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Economic Policy Ideology

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The present study summarizes the results of an interdisciplinary research which defined the outline of a new nationally-minded ideology of Russia’s economic policy. By introducing the category of “value” in the economic discourse, the authors formulate a methodologically new approach to analyzing economic phenomena and the government economic policy. A new ideology is formed in the context of the world philosophical and economic thought. The study extensively analyzes theory and practice of liberal and neoliberal concepts, paying particular attention to the monetarist trend in the economic theory. The idea of the market’s self-regulatory ability being absolute is demonstrated to be an ideological myth. Evaluating criteria and international ratings for national economies’ economic development are proved to be non-universal and biased. The study examines the Russian reforms of the 1990s in the context of world economic trends and the reforming experience in transition economies. Functions of a modern state in managing economic processes are defined.

Proposed ideas are confirmed by a wide range of historical examples and statistics.


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Preface

The very thought of having an ideology for Russia’s economic policy is a challenge to the system of governance that developed in Russia during the time of reforms and that exists today. The principle of de-ideologization became a political choice in the nineties.\(^1\) A ban on state ideology was even included in the Russian Constitution. (Article 13, paragraph 2: “No ideology may be established as state or obligatory one.”) Granted, zealous de-ideologization offered an opportunity to get rid of dogmatism, narrowness, and destructiveness typical of some Marxist-Leninist ideas. Having fulfilled their mission of providing ideological support for the accelerated modernization of the Soviet period, towards the end of the second millennium they became a deterrent for social development.

However, criticism of a specific ideology was expanded to all ideological concepts. The de-ideologization campaign eradicated organic niches which accumulated ideological and spiritual potentials of the statehood, its world-view staples, and its benchmark values. Just like a man cannot effectively live without a purpose, a state cannot exist without an ideology.

Some among Russia’s new generation of statesmen now realize that the ideological vacuum produced by this approach is a problem. Some cautiously suggest that there is a need for an idea that would integrate the Russian national community. But a nation-integrating idea is nothing else than an ideology.

In fact, there can be no such entity as an absolutely ideology-free state. One should not be deceived by declarations concerning the absence of a state ideology. Quite often they are in sharp disagreement with actual, ideology-based policies. For instance, who can claim that the United States of America has no state ideology? Ideological principles of the US not only serve as guidelines for politicians in the White House; perceived as being universal, they are expanded to the rest of the world, and quite often even imposed by force.

Quite often, a state that doesn’t have its own ideology simply conforms to the ideological format of another state and starts to serve its interests. Politics of the Russian Federation were extremely ideologized

\(^1\) Vladimir Yakunin, “K voprosu o kachestve gosudarstvennoi politiki,” Svobodnaya mysl (2007, #3).
in the nineties, despite all claims to the contrary. The reformatory trend in Russia during Yeltsin’s time used neoliberalism as its ideological foundation. Today, many neoliberalist stereotypes continue to impair the administrative efficiency of the Russian government.

Therefore, the choice is actually made not between the two poles of ideologization and de-ideologization but rather between substantially varying ideologies. A nationally-minded government should build its policies on an appropriate ideological foundation.

The word ideology here denotes a system of conceptually organized notions, ideas, goals, and values that reflect the collective self-identity of a political body, for example, a state. A general ideology that has become a national one may be then decomposed into more specific, individual policies the government pursues. The goal of the research presented in this treatise was to establish principles of a nationally-minded state ideology in the economic sphere.

The authors foresee two main objections to this intention. The first has to do with a popular practice of using the label of totalitarianism. To anticipate this, the authors point out that they use the term ideology with regard to a specific object. What they talk about is not building a new ideocracy as a political regime. An ideology of the policy is not an ideology of the society. Even the word “policy” here means the administrative practice of the state.

Administration requires some indispensable attributes: goals, means, subjects and objects, resources, plans and programs, a system for monitoring and making adjustments, etc. In this list, at least goals and means very much depend on one’s values, and values are elements of a world-view, of an ideology in the above-mentioned sense. Also, ideology is chosen by the state, the subject of administration, which doesn’t mean that people are not free to discuss ideological issues or that their personal rights and liberties are violated. Therefore, the easiest way to adapt to the problem of ideological choice is to understand it as a choice of values. What is valuable for a person, for a society, for a certain group, or for a state? What values, what goals of development, are viewed as ethical and universally beneficial? How do interests of various economic players contravene, and what should be a universally accepted approach to balancing them? These questions define an ideology that a state needs in order to have a meaningful and humanistic economic policy.
Another argument often used in the discourse is contrasting ideology with science. The economic theory, our opponents often tell us, allows no ideologization. Interestingly, even though they present their own theories, like neoliberalism, as purely scientific, these theories have all the attributes of an ideology. In reality, one cannot monopolize the right to claim the scientific nature for only one of several possible ideological approaches. What happens is that the term ideology is misleadingly used to denote one’s political (or often simply lobbyist) interests. Yet the element of ideology is always present in the general logic of the scientific progress. It determines researcher’s initial choice of a world-view and values. Also, a scientist may arrive at conclusions of ideological nature in the final stage of his research, when he combines scientific views from various fields into a general, conceptually integrated system.

The term strategy, as applied to the practice of governance in Russia, requires rehabilitation just as much as ideology. After all the criticism that Gosplan, the State Planning Committee in the Soviet Union, was (to a large degree deservedly) exposed to, the new tendency was to deny the need for any state planning whatsoever. Fortunately, today the need for indicative and strategic planning is realized more and more, although so far it is mostly limited to short-term programs.

However, neither short-term nor long-term planning can be effective if there is no set of values chosen, no goals set, if there is no general view of ways and methods to achieve the goals. The economic policy has to be considered from the strategic point of view. Without a strategy, the Russian economy will remain in a drifting, almost uncontrolled state, fully under the influence of external conditions and foreign political and geopolitical interests.

The fundamental term economic policy, as used in administration, is based on the general philosophical idea of social phenomena being knowable. For its epistemological foundation, the methodology approach proposed here uses the idea that economic phenomena are, in principle, knowable. Accordingly, the authors relied on the key principle of economic processes being relatively manageable. Therefore, they cannot completely agree with the unbalanced neoliberalist position, which rules out (or minimizes) the possibility of the state managing the economy and maximizes the self-regulatory potential of the market.
Theoretic foundations, which the economic policy is built on, are, in turn, based on a certain world-view and certain values, which include philosophical, ethical, and historic and cultural elements. The goal of this treatise is to reconsider the contents of these elements as regards governance in Russia.

The approach proposed here features the concept of a “value-oriented goal,” which is basic for administrative projects. The introduction of value-oriented goals into scientific and administrative usage is necessitated by the shortages of the customary, explanatory model of economics which relies on the abstract notion of *homo economicus*, the economic man. The proposed new approach suggests developing an alternative branch of the economic theory, which involves the category of *value*. The deformed concept of the “economic man” is substituted with that of the “harmonious man,” the “social man,” which takes into account the multifaceted nature of his personal existence.

By way of a methodology novelty, the concept of values in economics is expanded from purely explanatory application to the level of making administrative decisions. An economic program is deemed logical and consistent if it is in line with value-oriented goals.²

One of the main mistakes in the current governance practice is that value-oriented goal-setting is replaced with institutionalist goal-setting, value-oriented goals are replaced with administrative and managerial ones. There is a tendency for logical deformation of scientific theory by replacing goals with means and strategies with economic instruments. The authors believe that the dead-end of de-strategizing the economic policy may be overcome by going beyond traditional boundaries of economics as a discipline. It is impossible to comprehend the nature of value-oriented goal-setting unless one transcends the limits of economic understanding. There is a need for an interdisciplinary approach, which is implemented in this treatise.

The special feature of the value-oriented choice is its integrative nature. The extremes of modernism and conservatism are overcome in their centrist synthesis. The extreme approaches of value-oriented goal-setting in choosing economic decisions are defined by the following contrasts:

– globalism—self-isolation;

- openness—autarky;
- self-regulated market—administrative control;
- totally free competition—total state monopoly;
- absolute denationalization—statism;
- economic individualism—corporative collectivism;
- absolutely free enterprise—state paternalism;
- free labor market—mobilized economy;
- no social aid from the state—a distributionist state;
- absolutizing the principle of equal economic opportunities—social and economic levelling;
- purely material stimulating mechanisms—an ideocratic regime.

The practical task to be solved at the level of value-oriented goal-setting is to find an optimum for Russia among the above-mentioned alternatives for choosing priorities. The intended goal is to find a measure for implementation of value-oriented principles: the measure of autarky, the measure of statism, the measure of corporatism, the measure of ideologization, etc. The authors regard arguments about only this or only that decision guaranteeing successful economic development as futile and suggest they be dropped. In line with their principles, the authors consider a number of optimization problems using value-based optimum criteria.
Chapter One
Economic and Philosophical Strategy
Considerations

Theoretic foundations of an economic policy should include a basic world-view layer. Therefore, one has to consider the philosophy, ethics, and morality of economics.

Before one considers problems of managing economic processes, it is necessary to address the question whether they are manageable at all. This question, in turn, leads us to the discourse concerning knowability of economic phenomena and processes. Eventually, the question of a general epistemological paradigm of problem decomposition arises. To make a proposed strategy better-founded, one should present not only his own philosophical paradigm but, for verification purposes, that of his opponents as well. A research into historical and philosophical sources of economic strategies converts the problem under consideration to the question Russia is currently facing, namely, that of making, or adjusting, its world-view choice.

1.1. Epistemological foundations of economic theories

Is the strategic approach to economic processes possible at all? Strange as it may seem, the seemingly obvious answer about the need for a general strategy does not have a clear-cut solution in the theory of economics. Moreover, the predominant view is that the temptation to produce strategies for the sphere of economics should be resisted. The liberal trend, both in its classic and neoliberal version, generally denies the possibility of managing economy at all. To liberals, even slightest attempts to interfere into the operation of a self-regulated market system may yield but a negative result.

The very term economic policy hardly squares with liberal theories. Phrases like pricing policy and market-regulating policy are even more incongruous with them. The state’s functions are reduced to that of a night watchman. But why is the model of a self-regulated economy better than that of a managed economy? From the viewpoint of common sense, rational organization can at least cause no harm to an economy in the elementary sense of the word. If a company is deprived of its ba-
nal management, it will collapse. Why then this obvious truth at the microeconomic level is not accepted at the level of national economies?

