight, and Economic Growth in Russia," paper presented to the AAASS 2000 Annual Convention, Denver, CO, November 9-10, p. 12, Table 3.)

¹³ The increase in 2000 was 17.4 percent, followed by 10.0 percent in 2001 and 2.8 percent in 2002. Thereafter the number has moved in the 10.7 – 13.7 percent range. (CBR, official figures.)

that were scored may be reflected in the transformation of the label “Made in Japan” from something of a joke to a distinctive mark of quality.

Viewed against this background, Russia’s performance again comes across as rather dismal. While it is true that fixed capital investment under Putin has been substantial, it is also true that the drop under Yeltsin was even more so. Where the level of GDP may now have been brought back to the *status quo ante* reform, this is very far from the case when it comes to erosion and obsolescence of the capital stock.

Measured in macro numbers alone, we may note that over the years 2000-05 China invested a staggering 40 percent of GDP, a number that agrees well with the boomtown image of that country. The Euro Zone meanwhile came in at 21 percent and the US at 19 percent, with Russia trailing a no more than 18 percent.¹⁴ Short of comparing Russia with China, it should be obvious that Russia’s investment needs are of a different magnitude altogether than those of the US or the EU. Its poor performance must hence again be viewed as highly worrisome for the future.

To this may be further added that for reasons of monopoly power, most of the non-tradable goods that go into Russian fixed capital investment are sold in Russia at prices that exceed those on world markets. If the resources that are being bought with fixed capital investment outlays were to be counted at world market prices, Russian investment would come in at a mere nine percent of GDP,¹⁵ which is vastly below what would be needed for a serious upgrading and restructuring of the capital stock.

In order, however, to arrive at the real crux of the matter we must go beyond the macro numbers and look also at Russian investment priorities. Here we may find three disturbing patterns. One is that essential parts of Russian infrastructure, notably so pipelines and power generation facilities, are in such a serious state of disrepair that massive capital outlays will be needed over the coming years simply in order to prevent further decay. To this we may add a clear preference of Russian investors for brownfield over greenfield investment, and for downstream operations with low value added and a short payback time.

The second pattern concerns the prospects for generating much needed entrepreneurship from below. It bears noting here that no one has ever founded a

¹⁴ OECD (2006), *Economic Survey of the Russian Federation 2006*, Paris: OECD, pp. 26-27.

¹⁵ Gaddy, Clifford (2006), “The Russian Economy in the Year 2006,” *Post-Soviet Affairs*, vol. 23, no. 1, p. 45.

large corporation, and that the overwhelming share of the dynamism of a high performance market economy originates in the small business sector. This being the case, one must look with grave concern at the conditions that face hopeful Russian entrepreneurs when it comes to matters such as access to financial markets, protection against various forms of racketeering, and the right to expect due process in courts of law.

The third and perhaps most troublesome pattern relates to the sorry state of higher learning in the Russian Federation. Here it is not only the case that the previously solid foundations of Soviet science are being rapidly eroded, as a failure to recruit any serious numbers of young scholars into the scientific community causes the average age of that community to rise above the life expectancy for Russian men.¹⁶ In addition to this constraint on the *supply* of higher education, we also have to consider the impact on the *demand* side by what may be called an “internal brain drain,” i.e. a process that causes talented young men and women who could have proceeded to serious careers based on scholarly achievement to opt instead for more lucrative occupations with low value added and dubious moral foundations.

With respect to the quality of human capital development, reference might and should perhaps also be made to matters concerning health and demography, but news from that quarter is so sordid that bringing it into the picture would make the remainder of the argument resemble rearranging the deck chairs on the Titanic.¹⁷ We shall thus prefer to let it be for the moment.

Boyar Economics

Let us proceed instead to look at the means by which the seeming economic success of the Putin regime has been achieved. The main point to be established here is that Russia’s return to a position of great power, with an option to become a superpower, is warped not only in the sense that it rests on shaky economic foundations. It is even

¹⁶ Blank, Stephen (2003), “The Material-Technical Foundations of Russian Military Power,” *Ankara Paper* 7, London: Frank Cass.

¹⁷ Eberstadt, Nicholas (1999), “Russia: Too Sick to Matter?,” *Policy Review*, no. 95, June & July, Feshbach, Murray (2001), “Russia’s Population Meltdown,” *Wilson Quarterly*, vol. 25, no. 1, Feshbach, Murray (2003), *Russia’s Health and Demographic Crises: Policy Implications and Consequences*, Washington, DC: The Chemical and Biological Arms Control Institute.

more so in the added sense that the consolidation of power that generates the new sense of triumphalism has been achieved by means that are eerily familiar from long-term Russian history. We shall refer to this heritage as “boyar economics,” and we shall begin by providing a backdrop in the form of the ideal world of textbook economics.

