
UNLOCKING NORTHEAST ASIA'S DEVELOPMENT POTENTIAL: THE RUSSIAN PARADOX

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1. INTRODUCTION

Russia's Far Eastern development potential is legendary. For centuries a bonanza has been impatiently anticipated, but despite enormous investments during the Tsarist and Soviet periods the promise has gone unrealized. This essay examines the reasons for these failures in an era of increased regional autonomy, and assesses prospects for an economic miracle in the Russian Far East, and Northeast Asia.

The Russian Far East is a vast mineral rich territory which includes the Republic of Sakha (Yakutiya), the Jewish Autonomous Oblast, Primorskii Krai, Khabarovsk Krai, Kamchatka Oblast, Magadan Oblast, and Sakhalin Oblast. It stretches 6.2 million square miles, 36.4 percent of the Russian Federation, but is sparsely populated with its 8.2 million inhabitants representing only 5.4 percent of the Russian population.

The region has undergone rapid industrialization since 1923. According to official statistics, under the Soviet strategy of rapid state led development, regional industry grew at near double digit rates from 1923-85, in tandem with the national average, although the pace of advance steadily decelerated after 1937 (Table 1).

Table 1
Industrial Growth in the Russian Far East
(Annual Compound Rates: Percent)

	1923- 1928	1928- 1932	1932- 1937	1946- 1964	1965- 1970	1971- 1978	1976- 1980	1981- 1985
Gross Output	12.4	14.2	27.7	9.0	8.8	6.1	5.8	4.2

Source: Pavel Minakir and Gregory Freeze, eds., *The Russian Far East: An Economic Hand-book* (Armonk: NY, 1994), pp. 36-42.

This allowed the region to attain a standard of living measured by average monthly wages and salaries 1970-89 approximately 70 percent higher than the Soviet average.

Table 2
Average Monthly Ruble Wages and Salaries in the
Russian Far East and the Soviet Union 1970-89
(Ratio: Russian Far East/Soviet Union)

	1970	1980	1985	1989
Russian Far East	204.1	286.2	320.6	426.2
Soviet Union	122.0	168.9	190.1	238.0
Ratio	1.67	1.69	1.69	1.79

Sources: Minakir and Freeze, *The Russian Far East*, pp. 322-324; *Narodnoe khozyaistvo SSSR 1985*, p. 397; *Narodnoe khozyaistvo SSSR 1989*, p. 373.

Method: The average monthly wages and salaries figures for the Russian Far East are unweighted oblast averages. The wage and salary data for the Soviet Union in 1989 were only reported for industry. This figure was adjusted to approximate aggregate average money compensation by applying the 1985 ratio of these variables.

Average per worker labor income in 1989 was 7,633 dollars computed at the official exchange rate, placing the Russian Far East solidly in the ranks of the advanced industrial nations, when account is taken of non pecuniary income in the form of free education, medicine, housing and leisure services. These indicators of course disregard physical adversities and the vagaries of the material technical supply system, but nonetheless suggest that the future is now; that the Russian Far East has already successfully developed under Soviet tutelage.

2. WESTERN ASSESSMENTS

Although western analysts recognize that the Russian assessment needs to be qualified in various respects to allow for the extraordinarily low level of processed exports, the inferior quality of domestic goods and the backwardness of business organization, the statistical evidence of industrial development is seldom seriously challenged, creating a profound paradox. As an affluent member of the Northeast Asian community, the Russian Far East should be cooperating with Japan and South Korea to bring capital and expertise to North Korea, China and Mongolia, but the situation is otherwise. The Russian Far East is seeking assistance from Japan, South Korea and the advanced capitalist nations of the west to finance its modernization and the harnessing of its vast, untapped resources. Should the Russian Far East be assigned the role of an advanced industrial region or an emerging economy in devising a strategy for Northeast Asian development?

The answer turns on whether ruble statistics are reliable estimators of value added. Until recently Soviet economists argued that they were, and most western specialists concurred, albeit with reservations. The arguments were ab-

struse. Marxists contended that ruble data reflected socialist labor use value, while neoclassical economists insisted that they could be made to measure production potential through adjusted factor costing. By subtracting turnover taxes, adding subsidies, deleting accounting profits and imputing interest and rent, western economists following Abram Bergson¹ maintained that adjusted ruble values could be crafted to approximate opportunity costs. The Soviet economy in this conception operated with considerable efficiency on its production feasibility frontier, differing from capitalism mostly because the mix of goods produced wasn't responsive to consumer demand. Industrial output calculated in adjusted factor cost rubles therefore corresponded broadly with neoclassical requirements except to the extent planners' and consumers' tastes diverged. From this perspective the development of the Russian Far East wasn't a statistical illusion. It was a phenomenon distinguished primarily by its socialist characteristics.