This question demonstrates that we need to thoroughly consider philosophical and epistemological foundations of liberal concepts in the economic theory. These foundations can be most clearly traced in the works of liberalist classics, written at the time when economics and philosophy still constituted one discipline.

Epistemological sources of economics’ classic liberal concept are found in the philosophy of agnosticism. When Adam Smith laid the foundations of the self-regulated market theory, he was a follower of David Hume’s agnostic teaching. He thought economic processes were unmanageable because he thought they were unknowable. God’s purpose was thought to be impossible for man to perceive; thus, the best way to manage the economy was to leave it to its natural (i.e., divinely instituted) course, since it was impossible to produce a better management system artificially.¹

David Hume’s epistemological challenge was to accuse moral sciences of switching from is-statements to ought-statements.² “Hume’s Guillotine” was to sever the former from the latter. Economists tried to vindicate their science by distancing themselves from ethical theories accused of being unscientific. Hume’s contrast of values and facts produced a hindrance for axiological analysis in the economic sphere. The proposition concerning ethical ought-statements being unscientific, in turn, was used as a methodological taboo for any attempts to offer scientific grounds for managing economic processes.³

It would seem that since a number of states in the 20th century have achieved their planned (i.e., desired and predicted) macroeconomic goals, this has ultimately shaken the liberal doctrine of economy being unmanageable. But stereotypes of the classical liberal theory, which by that time have become ideologized, proved to be very deep-rooted. Even John Keynes treated long-term managerial problems with skepti-

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³ Viktor Kanke, *Filosofiya ekonomicheskoi nauki* (Moscow, 2007), 49.
cism typical for the tradition of agnostics. “In the long run we are all dead,” he said ironically about the very thought of having long-term strategic development plans. The Keynesian revision of classical economics did not lead, as some believe, to formulating the concept of its manageability. Keynes and his followers believed it was possible to regulate the economic situation, but they thought it was impossible to manage economic development.\(^4\)

The model of a manageable economy was developed in socialist countries, where it was epistemologically correlated with the Marxist idea of practice being the criterion of knowability. However, since the Soviet economic theory was scholastically overloaded with ideological statements of the 19th and the early 20th centuries, it failed to produce a modern and effective concept of management.\(^5\)

The abandoned principle of *laissez-faire, laissez-passer* was reinstated, as is well-known, by the neoliberal ideology. From the epistemological point of view, this was a modernized version of economic agnosticism. It genesis was matched with the intellectual expansion of postmodernist philosophy and axiology. Relativism of the postmodernist epistemological paradigm within the framework of this approach presented an insurmountable obstacle for producing proactive economic development strategies.

When economists practically refused to discover laws and give specific forecasts, this reflected the methodological dead-end they were in. Instead, they began to produce multiple scenario variations. Such multi-variant forecasts were of no value for statesmen. When a specific inquiry was routinely met with three possible scenarios for economic development: a pessimistic one, an optimistic one, and a “realistic” one, this was tantamount to acknowledging unpredictability of future economic development.

The neoliberal theory practically admitted it was unable to establish the hierarchy of factors and effects in a major economic system, such as a national economy. Of course, if one cannot discover factors, cause-and-effect links, and motives, naturally one cannot produce a theory of development management. Relativists cited factors’ heterogeneousness


and their infinite number, raising questions about functional uselessness of the economic science.

In the situation of the methodological dead-end, neoliberal could not think of anything better than to go back to the old platform of Adam Smith: the economy itself, better than any economists, can regulate problems and challenges it faces. This is where recommendations for denationalizing the economic sphere, embodied in the Washington Consensus, proceed from.\(^6\) Alienation of the state was viewed as a cure-all resolving the epistemological discourse. Paradoxically, methodological relativism transformed itself into the theory’s universalism. The same recommendation of absolute (i.e., not optimal) denationalization (i.e., essentially, withdrawal from managing the economy’s development) was given in every case, without considering the specific context of national economies.

The current critical condition of the economic methodology can be illustrated with statements made by a number of leading economists, admitting uncertainty with regard to the subject matter of economics. “We all talk about the same things, but we have not yet agreed what it is we are talking about,” Lionel Robbins wrote.\(^7\) Science philosopher Viktor Kanke made an interesting correction to this statement, saying it is impossible to achieve unity with regard to the subject matter while there is no unity of theoretic views.\(^8\)

“The evidence may be internally contradictory, so there may be no hypothesis consistent with it,” Milton Friedman wrote.\(^9\) On the practical level, this meant that Russian and East European reformers ignored substantial factual discrepancies between the liberal monetary theory and the actual course of reforms. “A theory is simpler [and thus, more perfect] the less the initial knowledge needed,” Friedman explained.\(^10\) It was such statements by Friedman that caused Paul Samuelson to call them “a monstrous perversion of science.”\(^11\)


\(^8\) Viktor Kanke, op. cit., 7.


\(^10\) Ibid.

A special place in the history of the liberal economic theory is occupied by Friedrich von Hayek. His works particularly emphasize agnosticism as the epistemological foundation for the concept of the spontaneous market order. The Austrian thinker believed that people are guided in their economic behavior by practical knowledge embodied in customs and habits. These are impossible to formalize at the theoretical level. Practical experience of economic agents is “scattered” and “perishable” information, which cannot be systemized into a theory. Unlike natural and technological knowledge, economic knowledge by definition cannot be formalized, Hayek believed.

Thus, any interference in the market order performed by man on scientific grounds can only result in its complete or partial ruin. According to Hayek, any result-oriented economic policy is ineffective, because it by definition cannot take into account the entirety of individual practical knowledge necessary for its implementation.

He considered it wrong to apply moral and ethical standards and parameters to economics. He claimed that ethics was as inapplicable to economic processes as it was to physical ones, like astronomical phenomena. Hayek argued with John Maynard Keynes, accusing him of overestimating capacity of science. He believed the very approach to economics based on macroeconomic modeling was erroneous and had nothing to do with reality, where all decisions are made at the microeconomic individual level. Planned management of the economy was even more unacceptable to Hayek than it was to Keynesianism. One of the key arguments in his criticism was the reference to the arbitrariness of values imposed on society. The Austrian economist did not consider the possibility of matching managerial value-oriented goal-setting with public interests and preferences.

His agnosticism can be classified as an indicator of the economic liberalism’s epistemology. It is Friedrich von Hayek, not Adam Smith nor Milton Friedman, that currently embodies the neoliberal trend in social sciences; thus, the agnostic paradigm of the spontaneous market economy is associated with him.\textsuperscript{12}

When we propose a strategy for managing economic development, it is based on a philosophical and epistemological foundation totally different from that of Adam Smith’s line. Epistemologically, it is linked with faith in human mind’s capabilities. Economic processes are knowable (to an adequate degree); thus, being a result of human activity, they are manageable. The higher the level of knowledge, the more extended in time managerial benchmarks may be.

Even G. W. F. Hegel criticized Hume’s agnosticism and spoke of economics as a science with great prospects of knowledge. “It finds laws for a mass of accidents. It is an interesting spectacle here to see all chains of activity leading back to the same point; particular spheres of action fall into groups, influence others, and are helped or hindered by others. The most remarkable thing here is this mutual interlocking of particulars, which is what one would least expect because at first sight everything seems to be given over to the arbitrariness of the individual, and it has a parallel in the solar system which displays to the eye only irregular movements, though its laws may none the less be ascertained,” he wrote in his *Philosophy of Right*.13

Famous Russian thinker Vladimir Vernadsky, who authored the concept of noosphere, also wrote about the idea of planning the economy as “a triumph of reason.”14 The problem of proving the possibility of verifying economic theories to overcome methodological agnosticism of neoliberalism has been successfully resolved in a number of modern researches. As a vivid illustration, one may recall the Nobel prize awarded in 2002 to Vernon L. Smith “for having established laboratory experiments as a tool in empirical economic analysis, especially in the study of alternative market mechanisms.” Among practical results of the experimental verification model he developed was the refutation of monopolies’ expediency, for instance, in the energy sector. The governments of Australia and New Zealand listened to recommendations

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of the American economist and made substantial changes to their planned energy sector reforms in the 1990s.\textsuperscript{15}

1.2. The ethical paradigm of economics

The phrase *ethical economics* sounds as a challenge to the dominating neoliberal trend in the economic theory. This trend leaves ethical matters outside its scope of research. Neoliberal reformers dismiss any attempts to call the policy of “shock therapy” immoral, claiming that moral categories should not be extrapolated to the sphere of economics.

However, the question of what is the subject of economics as a science arises here. Excluding morals from among economic factors significantly deforms results of any potential study. What we are suggesting is not a revolution in the definition of economics as regards its subject; on the contrary, we suggest that at this new stage economics should regain some of the things that have been either lost or become obscure.

Initially, at the stage of being formed as a science, economics was presented as an ethical discipline. Adam Smith was the Chair of Moral Philosophy while working at the University of Glasgow. Historians believe that his economic views were shaped very much under the influence of Francis Hutcheson’s ethical theory concerning innate human qualities (moral, religious, and esthetic ones). Smith’s self-regulating market was only possible on the condition of man being inwardly self-restricted. Interestingly, Adam Smith himself considered his book on moral philosophy, “The Theory of Moral Sentiments,” not his famous “Inquiry into the Nature and Causes of the Wealth of Nations,” his life-time achievement. The close relationship between ethics and economics was even more obvious in the works of Jeremy Bentham, the pioneer of British utilitarianism. He considered “eudaimonism,” the science or art of achieving well-being, as the only possible platform for economic analysis.\textsuperscript{16}

Not only hierarchs of the Russian Orthodox Church (ROC) now call for restoring the link ethics and economics (primarily, Metropo-

\textsuperscript{15} http://www.dvpt.ru.

litan Kirill’s speech at the 10th World Russian People’s Council). One of the leaders of the historical school Gustav von Schmoller spoke of national economics as a “great moral and ethical” science.\textsuperscript{17} A number of well-known Western economists in the 20th century supported the idea of synthesizing ethics with economics. The analytic ethics of R. M. Hare, the small group ethics of Michel Foucault, and the critical and rationalistic ethics of the French school as presented by Karl-Otto Apel and Jürgen Habermas all demonstrate this approach.\textsuperscript{18} “Based on contemporary knowledge and research,” says G. Corazziari, “one may say that the theory of the feedback between ethical values and economic development is the one closest to the truth.”\textsuperscript{19}

To the Russian economic philosophy, the ideal of ethical, spiritually-oriented economics was a must. The main reason the Western capitalism was not well-received in Russia was its ethical vice. “Orthodoxy cannot defend the capitalist system of economics as such for it is based on exploitation of hired labor, even though Orthodoxy can temporarily tolerate it because of its merits in increasing productive effectiveness and its general productive energy. But there are clear boundaries here, which cannot be crossed for whatever reason,” Sergei Bulgakov wrote.\textsuperscript{20}

Defining morality as the main criterion of economics, Russian thinkers realized the importance of values in the economic discourse much earlier than those in the West. When designing the economic strategy of Russia’s development, we can use as our motto Bulgakov’s imperative for building a viable economy: “National economy requires the nation to be healthy spiritually.”