Russian Tradition meets Textbook Economics

The textbook ideal of market economy that is derived from standard neoclassical theory rests on a set of well known basic principles. Prices determined via voluntary market exchange are assumed to provide actors with perfect information regarding available opportunities, based on which they proceed to adjust quantities so as to competitively profit and utility maximize. In the ideal world, this process is marked by consumer sovereignty and by a set of norms that cause actors to behave according to the golden rule of not doing to others what they do not want others to do to them.

While no one has ever pretended that this represents a perfect mapping of the real world, most members of the economics profession will hold that it does represent a reasonable approximation, based on which we can proceed to model and predict human behavior in the market place. The essence of this modeling is that we can derive general patterns of behavior, sometimes referred to as the “laws of economics,” which in turn provide the modeling with an aura of exact science, where fuzzy references to matters of culture and history may be safely left out.¹⁸

Given this professional legacy, it was rather predictable that the collapse of central planning, the hard core of which had been to displace the fundamental principles of market economy, would be associated with a firm belief in deregulation as a panacea. Once the debris of the inferior system of command economy had been cleared away, there would be sure efficiency gains.¹⁹ Today we know that reality would have it rather differently, but we are still far from achieving a consensus on

¹⁸ While numerous qualifying assumptions are being made regarding matters such as information asymmetries, hierarchies vs. markets and the presence of multiple equilibria, to mention but a few, it remains the case that few are willing to incorporate elements of culture and history that run counter to the basic belief that all countries are essentially the same, and that prescriptions for post-communist adjustment could hence be made according to a standard form.

¹⁹ For a balanced and succinct overview of arguments along these lines, see Roland, Gérard (2000), *Transition and Economics: Politics, Markets, and Firms*, Cambridge, MA: MIT Press, ch. 15.

why the by now close to 30 “transition economies” would score such different results.²⁰

For a rather original and provocative contribution to the ensuing debates on whether the outcome of transition should be viewed as a qualified success or perhaps as a dismal failure, we may turn to Alan Greenspan. In a June 1997 speech at the Woodrow Wilson Center in Washington DC, he made the following suggestion: “Much of what we took for granted in our free market system and assumed to be human nature was not nature at all, but culture.” Exactly how the notion of “culture” should be interpreted was not made very clear, beyond “laws, conventions, behaviors, and a wide variety of business professions and practices that have no important functions in a centrally planned economy.”²¹

Let us suggest here, for the sake of the subsequent argument, that the main implication of Greenspan’s intervention was to underscore the absence in Russian tradition – up to date – of one of the most fundamental, albeit often tacitly assumed, principles of market economy, namely that of *autonomy* in the market place. In the ideal world, actors are focused on horizontal relations in the market place. The game is essentially two-dimensional, and there is no room for firms, organizations or even states. The more we move away from this ideal, the more important it becomes to understand the emergence of hierarchies that displace market-determined behavior.²²

The Soviet system represented an extreme version of hierarchy, where voluntary horizontal exchange was criminalized, and where vital institutions such as property and capital markets were suppressed. The outcome instead was non-market based decision making, occurring in a world of deceit, falsification and influence games. While accounts of the formal dimensions of this system have filled libraries, much less has been written on the implications for such informal norms that are associated with Greenspan’s conventions, behaviors, and business practices.

²⁰ In its latest *Transition Report Update*, published in May 2007, the EBRD counts 29 such economies, for which it provides continual macroeconomic coverage. (The reports are available on www.ebrd.com.) One might perhaps wonder what it is, more precisely, that these diverse economies remain in joint transition to.

²¹ Speech available on <http://www.federalreserve.gov/boarddocs/speeches/1997/19970610.htm>.

²² Within “new institutional economics” in particular, there is a pronounced focus on precisely this type of problem. See further Williamson, Oliver E. (1975), *Markets and Hierarchies: Analysis and Antitrust Implications*, New York: Free Press, Williamson, Oliver E. (1985), *The Economic Institutions of Capitalism*, New York: Free Press, and Williamson, Oliver E. (1996), *The Mechanisms of Governance*, New York: Oxford University Press.

By far the most controversial dimension of the latter type of approaches is the possible presence of path dependence, suggesting that the informal norms of the Soviet era had roots in distant Muscovy, and that they have been carried over into the post-Soviet era.²³ The main ambition of the present paper is to make the latter argument, and to suggest some implications. As a first step towards realizing this ambition, we shall highlight a fundamental difference between the economic system that emerges out of the textbook world, and that which constitutes present-day reality in the Russian Federation.

In a panel presentation to the 2006 AAASS National Convention, Clifford Gaddy pointed at the need to manage the massive ground rents that are derived, in the main, from oil and gas, and outlined how the Putin regime has gone about meeting this need. The first step was that of *mobilizing* the rents, which was achieved via a combination of tax reform and enhanced enforcement. Then followed the need to set priorities for the *allocation* of rents, which essentially meant restoring Russian sovereignty by eliminating foreign debt and the associated dependence on the good will of foreign governments, and finally there was the paramount task of managing the actual *sharing* of rents between rival factions. The suggested role of President Putin himself in this scheme is to serve as linchpin, as the guarantor that the game is kept in good balance.²⁴

In the following, we shall argue that this role of the Russian president, and the associated mechanisms that are being deployed in order to meet the suggested needs, have roots that extend back to distant Muscovy. The argument will be made in three steps. First we shall sketch how the Kremlin went about recasting the energy complex into a foundation not only for securing sovereignty but also for maintaining control over the sharing of rents. Then we shall present the main dimensions of the Muscovite “matrix” that constitutes the historical origins of the current order, and in conclusion we shall outline how the means by which the functions suggested by Gaddy have been achieved are path dependently linked to old Muscovy.