A large number of eminent economists including Frederich Hayek, Ludwig von Mises and Lionel Robbins disagreed, contending that Soviet production was more aptly conceived as planned chaos.² Factors weren't paid the value of their marginal products, and planners demand was capricious. Proof that adjusted factor costing couldn't correct these deficiencies, except under conditions too improbable to be taken seriously, however wasn't forthcoming until the collapse of the Soviet Union. It has now been shown that Hayek and his circle were correct.³ Adjusted factor cost ruble prices cannot measure value added because they are unlikely to be proportional to marginal factor productivities, and factor compensation is determined on non-competitive grounds.

This means that composite appraisals of industrialization that go beyond the mere counting of heterogeneous physical products must be computed in dollars, or some other readily intelligible common standard of value. Ideally this should be accomplished by observing the competitive dollar prices of tradables produced in the Russian Far East on the global market and applying them to each good but this was precluded by the Soviet state monopoly of foreign trade. Western analysts and agencies like the CIA were consequently compelled to use approximative methods, matching composite goods, occasionally

1 Abram Bergson and Hans Heyman, Jr., *Soviet National Income and Product, 1940-48* (New York, 1954).

2 Ludwig Mises, "Die Wirtschaftsrechnung im sozialistischen Gemeinwesen," *Archiv für Sozialwissenschaften* (April 1920), pp. 86-121, reprinted in English in F.A. Hayek, ed., *Collectivist Economic Planning* (London, 1935); Lionel Robbins, *The Nature and Significance of Economics* (London, 1932).

3 Steven Rosefielde and R.W. Pfouts, "Neoclassical Norms and the Valuation of National Product in the Soviet Union and its Postcommunist Successor States," *Journal of Comparative Economics* 21:3 (December 1995), pp. 375-389; Idem, "The Misspecification of Soviet Production Potential: Adjusted Factor Costing and Bergson's Efficiency Standard," in Steven Rosefielde, ed., *Efficiency and Russia's Economic Recovery Potential to the Year 2000 and Beyond* (Aldersgate, 1998), pp. 11-32.

making crude hedonic, or input cost adjustments and tacitly assuming that differences in product characteristics could be costlessly eliminated if western manufacturers chose to produce goods according to Soviet specifications. The results of these calculations routinely showed Soviet performance to advantage (Table 3), and were corroborated by Goskomstat's own estimates (Table 4).

Table 3
Soviet Aggregative Performance: Comparative GNP Size
(Percent of American)

	1955	1965	1970	1975	1977	1987	1989
CIA	40.4	49.9	-	61.7	59.5	69	67
Bergson	45.2	-	62.9	71.5	-	-	-

Sources: Imogene Edwards, Margaret Hughes, and James Noren, "U.S. and U.S.S.R.: Comparisons of GNP," in *Soviet Economy in a Time of Change*, Joint Economic Committee of Congress (vol. 1, 10 October 1979), Appendix A, Table A-4, p. 394; CIA, *Handbook for Economic Statistics*, CPS88-10001, September 1988, Table 8; CIA, *Handbook of International Economic Statistics*, CPAS92-10005, September 1992; Abram Bergson, *Productivity and the Social System-The USSR and the West* (Cambridge, 1978), Table 5.1, p. 49, Table 5.7, p. 67; Abram Bergson, "Comparative Productivity: The USSR, Eastern Europe, and the West," *American Economic Review* 77:3 (June 1987) (unpublished appendix, p. 10, 1b).

Table 4
Comparative Size Estimates of National Income
Soviet Union as a Percent of America
(Dollar Purchasing Power Parties)

1950	1960	1965	1970	1981	1988
31	58	59	65	67	64

Sources: *Narodnoe khozyaistvo SSSR 1922-1982*, p. 91; *Narodnoe khozyaistvo SSSR 1988*, p. 680.

Soviet GNP on these measures was typically fixed at approximately two thirds the American level. According to the CIA, the gross national product of Soviet Union was 3,791.7 billion dollars measured in 1991 prices making it far and away the second largest in the world. Russia itself, excluding the other former Soviet republics had a 2,309 billion GNP, which exceeded all rivals other than the United States, including Germany, Japan and France.⁴ Soviet per capita GNP on this basis was 13,137 dollars, close to the first development tier threshold of 15,000 dollars, just below the European Community mean at 68 percent of the American norm. Since as previously shown average monthly wages and salaries in the Russian Far East exceeded the average Soviet rate by nearly 70

⁴ CIA, *Handbook of International Economic Statistics*, CPAS92-10005 (September 1992).

percent, it would seem to follow that the region's per capita GNP might have surpassed America's.