The idea of spiritualizing economic relations is as old as economic relations themselves. Each of the traditional religions had its own model for organizing an ideal economy. The phenomenon of the “Islamic bank,” based on unacceptability of exorbitant, by Muslim standards,

\textsuperscript{17} Peter Koslowski, “Eticheskaya ekonomika kak sintez ekonomicheskoi i eticheskoi teorii,” Voprosy filosofii (1996, No. 8), 68-69.
\textsuperscript{20} Russkoye Khozyaystvo (Moscow, 2006), 115.
rates of interest, is a good illustration of how economics may be adapted to highest moral commandments today. Usury, according to Muslim theologians, means exploiting your fellow-believers. In customary banking, a creditor gets income without divinely commanded labor. In Islamic banking, both the profit and the loss is divided between three partners: the bank, the investor, and the entrepreneur (the principle of Musharakah). Initially, the first two parties are not guaranteed they will get any income. Their profit comes as a result of their joint efforts together with the business. Thus, a loan becomes an investment; banks and investors acquire the function of providing organizational and moral support to their business partners, which is not typical for the customary Western system.

Currently, Islamic banking encompasses more than 40 states. Experts speak of the “triumph” of Islamic banks in the financial markets. According to a Citibank estimate, the capital accumulated by Islamic banks increases by 10-15% annually. Leading Western bank groups, such as aforementioned Citibank, Chase Manhattan Corp., Goldman Sachs, ING, Nomura Securities, JPMorgan, Deutsche Bank, HSBC, etc., open Islamic subdivisions. Giants like General Motors Corp., IBM, Alcatel, Daewoo, Societe financial holdings, etc., use interest-free loans from the Islamic Bank. Such a cooperation on the part of the world’s largest corporation is obviously not a coincidence.

The conclusion one should make when applying this experience to the Russian economic context is, naturally, not that the Russian banking system should become Islamic; rather, it proves that, in principle, it is possible to build an economic system according to traditional ethical imperatives.21

1.3. The abstract notion of “economic man”

According to Lyndon LaRouche, the founder of the alternative “physical economy,” the concept of economic man has its sources in the social doctrine of John Locke. In Locke's view, the society is a mechanistic combination of atomistic individuals. Their behavior is reduced to three basic impulses: “survive” (life impulse), “pursue sensual pleasure” (freedom impulse), and “satisfy greed” (property impulse).

21 Ye.N. Miroshnik, Islamskiye banki v sotsialno-ekonomicheskoi strukture musulmanskikh stran: Thesis (Moscow, 2000)
Thus, man’s economic activities were downgraded to the level of animal instincts.

LaRouche contrasted the Locke—Smith model of economics with the tradition originating from Gottfried Leibnitz. Divinization of economic activity was suggested as an alternative to its biologization. According to Leibnitz, labor made man similar to the Creator. Instead of the market’s self-regulation, Leibnitz viewed economic activity as cooperation with God in the eternal anti-entropic process of “winding up the world clock.” In reality, putting aside LaRouche’s polemic zeal, we should admit that the alternative variants of Locke’s and Leibnitz’s economic model reflected two theological approaches of the new times. The deistic concept corresponded to creationist management of economic processes, whereas the pantheistic concept corresponded to their natural self-regulation.

The model of economic man, defined by Adam Smith as a selfish person striving to accumulate more and more wealth, which is the basis of the liberal theory, has long become a target for all sorts of criticism. As early as in the 1890s, Thorstein Veblen, a founder of the institutional economics movement, indicated that Smith’s economic anthropology has long become obsolete. Man’s economic behavior, he said, cannot be reduced to merely pursuing material benefits. It is heterogeneous and includes other elements, like traditions, behavioral standards, self-preservation and clan-preservation instincts, subconscious tendencies for competition and imitation, curiosity, etc.

Sergei Bulgakov criticized the Smith—Bentham model of “economic man,” suggesting his theory of building a spiritual economy.

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There has never been such a thing as a universal economic man for all times. Each economic era and each culture produced its own dominating type of economic man. Such a spiritual type was also formulated within the framework of the Christian ethical tradition. The Smith—Bentham model of “economic man” is a product of a historically-defined world-view context. Sergei Bulgakov associated its appearance with the enlightenment ideology of the 18th century, which was translated into the classical political economy, on the one hand, through faith in pre-determined natural harmony, and, on the hand, through viewing the society as the totality of atomistic, mutually repelling representatives of various interests. Thus, said the philosopher, the classical political economy came to be dominated by the concept of man, “who doesn’t eat, doesn’t sleep, but spends all of his time calculating his interests to achieve maximum profit at the minimum cost." Of course, any economic system is a mechanism. But, says Bulgakov, it “is not and can never be merely a mechanism, just like a person is not merely a machine for calculating interests but rather a living and creative being. Economic activity is performed by a living person.” This remark by Bulgakov was significantly ahead of the economic theory of his times. Essentially, it laid a foundation for producing a new methodology, which combines the phenomena of laws and values in the economic sphere.

Contemporary Israeli psychologist Daniel Kahneman also proved the notion of man’s behavior being rational, which is basic for the economic discourse, wrong. For most people, behavioral motives depend more on emotions, various phobias, recollections, prejudices, and stereotypes than on calculations of their profit. Kahneman replaces calculated logic of abstract economic man with heuristic model of decision-making. The fact that Kahneman received the Nobel prize in economics demonstrates how important his conclusions are and at the same time indicates that the model of “economic man” is deemed unsound by top scientists today. However, the orthodox theory, which is cur-

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26 Russkoye Khozyaistvo (Moscow, 2006), 114.
27 Ibid.
28 Sergei Bulgakov, Kapitalizm i zemledeliye (St. Petersburg, 1900); Filosofiya khozyaistva (Moscow, 1990); Dva grada. Issledovaniya o prirode obshchestvennykh ide-alov (St. Petersburg, 1997).
rently being supported primarily by followers of the liberal monetarist trend, continues to adhere to principles of economic determinism. Thus, another Nobel laureate Gary Becker claims psychological factors may be measured and evaluated by considering man’s material interest (“economic behaviorism”).

The image of the “economic man” as a “hedonistic consumer,” developed by Adam Smith and particularly Jeremy Bentham, is in sharp contrast with the logic of economic development. Maximization of consumption does not ensure development. It is achieved exactly the opposite way. A businessman cares not about consumption but about investments for the future. It is no accident that Karl Marx, being indignant over Bentham’s utilitarianism, called the British philosopher “a genius in the way of bourgeois stupidity.”

There seems to be correlation between the economic growth rate and minimization of the personal consumption share in GDP revenues. To illustrate this, we could consider several countries with similar economics and culture. Thus, Ireland and Luxembourg had by far the highest growth rates among the EU countries in the 1990s. And yet these are the two countries that had the lowest share of GDP used for personal consumption among all EU countries. Generally speaking, the inverse relationship of these two parameters may be observed for other European countries as well (Fig. 1.1).

1.4. The value-oriented goal of economic strategies: a new methodological concept

What lies at the heart of strategic decision-making when shaping an economic policy? The key to this problem is to introduce the definition of a “value-oriented goal,” which is basic for managerial planning. Values are the context of strategic goal-setting. At the level of Kantian antinomies, the initial choice of the necessity model is determined by trivial preference. Preferences, in turn, have axiological nature, com-

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Fig. 1.1. GDP growth (1991-2000) and final consumption household spending in EU countries.
ponents of which have been structured with much detail in the works of adherents of the institutionalist trend in the economic theory.\textsuperscript{34}

When making strategy statements, there is the danger of substituting socially important values with personal sympathies of the manager. Therefore, top values should be nominated in a conventionalist manner. In this case, science finds an ally in religion, which represents the hierarchy of values which is traditional for the given macroeconomic environment. If there is no such platform, one may face the dead-end of freedom of methodological individualism, which Friedrich Hayek encountered in his reasoning. After values have been chosen, one has to be logically consistent in their managerial application. This concise thesis has been recently developed into the concept of “value resonance.”\textsuperscript{35}

Analysis of the history of economic teachings indicates that so far the phenomenon of value-based goal-setting has never been suggested as the platform for managerial strategization. Mistakes in setting the foundations of the strategy were usually the inward reason for the dysfunction of the economic policy based on it.

Some researchers define the revision of foundations of the classical political economy in the late 19th century as the marginalist revolution. In particular, marginalists revised the labor theory of value, which was dominating prior to that. They linked value, expressed in a market price, not to labor expenditures but to variable demand. Essentially, marginalists (the Austrian school), were the first to introduce the notion of value in the scientific economic lexicon. Granted, their interpretation reduced it merely to subjective usefulness (“economic good”). According to the definition given by the Carl Menger, the founder of the theory of marginal utility, “value is a judgment economizing men make about the importance of the goods at their disposal for the maintenance of their lives and well-being. Hence value does not exist outside the consciousness of men.”\textsuperscript{36}


\textsuperscript{35} Vladimir Yakunin, \textit{Protsessy i mekanizmy formirovaniya gosudarstvennoi politiki v sovremennom rossiiskom obschestve: Thesis} (Moscow, 2007).