²³ For a fuller account of long-term Russian path dependence, see Hedlund, Stefan (2005), *Russian Path Dependence*, London: Routledge.

²⁴ Gaddy, op. cit., pp. 41-42.

An Energy Superpower

As Putin's second term in office unfolded, it was becoming increasingly clear that the Kremlin was bent on using the country's energy complex as a means by which to make Russia great again. By early 2006, Vladimir Shlapentokh captured this ambition in presenting Russia as a "Newborn Superpower" and Putin as the "Lord of Oil and Gas."²⁵ There is, moreover, plenty of evidence to suggest that assembling this power house, upon which a new system of political power could be built, was an important priority from the very outset of Putin's ascent to power.²⁶

It bears noting that there were those who saw it coming, even before the spike in hydrocarbon prices had triggered the ensuing bonanza of petrodollar inflow. While most pundits were still debating the seeming irrationality of the Kremlin's onslaught against Yukos, then viewed as the crown jewel of the country's oil industry, perceptive analysts could see clearly a long-term political rationality. Peter Lavelle, for example, saw Putin being rationally "determined to re-order Russia's oil patch to serve national and international interests."²⁷

If we may thus accept that using the export of hydrocarbons as an instrument with which to regain Russia's lost international stature constituted an early priority of the Putin regime, it must be equally clear that given the events that had unfolded in the 1990's, realizing this ambition was a tall order. The essence of the "oligarchy" that emerged under Yeltsin was that of allowing a set of favored cronies of the regime not only to grab assets at bargain basement prices, but also to establish links with foreign partners and markets in a way that facilitated massive capital flight.²⁸

Any ambition to achieve a real break with this form of crony capitalism run amuck would have to deal with both of these dimensions; i.e., in addition to re-imposing state control over domestic players, it would also be necessary to break the influence of the foreign oil majors. As we shall see in a moment, the Yukos affair was designed to meet both these requirements.

The real watershed in the transformation of corrupt but market-friendly oligarch-run businesses into an authoritarian Kremlin-controlled energy power house may be dated to June 26, 2003, when a ceremony was held to mark the deal of the

²⁵ Cited from *Johnson's Russia List*, February 9, 2006, item 18.

²⁶ One of many indications of this fact may be found in the much publicized account of Putin's dissertation, which lays out the need for state control over mineral resources.

²⁷ Peter Lavelle (2004), "OPEC Dethroned, Putin's 'KremPEC' Arrives," cited from <http://www.futurebrief.com/peterlavelleyukos002.asp>.

²⁸ Tikhomirov, Vladimir (1997), "Capital Flight from Post-Soviet Russia," *Europe-Asia Studies*, vol. 49, no. 4.

century in Russian oil, a joint venture between BP and the Russian company Tyumenneftegaz. It was not only the size of the deal – \$14 billion – that caused banner headlines to appear. Even more important was the fact that BP would enter into the new venture – to be known as BP-TNK – as an equal partner. Present and smiling at the ceremony where Lord Brown committed BP to the deal were both Tony Blair and Vladimir Putin.

The market hailed what was then generally viewed as the start of a new era of strategic energy cooperation between Russia and the West. The anticipated next step on this road was a deal between Exxon and Yukos, which at the time was Russia's flagship oil company. The deal would have created a privately owned – and thus controlled – route for export of Russian oil via Murmansk and further on to the US. Given the strategic importance to the West in general of having an alternative source of energy that might reduce dependence on the Middle East, it was not surprising that expectations were riding high.

What few seemed willing to realize at the time was that the Kremlin had an altogether different agenda. Only days following the BP-TNK ceremony, the opening rounds were fired in a legal battle that would end in a *de facto* expropriation of Yukos and in the incarceration of the company's CEO and main owner, oligarch Mikhail Khodorkovsky.²⁹

The main beneficiary of the dismantling of Yukos was Rosneft, at the time the only piece of the old Soviet oil industry that had remained in state hands. Back in the spring of 1998, the Kiriyenko government had tried to sell it too, but failed because of the approaching economic crisis. As the Kremlin set out to break up Yukos, and to sell the pieces at auctions in order to recoup outstanding taxes, Rosneft came in handy. Via a series of rigged proceedings, it succeeded in picking up all the major assets. Following the absorption of Yuganskneftegaz, which had constituted the main operation of Yukos, Rosneft emerged as Russia's second largest oil company.