This of course is nonsense, but the real situation couldn't be clarified until Russian goods became freely exportable during the nineties. The data in Table 5 illustrate what has happened to perceptions of Russian per capita GNP in 1989 after the ruble's competitive devaluation and Goskomstat's subsequent revision of its purchasing power parities. Russia's GNP and per capita national income decline on Goskomstat's own purchasing power parities (not exchange rate estimate) by nearly 40 percent.⁵ GNP and per capita GNP fall to 1.4 trillion and 9,491 dollars respectively in Table 5, panel II, while the revision computed through the exchange rate is even more severe. GNP presented in panel III drops to 0.5 trillion, with per capita national income at 3,388 dollars. The verdict of the market clearly discredits governmental and scholarly estimates made when Russia was a closed economy. Instead of GNP and per capita income placing Russia in the world's first development tier in 1989, they consign it the upper tail of the fourth, with a standard of living less than 15 percent of America's.⁶

The culprit is the negligible international value of Russia's industrial goods, and the capital durables used to produce them. As a manufacturing giant with annual industrial wages through the first eight months of 1995 running 1,283 dollars,⁷ Russia should have been able to mass export its manufactures, but instead industrial exports contracted two thirds from eighteen percent in 1989 to six percent, while machinery and equipment comprised a third of the import total in 1995. Stripped of its non-competitive industrial wares, Russia finds itself more or less where it began at the outset of the Bolshevik revolution with an export economy chained to natural resources.

As the import data suggest, Russian domestic consumers have no higher regard for the nation's manufactures, substituting foreign for domestic consumer goods whenever possible. This predictably has played havoc with industrial production. Real industrial output declined 50 percent between 1991 and December 1995,⁸ while services expanded, causing the industrial share of GDP to

5 The purchasing power parities are computed by the OECD based on data provided by Goskomstat. The purchasing power parities have been revised downward further since 1995 (See Ch. 10 of this collection). Alexei Ponomarenko's estimate for 1995 in current purchasing power parity dollars is 3,813 (average gross regional product); for 1994 the figure computed through the exchange rate is 1,626 dollars which is compatible with the estimate shown in Table 5. Ponomarenko is Deputy Chief of the Department of National Accounts; Russian State Committee for Statistics.

6 The per capita GNP figure cited earlier referred to the Soviet Union which placed it in the second tier. Russia's GNP per capita in 1989 was 15,631 dollars, putting it in the first tier.

7 Russian European Centre for Economic Policy, *Russian Economic Trends 1995* 4:4 (London, 1996), pp. 130 and 140.

8 *Russian Economic Trends 1995*, Table 57, pp. 66-67.

contract from more than a third to less than a quarter.⁹ Like East Germany before it, Russia is in the process of writing off its nearly worthless inventories and industrial capital stock. These are the very same goods previously valued in established ruble prices, adjusted factor cost and purchasing power parities that drove Goskomstat's, the CIA's and Bergson's growth series. Then they were interpreted as value added, now it's evident they were merely value imagined.

Table 5
Changed Perceptions of Russia's Production Potential
(Billions of 1991 Dollars)

	1989	1995
I. CIA		
GNP	2,309	1,154.5
Percent of U.S.	40.8	17.9
GNP per Capita	15,631	7,722
Percent of U.S.	68	31.5
II. PURCHASING POWER PARITY (1995)		
GNP	1,402	701
Percent of U.S.	24.8	10.9
GNP per Capita	9,491	4,689
Percent of U.S.	41.3	19.1
III. EXCHANGE RATE		
GNP	500	250
Percent of U.S.	8.8	3.9
GNP per Capita	3,388	1,672
Percent of U.S.	14.7	6.8

Sources: CIA, *Handbook of International Economic Statistics*, CPAS92-10005, Tables 7 and 21, pp. 25 and 39; "The Russian Economy-Stabilization at Last?," *Transition*, World Bank, 6:5-6 (1995), p. 20; *Russian Economic Trends 1995*, Table A1, p. 112 and Table 27, p. 35; Economic Commission for Europe, *Economic Survey of Europe in 1993-1994* (United Nations, New York and Geneva, 1994), Table 2.2.1, p. 33; Economic Commission for Europe, *Economic Survey of Europe in 1994-1995* (United Nations, New York and Geneva, 1995), Table 3.1.1, p. 70; U.S. Department of Commerce, *Survey of Current Business*, 75:5 (1995), Table 7.1, p. 23; *Survey of Current Business* 74:8 (1994), Table 7.1, p. 32.