\textsuperscript{36} Carl Menger, \textit{Principles of Economics} (Libertarian Press, 1994).
To marginalists, value nominated the price. But this was not an axiological category yet. According to Eugen von Bührm-Bawerk, the optimal price is formed as a consensus between the subjective value for a buyer (the price of demand) and the subjective value for a seller (the price of supply). Using price categories did not mean, as followers of the “positive economics” like to suggest, decreasing its practical effectiveness. Eugen von Bührm-Bawerk was thrice appointed Austro-Hungarian Minister of Finance and twice used marginalist methods to lead his country out of inflation crises. The fact that his portrait has been placed on the Austrian one-hundred schilling note demonstrates the recognition he has received for his work.37 (Table 1.1)38

**Table 1.1**

**Principal differences between marginalism and the classical political economy**

<table>
<thead>
<tr>
<th>Economic category</th>
<th>Classical theory</th>
<th>Marginalism</th>
</tr>
</thead>
<tbody>
<tr>
<td>Value</td>
<td>An objective category based on combined labor expenditures, past and present</td>
<td>A subjective category determined by how important the good is for man</td>
</tr>
<tr>
<td>Price</td>
<td>Linked to value, determined by average cost of production</td>
<td>Forms as a balance between subjective values of demand and supply, determined according to the principle of the least marginal utility among series of goods</td>
</tr>
<tr>
<td>Profit (capital)</td>
<td>The difference between the current and the future price</td>
<td>Accumulated unpaid labor</td>
</tr>
</tbody>
</table>

The methodology of the historical school managed to overcome reduction, elementarization, of economic to the level of ultimately simplified unit of economy (“the economics of Robinson Crusoe”), which was traditional for the classical political economy. This school should be credited with contextualizing economic development within the framework of national value traditions. The abstract universal-


ism of the previous period was replaced with the teaching of national foundations of economics. Lujo Brentano, Werner Sombart, Max Weber and other representatives of the historical school wrote about cultural foundations of man’s economic behavior. They regarded Smith’s economic man, seeking maximum material profit, as a special cultural phenomenon contextualized in its genesis within the framework of the specific conditions of Western Europe’s development. The historical school made a most important contribution to clarifying axiological foundations of the economic choice. However, it reduced the problem of goal-setting in economics to explaining national adaptation potential.

Generally, Neo-Kantians spoke more about the attitude towards values than about values themselves. Max Weber, who brilliantly proved the influence of the Protestant religion on the formation of the capitalist economy, proposed to place such value categories as “worldview,” “conscience,” and “faith” outside the boundaries of science. “Politics has no place in an auditorium,” he said, advocating the axiological purge.

The historical school approached the matter of a value-oriented goal very closely but never started working on its solution. It is noteworthy that information about the historical school, which is at odds with Smith’s orthodox economic theory, is practically absent from appropriate curricula in Russia. One should remember that this trend in the history of economics was formed back in the pre-Keynesian era. Therefore, we see our goal in synthesizing ideas of the historical school with the theory of state management of the economy.

The predominant approach to value-related economic categories was formulated by Mark Blaug. According to the tradition of “Hume’s guillotine,” he contrasted values with facts. Since they are foreign to the essence of science, their role in the scientific discourse should be minimized, the American economist believed. But, being a historian of economic teachings, Mark Blaug was forced to acknowledge failures of attempts to create positive theories while ignoring norms and values. “Immense confusion,” he said, “has been sown by the pretense that we

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39 Lujo Brentano, Die byzantinische Volkswirtschaft (1917); Max Weber, Selected Works (Meredith Long & Company, 1989); Werner Sombart, The Jews and Modern Capitalism (Transaction Publishers, 1982); Burzhua (Moscow, 1924).

40 Max Weber, op. cit.
can pronounce ‘scientifically’ on matters of ‘efficiency’ without committing ourselves to any value judgments.”

The retrospective research of the genesis of economic teachings does not allow to find any propositions of the notion of “values,” let alone “value-oriented goal,” as the conceptual mainstream. (Table 1.2)

Table 1.2

<table>
<thead>
<tr>
<th>Theory and school</th>
<th>Year</th>
<th>Author</th>
<th>Main concept</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mercantilism</td>
<td>Since 1664</td>
<td>Thomas Mun, James Steuart</td>
<td>Bullion</td>
</tr>
<tr>
<td>Physiocrats</td>
<td>Since 1758</td>
<td>François Quesnay, Anne-Robert-Jacques Turgot</td>
<td>Agriculture</td>
</tr>
<tr>
<td>Classical economic theory</td>
<td>Since 1776</td>
<td>Adam Smith, David Ricardo, John Stuart Mill</td>
<td>Labor as the substance of value, just distribution of wealth</td>
</tr>
<tr>
<td>Marxism</td>
<td>Since 1859</td>
<td>Karl Marx</td>
<td>No exploitation</td>
</tr>
<tr>
<td>Institutionalism, including:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Historical school</td>
<td>Since mid-19th century</td>
<td>Friedrich List, Gustav von Schmoller</td>
<td>Unity of economic and social lives, evolution, motivations</td>
</tr>
<tr>
<td>“Old” institutionalism</td>
<td>Since 1867</td>
<td>Karl Marx, Thorstein Veblen, John Kenneth Galbraith</td>
<td>State as an economic institute, harmony of business and technology</td>
</tr>
<tr>
<td>Neo-institutionalism</td>
<td>Since 1940</td>
<td>Ronald Coase, Joseph Stiglitz, James M. Buchanan</td>
<td>Property rights, optimal contracts, transaction cost</td>
</tr>
<tr>
<td>New institutional economics</td>
<td>Since 1980</td>
<td>Douglass North, Laurent Thüvenot</td>
<td>Correlation between economic institutions and personal interests of economic agents</td>
</tr>
<tr>
<td>Marginalism</td>
<td>Since 1871</td>
<td>William Jevons</td>
<td>Marginal utility and marginal productivity</td>
</tr>
</tbody>
</table>

41 Mark Blaug, op. cit.
42 Viktor Kanke, op. cit., 110-111.
<table>
<thead>
<tr>
<th>Theory and school</th>
<th>Year</th>
<th>Author</th>
<th>Main concept</th>
</tr>
</thead>
<tbody>
<tr>
<td>Including: general equilibrium theory</td>
<td>Since 1874</td>
<td>Lišon Walras, Vilfredo Pareto</td>
<td>Equilibrium as the optimal state</td>
</tr>
<tr>
<td>Austrian school</td>
<td>Since 1871</td>
<td>Carl Menger, Ludwig von Mises, Friedrich von Hayek</td>
<td>Subjective utility</td>
</tr>
<tr>
<td>Theory of economic development</td>
<td>Since 1942</td>
<td>Joseph Schumpeter</td>
<td>Innovations, entrepreneurship</td>
</tr>
<tr>
<td>Neoclassical economic school</td>
<td>Since 1890</td>
<td>Alfred Marshall, John Hicks, Paul Samuelson</td>
<td>Optimal allocation of rare resources to meet consumers’ needs</td>
</tr>
<tr>
<td>New classical macroeconomics, including the theory of rational expectations</td>
<td>Since the 1970s</td>
<td>John Muth, Robert Lucas, Thomas Sargent, Robert Hall</td>
<td>Optimal goal functions of economic agents based on their rational expectations</td>
</tr>
<tr>
<td>Keynesian economics</td>
<td>Since 1936</td>
<td>John Maynard Keynes, Robert Barro</td>
<td>State's fiscal policy as a means to overcome the market's slumps</td>
</tr>
<tr>
<td>Including: New Keynesian economics</td>
<td>Since the 1960s</td>
<td>John Gray, N. Gregory Mankiw, Axel Leijonhufvud</td>
<td>The influence of collective agreements, salary level and imperfect competition on price adaptation</td>
</tr>
<tr>
<td>Post-Keynesian economics</td>
<td>Since the 1960s</td>
<td>Roy Harrod, Sidney Weintraub, Hyman Minsky</td>
<td>Specific agreements and a clearing system as a foundation for the successful operation of an economic system in the situation of uncertainty</td>
</tr>
<tr>
<td>Monetarism</td>
<td>Since the 1960s</td>
<td>Milton Friedman, Karl Brunner, Anna Schwartz</td>
<td>The influence of money on the operation of the economy</td>
</tr>
<tr>
<td>Economic growth theory</td>
<td>Since mid-20th century</td>
<td>Evsey Domar, Robert Solow</td>
<td>Economic growth</td>
</tr>
</tbody>
</table>
On the contrary, one may observe the tendency for logical deformation of the scientific theory through the means–goal metamorphosis. Strategy is replaced with tactics. Economic instruments are more and more come to the forefront. It would be possible to overcome the dead-end of strategizing by going beyond the traditional disciplinary boundaries of economics. Explaining economic phenomena through the lenses of economic phenomena themselves produces contradictions. We need to look at economics from a viewpoint outside eco-
nomics. This is where conceptual breakthroughs in the economic theories are achieved.

The category of “value” was also of a supereconomic character. It is impossible to come to categorical understanding of value-oriented goal-setting while one remains purely an economist, a sociologist, a political analyst, etc. The economic sphere in itself exists in theory only, whereas the real life of man and society cannot be exhausted by the subject of any discipline.

1.5. Implementation of long-term programs as a proof of economic processes’ knowability

The reasonableness of strategizing the economic policy may be proven by examples of practical implementation of long-term development plans on the macroeconomic level. The neoliberal approach claims that long-term plans have no chance of succeeding. But even Isaac Newton, when he was the Master of the Royal Mint, worked on the theory of long-term planning. The 20th century saw several models of planned organization of the economy: the Soviet one, the American one, the French one, the Japanese one, etc. Essentially, every geo-economically significant power in the world has developed its own system of planning.

USSR

GOELRO plan in the USSR was essentially the first complex modernization project implemented at the national economy level. Officially approved in 1920, it laid out prospects for 10-15 years’ time. Unlike following Five-Year Plans, GOELRO plan constituted synthesis of directive and indicative components of planning. During the same period, in the context of universal infatuation with the theory of forming planned assignments, Soviet statisticians designed the first-ever inter-industry input-output model. Future Nobel Prize laureate Wassily Leontief participated in the project. GOELRO plan, developed by a commission headed by Gleb Krzhizhanovsky, envisage a more-than-tenfold increase of industrial production as compared with the 1920 level. H. G. Wells, who visited Soviet Russia at the time GOELRO program was launched, expressed skepticism which was typical for the liberal theory with regard to the possibility of strategic planned
management: “Lenin, who like a good orthodox Marxist denounces all ‘Utopians,’ has succumbed at last to a Utopia, the Utopia of the electri-
cians. He is throwing all his weight into a scheme for the development
of great power stations in Russia…. Can one imagine a more coura-
geous project in a vast flat land of forests and illiterate peasants, with
no water power, with no technical skill available, and with trade and
industry at the last gasp?” Of course, those plans Wells called Utopian
were not only fulfilled but even exceeded (Fig. 1.2). In 1932, instead
of 8.81 billion kWh as planned, 13.5 billion kWh was generated.