²⁹ The first step in what was to be known as the "Yukos affair" was taken on July 2, 2003, with the arrest of Platon Lebedev, then CEO of Group Menatep and a major stakeholder in Yukos. Although at first he was not charged with offences relating to Yukos, it soon enough transpired that this was indeed what the "affair" was about. Following lengthy legal wrangling that included seizure of massive documentation from Yukos offices, Mikhail Khodorkovsky was himself arrested on October 26, 2003. At the conclusion of what can only be referred to as a show trial, in May 2005 he was sentenced to nine years in a Siberian prison camp. On a parallel track, the Kremlin also set out to destroy Yukos. Presenting claims for back taxes that reached close to \$30 billion, it first froze the company's assets and then proceeded to sell off its operations at a series of rigged auctions. Despite substantial efforts to win international litigation cases, the former stockholders have – to date – not been successful in making any headway against the Russian state.

The conclusion of the Yukos affair provided a powerful message to other members of the former oligarchy, who would prove more than willing to bow to the Kremlin's demands. In September 2005, oligarch Roman Abramovich accepted to surrender Sibneft to Gazprom for \$13 billion, and in July 2007, billionaire Mikhail Gutseriev announced that he was giving up control over Russneft. The latter deal followed upon a year of steadily mounting pressure. Gutseriev's initial attempt to resist selling his company, and to make public the pressures that were brought to bear on him, was interesting to watch but in the end proved futile.

Gazprom's acquisition of Sibneft, to be renamed Gazpromneft, was an important addition. With known gas reserves that are the third largest in the world (measured in barrels of oil equivalents), and with a daily output of gas that equals 10 million barrels of oil,³⁰ Gazprom now also emerged as a major player in oil. Although the two energy giants have often been at odds with each other, both Rosneft and Gazprom remain firmly under Kremlin control and together they provide a formidable boost to foreign policy.

On a parallel track, the Kremlin complemented its assault against the oligarchs with a drive to roll back the influence of foreign oil majors over Russian energy policy. The first victim was the involvement by Shell in the giant Sakhalin II gas field. The means chosen was to advance serious ecological concerns that might cause the company's concession to be revoked. Faced with this pressure, by December 2006 Shell felt compelled to sell its 51 percent stake in the operation to Gazprom. Following this change in ownership, it rapidly transpired that the ecological problems were no longer as serious as had been previously thought.

The next victim was BP-TNK, which had nurtured grand ambitions to develop the giant Kovytkha gas field. Its license, however, included a clause concerning production targets that had proven impossible to reach. As the company was denied access to the Gazprom-controlled pipeline grid, its only option was to sell gas on the local market, which fell far short of the stipulated volumes. Faced with the risk of losing its license, in June 2007 BP-TNK decided to sell its 63 percent of the stock. The buyer, again, was Gazprom.

The most recent victim is Exxon, whose operation of the Sakhalin I gas field had been linked to high hopes for exports to China. In this case there were neither

³⁰ Cited from www.russiaprofile.org, November 25, 2005.

ecological concerns nor production shortfalls, so another way had to be found. Shortly after Gazprom's takeover of the Kovytka field, Exxon thus began receiving clear signals that there would be no talk of any Chinese export. The likely outcome again will be that of a foreign oil company caving in to political pressure, and of Gazprom expanding its might even further.

In addition to the extension of Kremlin control over Russian production facilities for oil and gas, the energy weapon also entails control over the pipeline grid. While state-owned Transneft has a near-monopoly on oil pipelines, Gazprom controls almost the entire grid of gas pipelines. With this control over vital transport routes, the Kremlin has an effective stranglehold on nominally private and independent producers, foreign as well as domestic.

This stranglehold, moreover, is now in the process of being extended to cover exports of oil and – especially – gas to Europe.³¹ Once the Kremlin has secured control over the lion's share of energy imports to the European Union, it will be in a position to use this leverage in order to break any potential resistance to allowing Gazprom purchases of national distribution networks, and once that ambition in turn has been met, Moscow will quite literally have Brussels over a barrel. At the time of writing, it seems unlikely indeed that the EU will find the resolve necessary to preempt this outcome.

A Muscovite Pattern

Let us return now to Gaddy's portrayal of Putin as a rent manager, and use it as a bridge to our own portrayal of "boyar economics." The core principle of what we have referred to above as a Muscovite institutional matrix has been that of effectively suppressing the fundamental principles of market economy. In the following we shall demonstrate how this matrix emerged, in a series of steps that may well have been quite rational at the time but that over the centuries caused Russia to distance herself further and further from developments in the rest of Europe.