Method:

GNP: The CIA reported its geometric mean estimate of Soviet GNP in 1989 valued in 1991 prices at approximately .50 which converts to a dollar estimate of about 67 percent. The dollar figure is $.67 (5,659.3) = 3,791.7$ bil-

⁹ *Russian Economic Trends 1995*, Table 55, p. 64.

lion dollars. Russia's ruble share of Soviet GNP was .609, implying a dollar value of $0.609 (3,791.7) = 2,309$ billion dollars in 1991 prices.

According to the figures published in the *Economic Survey of Europe in 1993-1994*; *Economic Survey of Europe in 1994-1995*, Russia's GNP fell precisely 50 percent from 1989 through the first quarter of 1995. Russia GDP in the first quarter of 1995 can be estimated at $0.5 (2,309) = 1,154.5$ billion dollars. Cf. *Russian Federation: Report on the National Accounts* (Goskomstat and World Bank, Moscow, October 1995).

The American GNP (GDP) in 1989 and 1995 valued in 1991 prices were respectively 5,659.3 and 6,432.9 billion dollars. The percent of U.S. entries were calculated with these figures.

GNP per Capita: Population statistics derived for Russia are taken and estimated from CIA data for 1989 and after. The American figure is from the same source for 1989 and the *Survey of Current Business* for 1995. The 1989 figure is 22,982; for 1995 it is 24,514. Purchasing Power Parity: Russia's GDP in 1995 was 1,655,000 billion rubles. The average monthly purchasing power parity exchange rate was 2,224 rubles per dollar. The dollar value of the GDP therefore was 744 billion in 1995 prices and 701 in 1991 prices. The corresponding per capita figure in 1991 prices is 4,689. The 1989 GNP by construction is double the 1995 estimate, and per capita GNP is 9,491 adjusted for the intervening population growth (the population in 1989 was 147.6 million, in 1995 149.5 million).

Exchange Rate: Russian GDP in 1995 was 96 percent of 1994 (586,580 billion rubles). The exchange rate for 1994 was 2,250, before the government began intervening in the Spring of 1995. The dollar GDP is 266 billion dollars, in 1994 prices and 250 billion adjusted for comparability to 1991 prices. The 1989 figure is double this by construction.

N.B.: The GNP decline 1989-1995 reported in *Russian Economic Trends, 1995* (Russian European Center for Economic Policy) is 39 percent in line with the revisions detailed in *Rossiiskaya Federatsiya: Doklad o natsional'nykh schetakh*, Goskomstat, October 1995, Tables 1-3, pp. xx-xxi. If the revised figure is substituted for the 50 percent contraction previously reported, the comparative size of the 1989 GNP is further *diminished*.

It can of course be counter argued that Goskomstat's new purchasing power parities, and the market exchange rate prevailing in 1994 are wrong.¹⁰ The ruble has undergone a managed appreciation since the Spring of 1995 which increases

10 Yu. Ivanov, "O mezhdunarodnykh sopostavlenniyakh VVP," *Voprosy ekonomiki* 3 (1999), pp.112-127 argues that dollar purchasing power parities "experimentally" derived according to methods employed in a 1996 OECD study indicate that Russia's per capita GDP in 1996 is 27 percent of the U.S. figure. This estimate is 35 percent greater than the purchasing power parity figure shown in Table 5 and places Russia in tier 3, the mid range of the United Nation's five tier development classification. The figure is also 74 percent higher than Ponomarenko's estimate, which implies a standard of living in tier 4 (underdeveloped), in the vicinity of Thailand. Ivanov doesn't explain how his "experimental" purchasing power parities are derived, and does not appear to appreciate that cost based composite good purchasing power parities exaggerate global market value.

the comparative size of the Soviet GNP in 1989 from 14.7 to 18.7 percent of America's, but as the government decision in May 1996 to tilt the managed exchange corridor indicates there is little upside potential left until Russia can supplement natural resources exports with competitive manufactures and services. Whatever, the precise comparatives the big picture is clear. Hayek was right. Superior communist growth judged from a competitive international standard was a cruel illusion. The Russian Far East due to more than seven decades of mis-industrialization remains severely underdeveloped by competitive global standards. Its abundant natural resources may permit consumption to substantially outshine China, North Korea and Mongolia, but its ability to manufacture world class goods is negligible.