United States
The first five-year plan in the US was adopted in 1928, even before
the Great Depression set in. It was dedicated to developing American
aviation. As a result of planned development, the US became a leader
in civilian aircraft manufacturing. Although seemingly the system of
state planning was not developed any further in the US (which gave
American ideologists the ground to criticize the planned economy in
the USSR), practically it was present in the form of federal targeted
programs. Some of these programs were of inter-industry nature. Pro-
jects for developing space, metal, energy and food industries were the
biggest among them. Simultaneous, balanced planning for various in-
dustries helped form a flexible and effective state system of regulating
innovations and scientific research in the US.

Even back in the Roosevelt era, regional planning became popular
in the United States. The first program of this nature was the plan to
electrify the Tennessee Valley, similar to GOELRO plan. American re-

dional planning is conducted at the federal level and features clear de-
lineation of authority between federal and local government bodies.

Also, many major corporations pursue strict planning policies.
Why then does the neoliberal logic think directive plans are inappro-
riate for states, yet appropriate and even effective for multinational
corporations, which are comparable to states in scale?

43 H. G. Wells, Russia in the Shadows (Hodder and Stoughton limited, 1921).
44 R. Belousov, Istorichesky opyt upravleniya ekonomikoi SSSR (Moscow, 1987), 58.
45 Narodnoye khoyaistvo SSSR za 60 let (Moscow, 1970), 201.
46 A. Amosov, “Evolyutsiya ekonomicheskogo planirovaniya,” Promyshlennye ve-
Ruzvelta: Predposylki, logika, rezultaty,” Voprosy ekonomiki (1992, No. 11), 72-81.
Fig. 1.2. GOELRO objectives for crucial industrial goods compared with 1913 and 1920 levels
Japan

To a large degree, the Japanese “economic miracle” stems from the system of strategic state planning for the economy. The indicative nature of these plans does not make the goals they achieve any smaller. On the contrary, the use of recommendations addressed to private companies instead of directives dispatched by the State Planning Committee in the USSR significantly increases the value of the Japanese experience in proving the manageability of economic processes under market conditions.

Since the 1950s through the mid-1990s the Japanese government adopted 12 large-scale plans (Table 1.3).47 Each of them was designed according to a conceptually new development strategy. Significant failures in achieving the planned statistical benchmark was observed only in the 1970s. This was perhaps due to underestimating the rapid growth of oil prices initiated by OPEC, i.e., an external challenge to the planning logic. But in general the Japanese experience of designing indicative state plans proved the possibility of rational programming of economic processes by man. Thus, agnosticism of the theories proposed by those who advocate liberal self-regulation of the economy was refuted.

Table 1.3

National plans for social and economic development of Japan since the 1950s through the 1990s

<table>
<thead>
<tr>
<th>Plan and its duration</th>
<th>Strategic goal</th>
<th>Average annual GDP growth, %</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>planned</td>
</tr>
<tr>
<td>Five-year economic plan to achieve economic independence (1956–1960)</td>
<td>Achieving economic independence, ensuring complete employment</td>
<td>7.4</td>
</tr>
<tr>
<td>New long-term economic plan (1958–1962)</td>
<td>Maximizing economic growth, raising the living standards, complete employment</td>
<td>8.2</td>
</tr>
<tr>
<td>Income doubling plan (1961–1970)</td>
<td>Maximizing economic growth, raising the living standards, complete employment</td>
<td>10.5</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Plan and its duration</th>
<th>Strategic goal</th>
<th>Average annual GDP growth, %</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>planned</td>
</tr>
<tr>
<td>Mid-term economic plan (1964–1968)</td>
<td>Eliminating disproportions of development</td>
<td>9.9</td>
</tr>
<tr>
<td>Economic and social development plan (1967–1971)</td>
<td>Achieving balanced and stable economic and social development</td>
<td>10.2</td>
</tr>
<tr>
<td>New economic and social development plan (1970–1975)</td>
<td>Creating favorable living conditions for the nation by balanced and stable economic growth</td>
<td>12.4</td>
</tr>
</tbody>
</table>

**China**

China is the most impressive example of economic development being successfully managed by the state in modern times. In 1984, the People's Republic of China set the goal of quadrupling GDP by 2000.
The task seemed unrealistic at the time. Some Western and even “Soviet” analysts viewed these statements as another reanimation of the voluntarist policy from the times of the Great Leap Forward. However, skeptics were soon put to shame. By 2000, GDP per capita increase almost by 4.4 times. By the end of the millennium, China’s GDP increased five times over the pre-reform level.

Currently, China sets equally ambitious, long-term goals: to reach the level of the leading Western countries in per capita consumption within the next 30-50 years. By 2020, the Chinese society is expected to reach the average prosperity level. At the next stage, which is scheduled until 2050, the country should reach the level of highest living standards.48

Western experts, blindfolded by stereotypes of the liberal theory, are skeptical again. Planning for half a century! Russian statesmen, who think a three-year budget is a great achievement, probably cannot even imagine such a level of strategic planning.

1.6. Strategies of the modern economic history

The notion of “strategy” as applied to the sphere of economic management was not recognized until recently. Its absence in the lexicon of the economic theory reflected prejudice against long-term management modeling. It was not until 1962, at a conference in Vanderbilt University, that Igor Ansoff formulated the idea of strategic management, albeit he applied it mostly to corporate management.49

The history of the economic theory’s development demonstrates that dominating strategies periodically change. During the second half of the 20th century analysts identified six consecutive strategy platforms.50

The first stage, that of the 1950s-1960s, featured the idea of economic expansion. The main emphasis was on programming growth. Quantity of produced goods was the formula of strategic success.

The second stage, dated 1965–1975, was defined by the doctrine of diversification and merging. A diversified economy remained stable against potential crises. If the market situation for one of the goods changed, the system remained afloat due to other industries, unrelated to this one. The import-replacing model of development became popular in developing countries. Major multinational companies also stopped specializing in a narrow field of activity.

The diversification strategy became less popular in the 1970s, at the time of an unprecedented oil boom. Countries with a surplus of resources faced the temptation of mono-industrial export specialization.

The third stage in the evolution of economic strategies took place since the mid-1970s through the mid-1980s. It involved the imperative of economizing. Initially, transition to this strategy was a way for companies to adapt to more and more frequent crises and fluctuations. Gradually, most economists became convinced that the way to win in the global competitive struggle is to minimize costs. It was exactly during this period of strategy evolution that the Soviet formula of success “the economy must be economical” emerged.

The fourth stage of modifying economic strategies, that of de-concentration, was ideologically the opposite of the second stage. The economy was deemed successful if it was specialized. Any concentration, both on the state and the corporate level, was viewed as decreasing economic dynamics. Russia’s second ascension to the oil exports peak that started in the late 1990s matched the strategy of specialization, which dominated the world economic theory at the time.

The fifth stage was that of selective growth. It was logically linked to the previous era. Integral development of the system under harsh time limitations caused by competition seemed unrealistic. Selecting few breakthrough areas was the winning strategy. In particular, this kind of strategy caused several countries, including Russia, to concentrate their economic potential on a number of national priority projects. Disproportional development, which is a natural consequence of this strategy, was not viewed as a significant threat at that stage.

The sixth, current stage of strategic economic planning features the idea of investing in new promising technologies and growing markets. The concepts of “innovative development” and “economics of knowledge” become hallmarks of the new strategy. Transition from empha-
sizing material resources to intellectual renewable resources is view as a promising direction.

The fact that these economic strategies replace one another rather rapidly indicates that they are vulnerable. Essentially, every new crisis of the world economy put an end to yet another strategy, demonstrating its ineffectiveness.

Based on this experience, the task we face today is to formulate a strategy for long-term application. It seems that the concept of stable economic development meets this criterion. The principle of stability and morality makes it durable with regard to time. At the same time, making the idea of development, not just, say, growth or diversification, the banner of the concept causes us to focus on the goal of the economic policy, not on its means (which in reality often replace the goal).

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Thus, the international experience of economic development proves that economic processes are, in principle, manageable. If the nature of economic phenomena is knowable, then their results can be predicted, planned, and, most importantly, purposefully achieved. The strategy of long-term stable development of Russia's economy is based on faith in human mind. Accordingly, the tasks facing the economic science are no longer just to describe facts but to act creatively and constructively. It is necessary to overcome epistemological agnosticism of absolutizing the market, liberal self-regulation.

Another strategic barrier in the way of economics is its disciplinary self-isolation. If the category of “value” is added to the theory of economics as a factorial platform, it seems this will allow to overcome the methodological dead-end and synthesize the totality of humanitarian knowledge, which has greater creative potential, in the field of economics.

1.7. Concerning one problem of the methodology of scientific and expert analysis

When analysts use the method of comparing countries and historical periods, they deal with statistical data. But, interestingly, in scientific and expert discourse, this method yield opposite results with different researchers!
This may be caused by mistakes, including those made by the authors themselves. Thus, it would be good to double-check one’s work. Another possible explanation, especially when dealing with matters of public politics, is that the data is rigged; the information is “stretched” to match a certain “decision” made ahead of time. Clearly, such situations have nothing to do with science.

In particular, the above-mentioned challenge applies to conclusions made about the optimal share of government spending in GDP.

Opponents of the idea of optimal, rather high share of government spending in the country’s GDP, who represent the neoliberal, monetarist trend in the economic theory, also use statistics. To illustrate, we may analyze methods of presenting statistical evidence in the works of a former economic of the Russian president.  

He presents not only statistics, but even countries as examples, in a deformed manner. A single-aspect phenomenon, taken outside the general context of the system’s economic development, eventually assumes distorted, “interpretative” appearance. For instance, he refers to the dynamic growth of GDP in China and makes this part of his concept about the correlation between reducing the share of government spending and the growth of GDP. At the same time, the author ignores the specificity of the Chinese economy. Yet differentiation between private and state property in the Communist China is not so clear-cut. The permanent deficit of the Chinese budget also does not fit with the monetarist theory. But those facts that contradict the general logic of the monetarist theory are either ignored or artificially leveled out. 