First and foremost was the preclusion of any type of formal constraints on the exercise of power, constitutional or otherwise. Whether this should be labeled as

³¹ In addition to existing gas pipelines that transit Ukraine and Belarus, the Kremlin is busy constructing a northern route – the Nord Stream – that will connect Viborg in Russia with Greifswald in Germany via an underwater pipe through the Baltic. In the south, it is planning for a South Stream pipe that will link the Caspian basin with southern and central Europe. The main ambition of the latter is to block the EU's plans to construct a pipeline – the Nabucco – that would bypass Russia.

autocratic or authoritarian, or be listed under some other fanciful label, is beside the point here. The core of the matter is that there have been no formal institutional means by which the ruler can be held accountable. At a time, in the fourteenth and fifteenth centuries, when the survival of Muscovy was constantly at stake, it may have been rational to allow one of the grand princely families to wield unaccountable power. What is more challenging to explain is how this form of rule could be transformed into a founding principle for the state as such; symptomatically, it was not to be even questioned until the end of the Empire, and it was to be resurrected soon thereafter, in Soviet garb.

The second step is a derivative of the first, and concerns the absence of enforceable property rights. Again the label is immaterial. Whether we choose to speak of conditional, warped or absent rights to private property, the core is that the ruler does not recognize that subjects have any form of unalienable rights, whether to property or otherwise. Again this may well once have been a rational solution. At times of serious threats to national security, forcing the grand prince to enter into lengthy bargaining with propertied boiars might have produced fatal consequences. With unaccountable power to mobilize and dispose of all resources at will, the ruler instead was in a position to wield effective defense. On this foundation it proved possible for Muscovy, despite its initially poor resources, to fend off all threats and to emerge as a regional great power.

The essence of the system that thus emerged was that of reducing even the most senior members of the nobility to the status of “service nobles.” While this was highly expedient in terms of mobilization of resources, it also implied that the ruler would have to accept responsibility for sustaining his servitors. The latter was accomplished in two ways. One was the allocation of service lands, known as *pomestiya*, where servitors could derive a living, and the other was postings as officials in areas where sustenance, known as *kormlenie*, could be extracted from the local population. As neither of these entailed any formal rights, and as there were no alternative modes of securing a living, the servitors were completely beholden to their ruler. It is highly symptomatic that the Russian word for state – *gosudarstvo* – literally refers to membership in the household of the master.

The system reached its formal apogee under Peter the Great, when the Table of Ranks formalized mandatory life-long service for all adults. Following Peter’s death, when consolidation of the Empire reduced the needs to maintain an often

incompetent service nobility, the system began to erode. The first step was taken in 1730, when Empress Anna restricted mandatory service to 25 years. In 1762, Peter III abolished the service requirement altogether, and in 1785 Catherine the Great introduced a Charter of the Nobility, which guaranteed nobles due process and private property.

While these formal steps can be easily construed as a case for Russian movement towards Europe, a movement that would be continued throughout the nineteenth century, we shall have to remain wary of looking merely at the formal rules. As it turned out, freeing the nobility from compulsion to serve was far from the same as encouraging them to seek other ways of securing their living. On the contrary, the norms and necessities of service remained so strong that the system survived *de facto* long after having been abolished *de jure*.³²

Service Class Revolutions

One of the most striking aspects of Russian historiography has been the difference of opinion regarding how to interpret the distinctive patterns of oscillation between reform and repression. Has it been the case that every reform that has been followed by repression has brought the underlying system closer to Europe, in a way that holds up promise of eventual success around the corner? Or has it, on the contrary, been the case that every ambition to reform has triggered powerful forces from within that soon enough result in a restoration of the *status quo ante* reform?

Perhaps the best way of portraying the essential dynamics of this process is to borrow Richard Hellie's notion of a Russian "service state," a concept that entails imposing strict hierarchical bonds of allegiance and obedience. In his presentation, long-term Russian history has been marked by three cases of "service class revolutions," namely those occurring under Ivan IV, Peter the Great and Joseph Stalin.³³ The periods of authoritarian economic growth and force projection that followed upon these respective "revolutions" were concluded by "times of trouble," which in turn led up to a restoration of the old order.³⁴ Hellie's metaphor is well in line

³² See further Hedlund, *op. cit.*, ch. 8.

³³ Hellie, Richard (1977), "The Structure of Modern Russian History: Toward a Dynamic Model," *Russian History*, vol. 4, no. 1.

³⁴ This use of the notion of repeated "times of trouble" as interludes or punctuations between cycles of repression and liberalization is central also to Alexander Yanov's theory on the origin and evolution of Russian autocracy. (Yanov, Alexander (1981), *The Origins of Autocracy: Ivan the Terrible in Russian History*, Berkeley and Los

with our above argument on forced resource mobilization, leading cyclically to exhaustion, collapse and restoration of the *status quo ante*.

By far the most important implication of presenting current Russian developments against this historical backdrop is that it places in focus the traditional primacy, from Muscovy onwards, of opaque and personalized games of influence over transparent and enforceable rules of the game. There is nothing really remarkable about this. In a tradition that rests on the rule of men rather than on the rule of law, rules and regulations will always be trumped by personal friendships and loyalties. Russians know this fine well. It is the way that the game has been played for centuries, and they have amassed great skills in playing it.³⁵ But does this also mean that they will keep on playing the very same game, with the same outcome?