3. INDUSTRIAL POTENTIAL OF RUSSIA'S FAR EAST

The preceding reappraisal of the Soviet past has profound implications for Russia's future. It suggests that even if the collapse of the Soviet Union hadn't triggered a hyper-depression, the Russian Far East was and is likely to remain economically underdeveloped judged from the standpoint of per capita GDP for a long time to come. Its plight in 1996 after a 40-50 percent contraction in the GDP of the Russian Federation is correspondingly bleak.¹¹ The current dollar value of Russia's GDP calculated at the exchange rate prevailing in 1994 as shown in Table 5 is only 3.9 percent of America's. Per capita GDP is 1,672 dollars in 1991 prices, placing Russia in the upper tail of the fourth development tier, near Thailand, and is apt to deteriorate further until either industry contracts to its competitive core, or other sectors expand.

Over the long term, if the Russian Far East successfully transitions it can gradually recover lost ground, and ascend the development ladder toward the standards achieved in the west. But for the near term the crucial point to grasp is that its development prospects are handicapped by the legacy of Soviet mis-industrialization. The capital stock is substandard, unimproved by decades of value imagined, and probably cannot be cost effectively modernized because of its infungible embodied technologies. Soviet communism may be fading from Russia's landscape, but its poisoned legacy of mis-industrialization lingers on.

4. NORTHEAST ASIAN MIRACLE?

The World Bank's report on the East Asian Economic Miracle in 1993 generated considerable speculation about whether the success of Japan and the

11 Goskomstat Rossii i Mirovoi bank, *Rossiiskaya Federatsiya...* A team of World Bank and Goskomstat economists recently reduced the estimated size of Russia's depressed GNP from 50 to approximately 40 percent (allowing for the subsequent, continuing decline), but internal inconsistencies in their own tables makes this recalculation unreliable. The IMF periodically suggests that Russian GDP is still underestimated by 20 percent, but it is unclear whether this was also true in 1989.

Table 6
The Composition of Russian Foreign Trade: 1995
 (Billions of Dollars; Shares in Percent)

	Exports			Imports	
	Dollars	Share		Dollars	Share
Raw Materials and Processed Natural Resources	53,943	69.7	Food, Clothing, Medicine	9,119	19.6
Machinery and Equipment	4,635	6.0	Machinery and Equipment	15,484	33.4
Other	18,764	24.3	Other	21,798	47.0
Total	77,342	100.0	Total	46,401	100.0

Source: *Russian Economic Trends 1995* 4:4, Table 79, p. 85; Table 80, p. 86.

four Tigers (Singapore, Hong Kong, Taiwan and South Korea) could be replicated in Northeast Asia, and how this might be best accomplished.¹² Judged by the praise heaped on the Tigers for shunning managed development, prospects for the relatively controlled regimes of China, North Korea, Mongolia and the Russian Far East might appear grim, but Japanese economists of various persuasions are reluctant to accept this inference.¹³ Some have a high regard for the Japanese approach to managed development believing either that emerging members of the Northeast Asian community can independently emulate democratic corporatism or will benefit by accepting Japanese guidance in accordance with Kanemae Akamatsu's concept of "flying geese."¹⁴ Some believe that improved versions of traditional planning will suffice, while others have confidence in the creative potential of unconventional "transition" markets that blend socialist and capitalist institutions. Moreover, many in the international community like Anders Åslund and Michel Camdessus, Director of the International Monetary Fund contend that Russia, and presumably the Russian Far East have already completed their transition to free enterprise allowing the region to follow in the footsteps of the Tigers without being impeded by government controls.¹⁵

Hope once again appears to be triumphant over experience, with businessman, scholars and statesmen prepared to believe that Russian institutions and systems cannot frustrate their preferred strategy for rapid re-industrializa-

12 Paul Krugman challenged this assessment in the mid nineties. See Paul Krugman, "The Myth of Asia's Miracle," *Foreign Affairs* 73:6 (1994), pp. 62-78. The financial crisis which has swept Asia since the Fall of 1997 enhances the credibility of Krugman's position.

13 Edith Terry, "Miracle: The East Asian Paradigm," *Atlantic Economic Journal* (September 1996).

14 Pekka Korhonen, "The Theory of the Flying Geese Pattern of Development and Its Interpretations," *Journal of Peace Research* 31:1 (1994), pp. 93-108.