Even Karl Marx accused followers of Smith’s classic economics of propensity for metaphysics, of being static and of considering economic processes outside their historical context. Not much has changed in

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53 Aleksandr Selishchev and Nikolai Selishchev, op. cit., 112, 115.
the modern discourse. Static analysis is a typical method for stretching statistics with regard to the GDP growth.

Indeed, GDP growth is generally higher in those countries that have a lower level of government spending. This is quite understandable, because economically backward countries, as they switch to the way of modernization, must have higher growth than developed countries. However, this dynamics is caused not by denationalization, but often by other, multiple reasons. Absolute starting levels of macroeconomic indices are very important here.

For example, if the monetary aggregate in GDP of a country increases, it is one thing if the starting level of monetization is optimal or higher than optimal, and inflation in this particular economy is of monetary nature. Exceeding the optimal monetization level in this case will naturally lead to inflation.

However, if in this economy inflation is not monetary, prescriptions against it should be completely different. If the starting level of monetization is unreasonably low, as, say, in Russia today, then monetization may be increased by several times without causing inflation. But the former presidential advisor is not interested in these distinctions. The policy of decreasing the economy’s monetization, which he and the minister of finance support, is applied to Russia, where monetization is already extremely low.

Causalities cannot be established in a static model or when using average figures for different periods. In order to bring out cause and effect, one has to take a historical, temporal approach to modeling. Yet the former presidential advisor ignores it.54

In the meantime, if we consider the most dynamic national economies over medium and long periods of time (short-term data is of no use here), in every case we can see a trend for the state’s share to increase. If we lag behind economic leaders of the modern world in this regard, this does not mean their development is going the opposite way. On the contrary, increasing dynamics of economic growth is directly related to expanding the state’s involvement in the economy. Considering trends in the world, achieving the same level of state participation in the economic life as in developed countries and progressing economies is just a matter of time. Figure 1.3 demonstrates the general tendency for the share of government spending in GDP to increase both

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54 Andrei Illarionov and Natalya Pivovarova, op. cit.
for economically developed countries and for countries that pursue
them in their development.

Another typical method for manipulating statistics is to omit coun-
tries’ identification in presented graphic data. Countries are represented
with dots, without proper designation. Indeed, the highest dynamics of
the GDP growth is demonstrated by countries that have the lowest rate
of government spending in GDP. But the author does not specify what
stands behind those dots.\textsuperscript{55}

Yet the least nationalized economic systems in Europe are those
of Baltic States. The GDP growth in the Baltic States is indeed higher
than in Western Europe, but for compensatory reasons (see Fig. 1.3).\textsuperscript{56}
But can the economy model of the Baltic States be really regarded as
an pattern for economic decisions in countries that are totally different
from the small Baltic States? Statistical comparisons between countries
or historic periods with ensuing conclusions can only be made when
working with sets of comparable countries, only while taking into ac-
count their comparability.

Using the method of concealing countries’ identity, the expert
makes comparisons, yet fails to point out that the lowest share of gov-
ernment spending in GDP is in the countries of Black Africa. The same
countries demonstrate astounding zigzags of ups and downs, thus pro-
ducing from among themselves “world leaders” in terms of the GDP
growth. For instance, in 1994–2004 Equatorial Guinea had the highest
level of growth in the world.\textsuperscript{57} Undoubtedly, most often neoliberals ap-
peal to Western standards. But they conceal the fact that the West is go-
ing in the way opposite to the one they recommend to Russia by using
manipulated, nameless statistics.

With rare exceptions that only confirm the rule, even during short
periods developed Western countries demonstrate steadfast increase
in the share of government spending in GDP (Fig. 1.4).\textsuperscript{58}

\begin{itemize}
\item \textsuperscript{55} Ibid.
\item \textsuperscript{56} Rossiya i strany-chleny Yevropeiskogo soyuza. 2005: Statisticheskii sbornik. (Moscow, 2005), 186; Rossiya i strany mira. 2006: Statisticheskii sbornik. (Moscow, 2006), 286.
\item \textsuperscript{57} Mir v tsifrakh. 2007 (Moscow, 2007), 20.
\item \textsuperscript{58} Rossiya i strany-chleny Yevropeiskogo soyuza. 2005: Statisticheskii sbornik. (Mos-
cow, 2005), 186; Rossiya i strany mira. 2006: Statisticheskii sbornik. (Moscow, 2006), 286-287.
\end{itemize}
<table>
<thead>
<tr>
<th>Country</th>
<th>% of GDP</th>
<th>Country</th>
<th>% of GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sweden</td>
<td>58.1</td>
<td>Denmark</td>
<td>56.1</td>
</tr>
<tr>
<td>France</td>
<td>52.9</td>
<td>Austria</td>
<td>50.8</td>
</tr>
<tr>
<td>Finland</td>
<td>50.5</td>
<td>Belgium</td>
<td>48.4</td>
</tr>
<tr>
<td>Netherlands</td>
<td>48</td>
<td>Italy</td>
<td>47.8</td>
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<tr>
<td>Germany</td>
<td>47.3</td>
<td>Slovenia</td>
<td>45</td>
</tr>
<tr>
<td>Portugal</td>
<td>44.8</td>
<td>Poland</td>
<td>43.4</td>
</tr>
<tr>
<td>Belarus</td>
<td>44.1</td>
<td>United Kingdom</td>
<td>42.9</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>40</td>
<td>Hungary</td>
<td>42.5</td>
</tr>
<tr>
<td>Slovakia</td>
<td>39.4</td>
<td>Bulgaria</td>
<td>36.6</td>
</tr>
<tr>
<td>Switzerland</td>
<td>35</td>
<td>Spain</td>
<td>34.3</td>
</tr>
<tr>
<td>Latvia</td>
<td>33.3</td>
<td>Lithuania</td>
<td>31.5</td>
</tr>
<tr>
<td>Estonia</td>
<td>28</td>
<td>Romania</td>
<td>25.9</td>
</tr>
</tbody>
</table>

Fig. 1.3. European countries by the share of government spending in GDP
The statist tendency of development among Western countries becomes even more obvious when we consider a longer period (Fig. 1.5). Thus, the dominating position of the Western economy in the modern world was formed as the state factor increased. Therefore, the historic trend was exactly the opposite of what the former presidential advisor claims as correlation and recommends to the Russian authorities.\textsuperscript{59}

Such manipulations are not innocent. They have been the foundation which Russia’s economic policy is based on. This seems to be a grave mistake and causes huge harm to the country. Back in 1997, the share of government spending in Russia’s GDP was 47.9%, but by 2003 it had already reduced to 36.3%. This figure is one of the lowest among European countries. Surprisingly, Russia, which has a long historical tradition of statism, became the most denationalized country, while

the West, with its characteristic liberalism, is now definitely taking the lead in statism.

As a rule, a comprehensive economic analysis considers both the growth dynamics of GDP and its absolute value. However, those engaged in manipulations limit themselves in their analysis to the former element. Had they analyzed, in addition to correlation between government spending and growth dynamics, correlation with GDP absolute values, their conclusions would have been contrary to the ones they drew without doing so. If the correlation index for these two factors were -0.2, this would indicate that the state’s involvement in managing economic processes is a most important factor of economical development in the modern world.\textsuperscript{60}

\textsuperscript{60} Rossiya i strany — chleny Yevropeyskogo soyuza. 2005: Statistichesky sbornik (Moscow, 2005), 186; Rossiya i strany mira. 2006: Statistichesky sbornik (Moscow, 2006), 75–77, 286–287.
Of course, one has to keep in mind that what we mean by the state’s involvement in managing economic development is not global and rigid planning and distribution, but rather a possibility to use the state’s economic mechanisms (law-making, investment policy, monopoly regulations, etc.).

Another fundamental belief of the neoliberal approach advocated by the former presidential advisor is that a surplus budget is a key factor of economic development. He presents statistics for various countries, “proving” that a budget deficit has a negative effect on the economy. But again, he keeps mum about what countries in the deficit-surplus spectrum he is talking.

For instance, if we consider statistics for G8 countries’ budgets, we will see that Russia and Canada are the only two countries to have a positive budget balance (the Canadian economy, to a large degree, is but an appendix to the US economy—Fig. 1.6).\(^\text{61}\) China and India, usually viewed as future geo-economic leaders, have permanently deficit budgets. The Maastricht Treaty indicates that EU member states are allowed to have a budget deficit under 3%.

\[\begin{array}{cccccccc}
\text{Country} & \text{Russia} & \text{Canada} & \text{United Kingdom} & \text{Germany} & \text{Italy} & \text{France} & \text{Japan} & \text{United States} \\
\text{2000} & -1.2 & 1.9 & -4.2 & -3.8 & -1.8 & -3.5 & -3.6 & -5.7 \\
\text{2001} & 2.9 & 1.7 & 1.1 & -3.1 & -1.5 & -2.6 & -3.6 & -5.5 \\
\text{2002} & 1.3 & 2.8 & -0.3 & -1.8 & -1.2 & -0.1 & -2.3 & -3.5 \\
\text{2003} & 0.9 & 3.4 & -0.4 & -1.2 & -1.8 & -3.5 & -2.1 & -3.5 \\
\text{2004} & 4.5 & 3.4 & 2.4 & 2.8 & 0.8 & 3.4 & 2.4 & -3.6 \\
\end{array}\]

Fig. 1.6. Budget deficit/surplus in G8 countries (percent of GDP)

\(^{61}\) “Gruppa vosmi” v tsifrakh. 2006. Statistichesky sbornik (Moscow, 2006), 81.
The goal pursued by the former presidential advisor was to justify the obvious contradiction between the recommendations for Russia’s development he insisted on and the experience of Western countries. The solution he found was to use a special method of dividing world economies into groups; according to this division, Russia does not belong to the group of developed countries. Based on this assumption, he asserted it was wrong to apply their statist logic of development to Russia. The conclusion he made was that the government spending level of 36–38% is too high for Russia. He recommended the level of 18–21%.62

Based on the proposed method of dividing countries into groups, the former presidential advisor claimed that the size of a state, understood as the scale of its activities in the economic sphere, does not depend on whether the state has access to the ocean, on whether it has enough land for agricultural needs, on the population density, on religious diversity among the population, on the GDP absolute value, on oil exports or imports, on the administrative division of the country, on its inflation tax, or on the index of trade conditions.63

As a result, the environmental conditions in which states develop were ignored. The classification was carried out solely according to GDP per capita.64 Eventually, Russia was placed in the group of economic underdogs together with countries of Black Africa. (Its closest neighbors, according to the per capita income, are Congo and Botswana.) The analysis simply ignored all Russia’s potential resources and historical accumulations.