The Putin Transition

At the time of writing, it seems fairly certain that Putin will hold on to power. By exactly what means this is to be achieved will most likely remain shrouded in fanciful speculation, right up until the very end of the election season. The bottom line, however, is that we may realistically look forward to an extended period of rule that continues along the trajectory of Putin's second term in office. There are several reasons to look upon this prospect with some apprehension, reasons that extend beyond the increasingly shady record on human rights abuses.

From a social science perspective, the main question that must be asked today concerns sustainability. Let us assume that Hellie is correct in suggesting that developments under Putin may constitute a "fourth service class revolution."³⁶ The most immediate implications would be those of reimposed authoritarian control, of retrogression to conditional property rights and the associated dependence on playing personalized influence games, and of recasting the state in the role as an

Angeles, CA: The University of California Press.) See especially his presentation of the "Political Spiral" (on pp. 59-65).

³⁵ Ledeneva, Alena V. (1998), *Russia's Economy of Favors: Blat, Networking and Informal Exchange*, Cambridge: Cambridge University Press.

³⁶ Hellie, Richard (2005), "The Structure of Russian Imperial History," *History and Theory*, Theme issue 44, December, p. 112.

engine of growth. In short, it would represent a triumph of boyar economics over the attempted introduction of market economy.

While such an outcome would clearly represent a major deviation from the expected path of transition to democracy and a rules-based economy, when it comes to assessing the sustainability of the new course we are still left in the dark. Based on the teachings of standard textbook economics, suppressing the main foundations of market economy should lead to loss of efficiency and thus to deteriorating performance. Yet, the experience of the 1990's was that seeking to introduce market economy did not bring about the expected gains in efficiency.

Can it thus be that the traditional Muscovite pattern of boyar economics is somehow better attuned to the surrounding dimensions of the institutional matrix of Russian society, and that the present policy of moving backwards into the future does represent a correct prescription for taking Russia out of the "time of trouble" that marked the Yeltsin years?

A superficial way of approaching this question might be to look at macroeconomic performance and argue that the current policy is working, either because it rests on a steady improvement in the basic institutions of market economy or despite the fact that this is not happening. As we shall argue in the following, however, such a narrow focus on the numbers will not get us very far. This is so not only due to the fact that the success story thus far is way too hollow to allow any conclusions to be drawn. More importantly, as Khanin was cited noting above, in order to make a proper assessment of sustainability we must take a broader perspective that includes human capital development and the moral condition of society.

At the outset of this paper, it was suggested that the question of whether Putin's policy will be successful hinges on whether it is conducive to such broad-based entrepreneurship and innovation from below that constitutes a *sine qua non* for achieving a competitive edge on global markets. As this in turn was linked to Olson's concepts of "market augmenting government" and "property rights intensive production," we have also included here the role of the state as an impartial third party enforcer, and the presence of a legal culture that supports a belief in contracts and in enforceable rights more generally.

As we have presented it above, boyar economics does not entail any of these fundamental components of what is normally understood as a high performance

economy. But does this also mean that Russia's Muscovite strategy of authoritarian mobilization will underperform the West? From a social science perspective, this really is the key question. Is Russia still in transition towards market economy? Has it failed in this ambition, or has it perhaps rediscovered a model that will permit high performance? These questions touch on the very core of our understanding of "transition," and of "systemic change" more generally, and they illustrate how little social science has been able to contribute towards uncovering what is really going on here.³⁷

Rather than pursue this track, we shall return here to the question of sustainability, and we shall begin by looking at it from a political perspective. At a casual glance, Putin's authoritarian restoration does come across as a great success. *Inter alia*, the duma has been reduced to a rubber stamp, the media have been muzzled, and the once powerful regional barons have been cowed. These moves, moreover, have met with sweeping popular approval. A quick look at recent opinion polls will tell us that Russians overwhelmingly feel that democracy is a fraud, that private property is a façade for corruption, and that outsiders are not to be trusted. They feel comfortable with a one-party state, place order before freedom, and have little problem with censorship of the media. Above all, they want Russia to be a great power again, and they see more government involvement in the country's economic life as a way to reach that goal.³⁸ Putin is set to deliver on all counts.

Beyond these generally worrisome trends, it must, however, be recognized that the sustainability of Putin's model of development hinges not on popular approval or on the effective suppression of democratic rights and freedoms. While these are important components, the acid test will lie in the Kremlin's ability to maintain balance between rival factions. Here we may usefully recall what Gaddy had to say about the role of Putin as a rent manager.

In the plethora of conspiracy theories that have been floated to suggest ways in which Putin might be prevented from leaving office, one of the more sinister versions begins with a decision to anoint one of the two main contenders for succession, i.e. Sergei Ivanov or Dmitry Medvedev. As this promotion of one side in the struggle for power would present the other side with a threat of imminent asset

³⁷ On the role of social science in seeking to understand Russia's transition, see further Hedlund, Stefan (2008), "Such a Beautiful Dream: How Russia did not become a Market Economy," *The Russian Review*, forthcoming.