15 Anders Åslund, *How Russia Became a Market Economy* (Washington, D.C., 1995).

tion, modernization and development. At the risk of seeming churlish, it may be useful to dash cold water on all five stratagems. First, there is no cultural basis for Russia independently adopting Japanese democratic corporatism. Second, there is no possibility that the Russian Far East would accept a subordinate position in a Japanese led development flock. Third, the Soviet Union invested a fortune in trying to reform the traditional planning system and there are no grounds for supposing that the Russian Far East will succeed where the Soviets failed. Fourth, there is no basis for believing after seven years of uninterrupted contraction, that the growth promoting characteristics of the Russian Far East's mixed system can seriously rival the forces of free enterprise exemplified by the Tigers. And finally, contrary to Åslund's and Camdessus's assertions, headway on balancing the state budget, liberalization and collectivist privatization are insufficient to justify the claim that the Russian Far Eastern economy has transitioned to competitive capitalism.¹⁶ Entrepreneurial initiative remains stifled by state regulation, over taxation, restrictive credit, monopoly and mafia machinations. As already previously demonstrated the Russian economy has deindustrialized, collapsing to its natural resource base and the derivative services it engenders, including the substitution of imported for domestic consumer goods. Statistics on Japanese trade with the Russian Far East illustrated in Table 7 show precisely the same pattern. None of this proves that the Russian Far East can't reindustrialize and stimulate Northeast Asian growth, but it does suggest that it won't happen spontaneously of its own accord. A new modernization strategy is required that is at once compatible with Russian

Table 7
The Composition of Russian Foreign Trade with Japan: 1994
 (Billions of Dollars; Shares in Percent)

	Exports			Imports	
	Dollars	Share		Dollars	Share
Raw Materials and Processed Natural Resources	2,106	97.3	Food, Clothing, Medicine	0	0
Machinery and Equipment	22	1.0	Machinery and Equipment	585	53.0
Other	37	1.7	Other	519	47.0
Total	2,165	100.0	Total	1,104	100.0

Source: Foreign Economic Relations of the Russian Federation, Goskomstat, MFER, Moscow, 1994, reported in Economic and Social Commission for Asia and the Pacific, *Trade and Investment Complementarities in North-East Asia* (UN, 1996), Tables 4 and 5, pp. 226-227.

16 Gregory Yavlinskii, "Russia's Phony Capitalism," *Foreign Affairs* 77:3 (1998), pp. 67-79. Åslund appears to have altered his prior position. See his "Rentoorientirovanoe povedenie v Rossiiskoi perekhodnoe ekonomike," *Voprosy Ekonomiki* 8 (1996), pp. 99-108.

culture, and capable of constructively channeling the resources and skills of the region toward self-sustaining advanced industrial development.¹⁷

5. A GERSCHENKRON-AOKI SYNTHESIS?

The predicament confronting the Russian Far East is hardly novel. Alexander Gerschenkron demonstrated long ago that during the course of the last millennium Russia repeatedly found itself in a condition of acute economic backwardness which it sought to overcome by means of state intervention.¹⁸ This strategy which relied primarily on state orders and mercantilist preferences during the latter half of the nineteenth century generated two successful growth spurts 1860-1880 and 1890-99, but its efficacy waned thereafter in the wake of the Russo-Japanese war and the 1905 revolution due to an erosion of entrepreneurial vitality attributed to corrupt banking practices and cartels. The approach was revived with catastrophic consequences during War Communism and then applied with more apparent success by Stalin during the industrialization drive of the thirties. The essence of the technique both in the Tsarist and Soviet periods was the mobilization of resources. Gerschenkron thought that this was sufficient, but as demonstrated earlier in this essay the Soviet effort resulted in an unprecedented, colossal mis-industrialization because development wasn't guided by globally competitive market forces. In retrospect, it is now obvious that state intervention isn't a sufficient condition for sustained modern growth. It may suit some Russian cultural requirements, but will only produce the desired effect if combined with other elements.

Masahiko Aoki has addressed this problem in another context by showing that Paretian neoclassical general equilibria are only optimal for a particular culture-conditioned economic system.¹⁹ He argues that the Japanese model may be superior to the competitive American paradigm even though some of the axioms of the latter are violated due to compensating efficiencies, and sug-

17 On July 1, 1996 *Nezavisimaya gazeta* published an open letter from leading Russian and American economists including Leonid Abalkin, Stanislav Shatalin, and Nobel prize winners Wassily Leontief, James Tobin and Lawrence Klein arguing that government should play a greater role in the transitional economy since laissez-faire policies have failed to achieve the desired results (*OMRI Digest*, No. 128, Part 1, July 2, 1996).

18 Alexander Gerschenkron, "Economic Backwardness in Historical Perspective," in Gerschenkron, *Economic Backwardness in Historical Perspective* (Cambridge: Mass., 1966), pp. 5-30; Idem, "Russia: Agrarian Policies and Industrialization, 1861-1914," in Gerschenkron, *Continuity in History and other Essays* (Cambridge: Mass., 1968), pp. 140-248.