The result of the correlation analysis, performed on such groups, was that a tendency was “discovered”: underdeveloped countries with medium or large populations have the lowest level of government spending, while developed countries demonstrate highest levels. Therefore, since Russia does not belong to the latter group, its proactive state policy is not typical for its level.

Such manipulative correlations collapse when the regional context of compared countries is considered. It is obvious that the economy of European countries is very different from that of African countries in

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62 Andrei Illarionov and Natalya Pivovarova, op. cit., 42; Andrei Illarionov, Razmery gosudarstva v Rossii vdvoye bol’she, chem. mozhet vnesti otechestvennaya ekonomika.
63 Andrei Illarionov and Natalya Pivovarova, Razmery gosudarstva i ekonomichesky rost, 24.
its institutional parameters. For the analysis to be correct, the tendency should have been verified for each region separately.

Let us now do it based on European countries’ statistics. Correlation analysis indicates that the inverse relationship between the share of government spending in GDP and the population of the country, “discovered” by manipulations, does not exist. (The correlation coefficient is merely 0.19.) The Baltic states have relatively small population, and they also have the lowest levels of government spending in GDP.65

Another manipulatively “discovered” tendency is based on the proposition that the budget deficit decreases with the level of economic development. “In other words,” writes the author, “as the level of economic development rows, the budget policy becomes more responsible, and its quality, as a rule, improves.”66 Responsibility means spending less money from the budget. To verify this statement, let us now turn again to statistics of West European countries and compare the countries’ list against the deficit or surplus balance of their consolidated budgets (Table 1.4).67

<table>
<thead>
<tr>
<th>Deficit budget</th>
<th>Surplus budget</th>
</tr>
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<tbody>
<tr>
<td>Austria</td>
<td>Belgium</td>
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<td>United Kingdom</td>
<td>Bulgaria</td>
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<td>Hungary</td>
<td>Greece</td>
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<td>Germany</td>
<td>Denmark</td>
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<td>Netherlands</td>
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<td>Poland</td>
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<td>Portugal</td>
<td>Romania</td>
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<td>Slovakia</td>
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<td>France</td>
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<td>Czech Republic</td>
<td>Switzerland</td>
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<td></td>
<td>Sweden</td>
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<td></td>
<td>Estonia</td>
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</tbody>
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65 Rossiya i strany — chleny Yevropeyskogo soyuza. 2005: Statistichesky sbornik (Moscow, 2005), 186; Rossiya i strany mira. 2006: Statistichesky sbornik (Moscow, 2006), 13, 286.
66 Andrei Illarionov and Natalya Pivovarova, op. cit., 28.
67 Rossiya i strany — chleny Yevropeyskogo soyuza. 2005: Statistichesky sbornik (Moscow, 2005), 186; Rossiya i strany mira. 2006: Statistichesky sbornik (Moscow, 2006), 286.
It is obvious that, economically, the countries in the left column look more impressive; it is this column that EU economic leaders like Germany, United Kingdom, France and Italy are in. Does this mean that their budget policies are less responsible than those of Romania and Estonia? The conclusions drawn by the former presidential advisor not only cannot be confirmed from European statistics; in fact, they are contrary to the actual situation.

On the one hand, the above-listed examples confirm that erroneous and harmful decisions are being imposed in Russia in various ways. On the other hand, they demonstrate how crucial it is to have proper grounds for making strategic, managerial decisions for the country’s economic policy to be successful.
Chapter Two
The Myth About the Market
Being Absolutely Self-regulated

Neoliberalism suggests building the system of a self-regulated market as the main benchmark in its guidelines for the economic policy. The idea of the market mechanism being functionally self-sufficient is at the heart of the neoliberal concept.

However, while we recognize the ideal of the free market as one of the models in the history of social thinking, one has to ask whether it is at all possible to organize such a system in real economic practice. In keeping with this question, the goal of our analysis will be to verify neoliberal development benchmarks, to see if there are any logical contradictions in them and to assess how realistic these benchmarks are. One should not forget that the goal of switching to the free, self-regulated market was the keynote of the reforms that took place in Russia’s economy in the 1990s. The goal still remains on the agenda today.

2.1. The world-view context of the genesis of the self-regulated market theory

Recently, experts who analyze the development of transition economies began to use the term “market fundamentalism” to describe the axiological and mental outlook of neoliberal theories’ supporters. The phenomenon is deemed similar to that of religious fundamentalism. Indeed, the similarity here is not only qualitative but even genetic. The theory of the self-regulated market was founded on a particular model of world perception.

The genesis of the concept of the free, self-regulated market took place within the framework of a specific model of the universe, which became popular in Western Europe in the second half of the 18th century. It won’t be an exaggeration to say that the principle of laissez-faire, proposed by Adam Smith, originated from the religious beliefs of the

Scottish scientist. To him, political economy was not an independent discipline; it was the fourth, final part of the course that included theology, ethics and law as well. If separated from the theological level, the economic section would be deformed, which is what happened with the followers of Smith’s approach.

The concept of the self-regulated market was directly related to the pantheistic teaching, which was widespread in the Age of Enlightenment. Pantheism implied natural emanation of the divine substance. According to this understanding, nature was endowed with reason.

This is where the concept of the self-regulated market originates from. Its was thought to be self-regulated based on faith in that economic mechanisms were initially ordained by the Supreme Reason. To deny the self-sufficiency of the market was to question the reasonableness of the divine order. While being self-regulated in the human sense, the market was manageable theologically. In line with the Zeitgeist of the Enlightenment, the market economy was viewed as a smoothly running mechanism. Even free competition was viewed as a mechanical process. Each competitor was thought to perform divinely appointed mission in the general plan of the system. The “invisible hand,” which governs the market in Smith’s theory, is the “divine Providence.”

It was only in this world-view approach that the state was justified in not managing the market. Of course, state management could not be more perfect than the divine one. But should a modern economist share the views of Smith’s theology?

It is obvious that the self-regulated market has strong ties with the context of the “natural religion” of the 18th century. Whenever another world-view paradigm is chosen, the logic of the self-organized market system falls apart. Also, it is necessary to point out that the theology of the Supreme Reason is cardinally different from that of traditional religions (e.g., the Orthodoxy).

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2 V.V. Sokolov, “K istoricheskoi kharakteristike panteizma v zapadnoyevropeiskoi filosofii,” Filosofskie nauki (Nauchnye doklady vysshei shkoly) (1960, No. 4).
3 Andrei Anikin, Adam Smith (Moscow: Molodaya Gvardiya, 1968), 58-64; Valentin Yakovenko, Adam Smith. Yego zhizni i nauchnaya deyatel’nost (St. Petersburg, 1894); Adam Smith, The Theory of Moral Sentiments (Cambridge University Press, 2005); David Hume, The Natural History of Religion (Stanford University Press, 1957); Dialogues and Natural History of Religion (Oxford University Press, 1998).
Adam Smith’s considerations concerning the market model of economy were based on the concept of a universal type of man—*homo economicus*. The motives of human behavior were reduced solely to economic interests, to obtaining profit. However, Karl Polanyi has already proved Smith’s anthropology wrong. According to him, man follows primarily social motives, not economic ones. Therefore, his behavior does not always match the simplistic scheme of looking for pragmatic benefit.

Some Nobel laureates have recently engaged in research to refute the myth of *homo economicus*. In 1986, the Nobel prize was awarded to James M. Buchanan “for his development of the contractual and constitutional bases for the theory of economic and political decision-making.” Later, the American economist wrote, “The theory requires for its usefulness only the existence of the economic relation to a degree sufficient to make prediction and explanation possible. Furthermore, only if the economic motivation is sufficiently pervasive over the behavior of all participants of market activity can economic theory claim to have operational meaning.”

In 2002, the Nobel prize in economics was awarded to a psychologist rather than to an economist—to Daniel Kahneman from Israel. Essentially, he discovered that grounds for economic activities were psychologically variable (“for having integrated insights from psychological research into economic science, especially concerning human judgment and decision-making under uncertainty”). In a number of works, Kahneman has vividly demonstrated that “economic man” is a rather rare type of person. Moreover, it is a sort of deviation against the backdrop of the majority of mankind thinking uneconomically.

Thus, the self-regulated market was proved to be merely a metaphysical abstract notion that has nothing to do with people’s actual economic behavior.

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5 “Velikaya transformatsiya” Karla Polanyi: *Proshloye, nastoyashcheye, budushcheye*, Ed.: R.M. Nureyev (Moscow, 2006), 143.
2.2. What does this have to do with liberalism?
The historical genesis of the market economy

The free market at the scale of national economies has never and nowhere existed. This was an ideological marker of a type of system, not an actual practice of regulating economic processes.

The neoliberal discourse uses misleading terminology. The market economy is identified with the market self-regulation. To understand the distinction between the two, we may consider their dual opposites. While the model of managed economy is the antipode of the self-regulated market, a totally different essential paradigm is the alternative of the market system. Its opposite is not state regulation but rather a model of natural economy.

Historically, the genesis of the market was not linked to liberalization neither at the microeconomic nor at the macroeconomic level. Its determinative factor was the process of professional division of labor. When labor diversification reached the level where the majority of a country’s population were market-oriented, i.e., preferred to sell their labor and its results, the crucial transfer from natural macroeconomics to market macroeconomics occurred.

The neoliberal illusion is rooted in the anti-historical approach of Adam Smith’s theory, which considers economic processes outside of their temporal context. This approach was typical of the mechanistic understanding of the world during the Enlightenment era, but it is hopelessly archaic in modern times.

Market mechanisms were developed under the state’s supervision throughout history. The institutionalization of the state authority in itself was a form of labor division; thus, it was inseparable from the development of the market. To support the authorities materially, there was a need for surplus, and this required going beyond the traditional format of the natural economy.