³⁸ For a summary of the results of several polling organizations, see Pipes, Richard (2004), "Flight from Freedom: What Russians Think and Want," *Foreign Affairs*, vol. 83, no. 3.

redistribution, the losing side would in turn have a powerful incentive to create such a spectacular incident that it would be simply impossible for the president to step down.

Irrespective of how seriously such speculation should be taken, it does point at the crucial importance of managing the sharing of rents.³⁹ It is also precisely this that makes the project of strengthening the “power vertical” assume such a distinctly Muscovite pattern of yet another “service revolution.” What makes this perspective so especially important at the present time is that the transition from Yeltsin to Putin has meant a whole new set of friends being brought into the game.⁴⁰ While there was nothing surprising as such in this, it does highlight the role of the president in managing built-in rivalry for wealth and power.

A closer look at the new guard that makes up Putin’s friends will show two important features, namely that they are almost all from the old KGB and that they are almost all in business.⁴¹ While the former adds an ominous shade to questions of democracy and human rights, the latter tells us much about how the game will continue to unfold. The business interests of Putin’s men have spread out of the energy complex, into transport, arms and metals. What they are presently busy creating may be viewed as a holding company that controls a steadily expanding share of Russian GDP, and that places massive slush funds at the Kremlin’s disposal.

It might be tempting to say that this was precisely what emerged with the oligarchs under Yeltsin, but that would miss the whole point of the argument. The crucial difference between Yeltsin’s oligarchs and Putin’s neo-boyars lies in the two dimensions that were indicated above as hallmarks of the Yeltsin era, namely property rights and access to foreign friends. While some of the most favored amongst the new class of power holders will clearly be both wealthy and powerful, they will also be held in constant awareness of the fragility of their personal positions.

³⁹ It may be noted that this practice has deep roots. In order to maintain balance between their servitors, grand princes in old Muscovy found it necessary to practice rotation of boyars between lucrative *kormlenie* postings. (Vernadsky, George (1953), *A History of Russia, Volume III, The Mongols and Russia*, New Haven: Yale University Press pp. 359-60.)

⁴⁰ One might draw another long parallel here, back to times of royal weddings in old Muscovy when a whole new set of relatives was brought into the inner circle. In the words of Edward Keenan, these were the times when “one heard the thud of limp bodies in the Kremlin.” (Keenan, Edward (1986), “Muscovite Political Folkways,” *Russian Review*, vol. 45, no. 2, p. 144.)

⁴¹ For a detailed survey of the membership of Putin’s elite, and of the blurred line of demarcation between “liberals” and “siloviki,” see Kryshtanovskaya, Olga and Stephen White (2005), “Inside the Putin Court: A Research Note,” *Europe-Asia Studies*, vol. 57, no. 7.

Where Yeltsin's cronies had at least formal rights to property, and very real rights to move their wealth abroad, Putin's men have neither. They control their assets only for as long as they please the Kremlin, and they have no safe places abroad where they would be welcome. Like the boyars of old Muscovy, they will thus be completely dependent on their tsar – they have no personal property, and they are unable to enter into the service of another prince.⁴²

Returning again to the question of sustainability, this resurrection of an old Muscovite institutional arrangement is at the same time very robust and very fragile. It is robust in the sense that by making all servitors cognizant of the fact that they are completely dependent on playing personalized influence games with the Kremlin, there will be no serious risk of any form of challenge to the supreme power. Throughout Russia's long and tumultuous history, there have symptomatically only been three cases of attempts from below to impose restrictions on the ruler, and they all failed.⁴³ It is, however, at the same time also fragile in the sense that the crucially important function of rent management has become so dependent on the price of hydrocarbons. A sudden and substantial drop in the market would send shock waves through the system that might prove overwhelming. As this volatility represents something entirely new, it is hard to say what the consequences might be. It does, however, lead us over to the economic dimension of Putin's policy, where the question of sustainability becomes even more challenging to assess.

Based on what has been said above, there are solid grounds to worry about macroeconomic performance. No matter what scenario we choose to lay out, it will remain necessary to start from the fact that the current Russian economy faces "colossal difficulties," which according to Khanin "may be insurmountable." In his view, the main items on the list are "the extreme ageing and rapid decline of fixed capital, the rapid diminution of reserves of raw materials, the huge reduction in intellectual potential as a result of the brain drain, the worsening in the quality of education and the cuts in the post-Soviet period in the scientific-intellectual sphere."⁴⁴

⁴² From this perspective, the present-day relation between President Vladimir Putin and ex-oligarch Boris Berezovsky may be viewed in terms similar to the classic relation between Grand Prince Ivan III and Prince Andrei Kurbskii, who fled Muscovy and entered in the service of Lithuania. Having betrayed their respective masters, both become apostate and faced life-long exile.

⁴³ The first was an attempt by a group of boyars, during the original "time of trouble," to strike a deal with the Polish Crown. The second was an attempt by the Privy Council, in 1730, to impose on the incoming Empress Anna a Russian version of the Magna Carta, and third was the violent Decembrist coup in 1825. At each such instance the old system emerged victorious.