19 Masahiko Aoki, Hugh Patrick and R. Sheard, "The Japanese Main Bank System: An Introductory Overview," in Aoki and Patrick, eds., *The Japanese Main Bank System: Its Relevancy for Developing and Transforming Economies* (Oxford: UK, 1993); Masahiko Aoki and Hyung-Ki Kim, eds., *Corporate Governance in Transitional Economies: Insider Control and the Role of Banks* (Washington, D.C., 1995).

gests the same might be true for a properly designed Russian alternative. For example, labor immobility associated with lifetime employment may be offset by the continuity of corporate knowledge. Or collusion in restraint of trade caused by the keiretsu system may be compensated by socially constructive cooperation.

In the case of the Russian Far East special mechanisms are needed to coax the state and elites into establishing a dependable set of property rights and regulations that promote competitive entrepreneurship, investment in globally viable ventures, labor effort and full employment. These mechanisms must be designed to counter monopoly, asset stripping, extortion, expropriation and capital flight which incline Russian businessmen to focus on short term profiteering instead of socially beneficial region building. In some cultures these institutions might generate themselves spontaneously because predatory behavior diminishes most people's ability to create long term wealth, but Russia's emerging elites don't see it that way, preferring a bird in hand today to two in the bush tomorrow. As long as this attitude persists, it will be self-fulfilling because businessmen will refrain from taking the risks which make general future prosperity possible.

A clear vision of culturally appropriate institutional reform thus is likely to be a prerequisite for successful development. Without a socially sanctioned consensus between the state and elites on how to transform the dysfunctional aspects of Russia's laissez-faire into a system fostering national and regional welfare, liberalization is apt to serve as a foil legitimating elite profiteering at everyone else's expense.

6. GAIATSU: EU FUNCTIONALIST ENGAGEMENT

Stephan De Spiegeleire however has suggested that regional forces may succeed where the center has failed. The European Union in his view is intentionally striving to transform post-Soviet culture through a process of functional engagement both with the center and the regions following the security model adopted in Western Europe after the Second World War. His data indicate that regional authorities are avidly seeking foreign investment, and improving business practices, prompting him to surmise that in the not too distant future Russia will be transformed into a federation of regionally Pareto efficient market capitalist subeconomies.²⁰ Thus if the G-8 engineered revolution from above aborts, as it did during the August 17, 1998 financial crisis, it will be re-engendered from below.²¹

20 Spiegeleire is a research fellow at the Institute for Security Studies, Western European Union. See Ch. 12 of this collection.

21 For two alternative viewpoints on the crisis which Spiegeleire failed to foresee see Yu. Ol'sevich, "Institutsionalizm - novaya panatseya dlya Rossii?," *Voprosy ekonomiki* 6 (1999), pp.27-42; Evgenii Gavrilentov, "Permanent Crisis in Russia: Selected Problems of Macro-

Regional distinctions in this conception are largely irrelevant, and only play a role insofar as they permit provincial authorities to circumvent the illiberal policies of the center. Clearly, if the model is correctly specified, and regional officials are committed to economic globalism, the only issue at stake is whether the periphery can overcome the resistance of the center. But are provincial leaders really anti-kleptocratic, or do they just want to keep the spoils for themselves?

The postcommunist experience in the Russian Far East is illuminating. As Spiegeleire maintains, the periphery has gained considerable independence from Moscow. Regional entrepreneurs have been active; non-defense privatization Russian style is nearly complete,²² and foreign investment has been significant (550 million US dollars 1991-1996), but the "rent-seeking" and "asset-grabbing" behavior which has demobilized resources throughout the country still predominates. Although 75 percent of the Russian Far East's product is now sold within the region compared with 25 percent before 1992, and the export share has tripled from 4.5 to 13 percent, the GRP fell 58 percent 1990-1997.²³ The decline in per capita income 1989-95 computed in purchasing power parity US

economic Performance," *Hitotsubashi Journal of Economics* 40 (1999), pp.41-57; Steven Rosefielde, "Who is Losing Russia? The August/September Crisis and Its Dismal Aftermath," *ERINA Report* 26 (December 1998), pp.18-21; *Ibid.*, "Russia's Warped Transition: The Destructive Consequences of Ethically Unconstrained Utility Seeking," *Eastern Economic Journal* (2000 forthcoming); *Ibid.*, "Permanent Crisis in Russia: Systemic Roots," *HSE Economic Journal* 3 (1999), pp. 327-352.