⁴⁴ Khanin, *op. cit.*, p. 160.

All of this agrees well with what has been said above, and it clearly constitutes a tall order, where the bonanza of petrodollar windfall may at best provide the *necessary* conditions for turning the ship around. In order to overcome its backwardness, the Russian economy would need over the coming 15 years to achieve a growth in capital stock by 6-7 percent per year, which must be viewed against the current rate of *decline* by 2-3 percent per year. Arguing that the “current Russian socio-economic and political mechanisms are nonviable and extremely inefficient,” Khanin views as likely a reduction in GDP in the coming 10-15 years by 20-30 percent.⁴⁵

Whilst noting that this stands in sharp contrast to the Kremlin’s happy talk about a doubling of GDP, we again shall refrain from entering into the numbers game. The main scholarly challenge rests in uncovering the core of the system as such. If this can be achieved, assessing its macroeconomic performance will be all that much easier. Let us thus return to the question of economic sustainability, where the first step must be to recognize the growing might and influence of the *siloviki*.

The bottom line here is that the Kremlin’s new policy is concerned with so much more than just foreign energy policy, or even with putting cash into the pockets of a new set of cronies. What is really at stake is a complete reconfiguration of domestic power. What we are presently witnessing is the formation of a new boyar дума, an elite group of men who control the commanding heights of both the economy and the political sphere.

If we maintain our image from above, of a holding company that is emerging to control the commanding heights of the Russian economy, we may add here two further components out of Gaddy’s presentation of rent management, namely the Kremlin’s demands for “informal” taxes (contributions that are required not by law but by political pressure) and for bowing to foreign policy demands that might run counter to the interests of the company.⁴⁶ In both cases, the sovereignty of the enterprise is violated, often in a willful manner, and enterprise management is again made aware of the primacy of opaque influence games over transparency and enforceable rules.

While this is highly conducive towards enhancing the central mechanism of resource mobilization from above, it also produces tangible collateral damage. The most immediate item on this list is deteriorating corporate governance, and thus

⁴⁵ Ibid., pp. 160-61.

⁴⁶ Gaddy, op. cit., p. 40.

reduced efficiency in production. It is not only the case here that spooks tend to be less effective as corporate managers. We must also recognize that even the most effective of corporate managers would find their performance seriously impaired by having to engage in influence games of the type described above.

To these effects may be added that the increasingly wobbly nature of property rights, and the increasingly political nature of senior management, will have serious repercussions for the emergence of entrepreneurship and innovation from below, and as we have noted above it is in the small business sector that successes are born and raised.

Finally, and with respect to the pressing needs for increased capital formation, it is clear that the increasing influence of the managers of the “holding company” will place a heavy mark on the nature of future investment decisions. The real needs of the economy should be viewed not only in terms of a massive boost, but also in targeting investment so that the outcome will be restructuring, diversification and innovation. To Putin and his boyars, however, other priorities will dominate. Gaddy refers to this risk as a “bear trap,” the essence of which is that “a big investment program in Russia today would carry a huge risk of lock-in of the existing structure. That is, investment could make Russia’s problems worse.”⁴⁷

To an outside observer, it may seem strange indeed that the Kremlin is so obviously committed to keep on playing the same old Muscovite game. The track record of the past few centuries is not encouraging, and numerous warning bells indicate that the present course is leading in the wrong direction. The problem with such impressions is that they fail to appreciate just how path dependent the Russian way has become. From the Kremlin’s point of view, the Muscovite model has numerous advantages that clearly trump the downsides. Most importantly, it offers instruments of control that may be used for the dual purpose of keeping servitors in line and of mobilizing resources for priority project. If the price to be paid for this control is reduced efficiency then so be it. Dazzled by the sudden accumulation of petrowealth, Kremlin managers may even be deluded into thinking that their model is superior also in terms of efficiency.

We should be wary here of confusing path dependence with determination. Over the centuries, Russia has been faced with numerous windows of opportunity,

⁴⁷ Ibid., p. 45.

where major changes in course have been implemented and where short-term successes have been scored. On every such occasion, however, the eventual outcome has been a reversal to the *status quo ante*. While it is surely the case that Russia has been modernized, and that the townscape has assumed a distinctly western style, it is also true that up to date Russia has failed to westernize. The most recent attempt that followed in the wake of the collapse of the Soviet order was the most valiant yet, but as Hellie suggests it is now being consumed by yet another “service class revolution.”

This, in conclusion, appears to be the real and lasting outcome of shock therapy and attempted systemic change – yet another return to traditional Muscovite games of *neglasnost* and of vicious infighting over seats close to the tsar, coupled with remuneration for “service” that takes place via a host of informal and clandestine channels. The Russian Federation will surely continue projecting an image of modernity and globalization, and foreign audiences will be playing along. It is all part of the game. Behind the façade, however, Kremlin rules again will be those of old Russia rather than of modern Europe.