22 A. Radygin, "Pereraspredelenie prav sobstvennosti v postprivatizatsionnoi Rossii," *Voprosy ekonomiki* 6 (1999), pp.54-75 provides data on the evolution of insider and outsider shareholding for private corporations. According to the latest estimates by S. Aukutsionek, R. Kaplyushnikov, and V. Zhukov, "Dominant Shareholders and Performance in Industrial Enterprises," *The Russian Economic Barometer* 1 (1998), pp.8-41 insiders held 58.5 percent and outsiders excluding the state held 31.7 percent of industrial corporate shares in 1995. The state retained a 9.5 percent stake. Workers owned 48.5 percent of the total, directors 10 percent. Outsiders respectively held the following positions: banks 1.6 percent, investment funds 7.2 percent, holding companies and FIGs 8.1percent, individuals 9.6 percent, foreigners 1.7 percent. Other accounted for 0.3 percent. The authors' forecast a decline in workers' ownership to 36.3 percent, and the state's share to 2.7 percent in 1999 with the primary gainers being managers (15 percent), FIGs (11.8 percent) and individuals (15.6 percent). Separately, the American specialist John Earle believes that there has been little change in ownership structure since 1994. Cf. John Earle and Saul Estrin, "After Voucher Privatization: The Structure of Corporate Ownership in Russian Manufacturing Industry," paper prepared for the American Association for the Advancement of Slavic Studies meetings, Seattle, November 22, 1997. Radygin concludes that the structure of ownership isn't as important as the corrupt control of managers. For a contrary view about the positive effects of privatization see Yu. Perevalov,, I. Grimadi, V. Dobrodei, "Vliyaet li privatizatsiia na deyatel'nost' predpriyatii?," *Voprosy ekonomiki* 6 (1999), pp.76-89.

23 Pavel Minakir, "Russian Far East: Time for Decision," paper presented at the 8th Northeast Asia Economic Forum, Yonago, Japan, July 28-30, 1998.

dollars according to Gosplan data exceeds 75 percent.²⁴ The absolute figure is in the vicinity of 2,500 dollars, just below the UN's estimate for China.²⁵ And the deterioration continues. Russia's Far Eastern GDP dropped 5.6 percent in 1997.

The performance of the industrial sector has been especially bleak. Coal extraction has fallen from the highs set in the eighties by 4 percent, oil 27 percent, timber 72 percent, fish 44 percent, gold 15 percent, steel 90 percent, wood products 88 percent, paper 90 percent and cement 23 percent.²⁶ Investment in 1997 was 15 percent of the level achieved in 1990. The production of industrial consumer goods is now only 0.6 percent of GRP, reducing the Far East to a natural resource hinterland.

Obviously, the distinct cultural and locational features of the Russian Far East and its growing autonomy have not inoculated it against the disease of Russian mis-liberalization. The anti-productive aspects of crony capitalism which are besetting the nation generally are not easily countervailed, so that while regionalism is important for many reasons, it cannot plausibly be heralded as the cure for Russia's ills.²⁷

7. CONCLUSION

The position of the Russian Far East in the Northeast Asian development puzzle is paradoxical. Historical statistics suggest that the region is already well developed and should constitute a growth node for Mongolia, China and North Korea, but Russian officials and foreign businessmen usually portray the region as a candidate for capitalist investment and assistance. The solution to this riddle has been found to repose in Russia's mis-industrialization. The Soviets indisputably accumulated a vast inventory of physical capital, but this equipment has negligible value on the global market because it cannot be used to produce goods with characteristics responsive to competitive demand. Russian officials and foreign investors thus are right. The Russian Far East is po-

24 This estimate assumes as Soviet data indicate that per capita Far Eastern GRP substantially exceeds the national average (see Table 5), and that the unweighted subregional data reported in Ch. 10 of this collection closely approximate the weighted mean. Ponomarenko's unweighted average expressed in 1991 prices is approximately 2,500 dollars per annum in 1995. See: B. Chavance, "Evolyutsionnyi put' ot sotsializma," *Voprosy ekonomiki* 6 (1999), pp.4-26 which provides an interesting analysis of the behavioral differences between the contemporary Russian and Chinese systems. Also see Radygin, "Pereraspredelenie..."; Ol'sevich, "Institutsionalizm..." and Rosefielde, "Russia's Warped Transition."

25 Rosefielde, *Efficiency and Russia's Economic Recovery Potential...*

26 Minakir, "Russian Far East."

27 Pavel Minakir, "Investment and Economic Development in the RFE," *Bulletin of the Association for the Inter-Regional Study Between Hokkaido and the RFE Russian Far East* 1 (1998), pp. 55-60; Peter Kirkow, "Foreign Trade Arrangements in Russia and Its Regions: Relying on Foreign Capital to Generate Growth?" Unpublished Paper (March 1998).

tentially a land of fabled opportunity, but as in the past systemic obstacles are retarding its swift realization despite increased regional autonomy, and may not be overcome without a clear vision of Russia's systemic deficiencies, international cooperative assistance; and extraordinary perseverance.