Fernand Braudel was one of the first to point out a correlation between a strong political regime and the country’s dynamic economic development. Those states that found strength and resources to regulate their economies experienced swift economic growth. “At the centre of the world-economy, one always finds an exceptional state, strong, aggressive and privileged, dynamic, simultaneously feared and admired. In the fifteenth century it was Venice; in the seventeenth, Hol-
land; in the eighteenth and still in the nineteenth it was Britain; today it is the United States. There were strong governments then, in Venice, even in Amsterdam, and in London, governments capable of asserting themselves at home, of keeping ‘common people’ of the towns in order, of raising taxes when the situation required, and of guaranteeing commercial credit and freedom; capable too of asserting themselves abroad,” Braudel wrote based on his studies of the Middle Ages and modern history.\(^8\) Hardly anyone can question the fact that the listed states dominated the world, each in its own era, asserting the principles of market orientation.

The development of national markets in Europe was one of the mechanisms of the state centralization pursued by monarchy. “Not surprisingly then, there was inevitably behind the national market a centralizing political will—fiscal, administrative, military or mercantilist.”\(^9\) It is noteworthy that the emergence of national markets in Europe coincided in time with the formation of absolute monarchies.

To develop market infrastructures of the state authority, it was necessary to tear down various feudal barriers, such as internal tolls. Of course, there could be no self-regulated economic system at the time. The creation of the national market in the 17\(^{th}\)-century Muscovy was taking place simultaneously with the institutionalization of serfdom. Thus, the market-oriented nature of the economy did not correlate with the level of freedom. Moreover, had the market been left to its own devices, without proper care from the state, it would have been doomed. There may have been variations among market economies as to the level of state regulation, but having no regulation was not an option. The goal for each specific national system is to find the optimal level of regulation.

There were some deviant forms of development in the history of the world economy, usually in economically peripheral areas. The self-regulated market is one of these economic deviations. As a rule, such free enclaves appeared outside states’ economic borders. Their most typical format was a colonial trading post. The cooperation between colonizers and autochthons was based on the principles of free-market exchange. Of course, everybody knows what the con-


\(^9\) Ibid., 187.
sequences of this free market were for indigenous peoples. Slavery (which, by the way, made the United States wealthy in the 18th and 19th centuries) was but one of many catastrophic manifestations of absolutizing the principle of market freedoms. African tribes did not have a developed state, which could subdue the element of the market, at the time.\textsuperscript{10}

British colonizers exported the self-regulated market not only to Africa but also to other places, e.g., Ireland. Back in the 18th century, British politicians were fully aware of the free market concept as a universal ideology of colonial exploitation. Adam Smith, who was an employee of the East India Company, must have understood this very well. For Ireland, the free market turned into a “humanitarian catastrophe.” As the Bishop of Cloyne was listing numerous agricultural products exported by the Irish to Britain, he wondered “how a foreigner could possibly conceive that half the inhabitants are dying of hunger in a country so abundant in foodstuffs?”\textsuperscript{11}

The paradox of extreme poverty paired with vast resources is now familiar to Russia as well. The source of this paradox is in the ideological myth concerning the free market.

The implementation of market mechanisms in economically successful countries of the modern world took place asynchronously, in different historical eras. This process spanned more than three centuries. Although it had its peculiarities in each country, the general trend was that the role of the state increased during the transfer from paternalist economy to the market. For Great Britain in the 18th century the state factor did not play a major role in establishing capitalist relations. For Germany and the United States, which went through market reforms in the 19th century, the role of state regulation has increased significantly. For Japan, the state factor played a decisive role in switching to the market economy. Finally, for China or South Korea, who were among the last to start building the infrastructure of the private market, the state management was the core of the market development. Therefore, the absolute denationalization of the Russian reforms was contrary to transformation tendencies in the rest of the world.

\textsuperscript{10} D.P. Ursu, \textit{Istoriografiya istorii Afriki} (Moscow, 1990).

\textsuperscript{11} Fernand Braudel, \textit{The Perspective of the World} (Harper & Row, 1984).
2.3. Free market as a deviation in the history of economics. The case of Africa

Even today, the absence of balanced state regulations and the deviation towards self-regulated market exchange is a detonating factor for developing countries’ national economies. The devastating consequences of the free-market orientation are most clearly visible in the modern world. This may be demonstrated by economic development parameters of African states, which allow us to compare the effectiveness of the two development models they have used after achieving sovereignty.

Initially, liberated peoples of Africa favored the system of tight state regulation with elements of nationalization and with an emphasis on replacing imported goods with their own production. For example, the public sector in Guinea accounted for almost 100%; in Algeria, 85%; in Tanzania, 75%. Taking into account the experience of the USSR, African countries intended to carry out industrialization over a short period of time. “Thus, during the first 10-15 years, the economic development of almost all African countries followed the scenario of administrative regulation, replacing imports, and limiting foreign capital,” modern researchers of the foreign economies’ history write.

In the 1980s, when the international socialist system collapsed, the IMF and the IBRD initiated a change in the economic development model of African states. As a condition for further loans, they demanded that African countries reduce state control, privatize the public sector, shift the emphasis on export industries, and liberalize imports.

As a result of the African continent’s denationalization, its economy degraded for a long period of time. The share of Black Africa in the world output, which initially grew, albeit very slowly, now began to reduce (Fig. 2.1). Average GDP per capita for the region decreased (Fig. 2.2). Such a drop in the per capita GDP was observed in the 1980s in 21 of 38 African countries; in the 1990s, in 19 countries. At the same time, those countries that did not join the IMF program retained the dynamics of a moderate growth (1% per annum).

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Fig. 2.1. The share of Black Africa in GWP

Fig. 2.2. GDP per capita in Black Africa countries (in 2005 prices and PPP)
The catastrophic collapse of the Congolese economy is particularly striking. In 1980, the socialist republic had the 8th highest per capita income in the world ($22,400). Ten years later, at the end of the socialist era, the country had reached the 5th place ($27,700) immediately behind developed Western countries: Luxembourg, the Netherlands, the United States, and Switzerland. But after another ten years, in 2000, the liberalized Congo was at the 47th place; five years later, in 2005, its national economy dropped on the international scale of development by five more lines. By the way, the next line was occupied by Russia.\(^\text{14}\)

Western theoreticians of the free market recommended African countries to minimize state management of the social sphere. As a result, vast majority of the Black Africa population lost access to education and health care. Thus, in 1960, Ghana spent $4.2 per capita on education; and in 1972, $12; but in the 1990s, only $1. Without proper financial support, the health care system degraded, and the African continent fell to all sorts of pandemics.

One of them was AIDS, which now poses a threat to all mankind. It swiftly spread across the continent right at the time when the model of state management in economy was replaced with the paradigm of the free market. Of 34 million people infected with the immunodeficiency virus, approximately two thirds live in Tropical Africa. The example of Africa vividly demonstrates the destructive power of absolutized liberal reforms, which can affect not only individual countries but even continents.\(^\text{15}\) What is taking place in Russia is not much different from the situation in the above-mentioned countries.

This conclusion is also confirmed by the materials presented in the works of Joseph Stiglitz, who has thoroughly analyzed IMF and World Bank activities in African states.

2.4. An anti-market deviation: the experience of the Communist economy

Another deviation from the market economy was an attempt to switch from the market, which implies buying and selling goods, to

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administrative distribution. While the first deviation pushed the market principle beyond any reasonable limit, the second one emphasized the idea of manageability too much.

In fact, the system of total distribution in its pure form was extremely rare: the policy of wartime communism in Russia, Maoist experiments during the Great Leap Forward era in China, and the Khmer Rouge regime in Kampuchea. The abolishment of money was to become the next step in a transfer to distributive management mechanisms. But the money, as well as the market exchange of goods, did survive. Any attempts to abandon the market economy were short-lived and were always renounced because of the colossal economical damage they incurred.¹⁶

The liberal stereotype concerning the economic system of the USSR not being market-type has been deeply entrenched in the minds of the people. In reality, elements of the market were present in the Soviet Union even during most authoritarian periods of its history. Administrative planning and strict pricing policy did not mean that the principle based on professional division of labor and exchange of goods was cancelled. In this case, the state assumed the function of a mediator. Soviet textbook on political economy always included a section on the special nature of the socialist market.

The actual system of economic development in the USSR was cardinally different from the Utopia of the extreme left. In the West, there was the same discrepancy between ideology, with the concept of the free market at the core, and practice. Interestingly, Leon Trotsky, a consistent follower of the leftist Communist ideology, saw one of the main defects of Stalin’s “counterrevolutionary” transformation in switching the entire Soviet economy to monetary circulation.¹⁷ Tuition fees, gas meters, commercial stores—all these historical facts of the Soviet era do not square well with the modern historical stereotypes. Some market elements were retained even during the period of maximal mobili-

¹⁶ Fyodor Burlatsky, Mao Zedong: “Nash koronny nomer — eto voina, diktatura” (Moscow, 1976); V. Vyatsky and F. Dyomin, Ekonomichesky avantyrizm maoistov (Moscow, 1970); S.A. Pavlyuchenkov, Voyenny kommunizm v Rossii: Vlast i massy (Moscow, 1997); N.S. Prisyazhny, Ekonomicheskaya chuma: Voyenny kommunizm v Rossii (Istoriko-ekonomichesky analiz. 1918-1921 gg.) (Rostov-on-Don, 1994); K.V. Kharchenko, Vlast—imushchestvo—chelovek: Peredel sobstvennosti v bolshevistskoj Rossii 1917 — nachala 1921 gg. (Moscow, 2000).

¹⁷ Leon Trotsky, Predannaya revolutsiya (Moscow, 1991).
zation component of the wartime state management. Already in 1944, along with the card system of goods distribution (ration cards were introduced in other European countries as well, e.g., in the United Kingdom), market-price trade centers were opened.\footnote{Ye.A. Osokina, \textit{Za fasadom “stalinskogo izobiliya”: Raspredeleniye i rynok v snabzhenii naseleniya v gody industrializatsii. 1927-1941} (Moscow, 1997); Ye.Yu. Zubkova, \textit{Poslevoennoye sovetskoye obshchestvo: Politika i povsednevnost. 1945-1953} (Moscow, 2000).}

Therefore, the market reform in the USSR could have been formulated not in the extreme dogmatic neoliberal formula: decentralization, desovietization, denationalization (DDD, according to G. Popov), which was aimed more at the destruction of the state, as it did happen in reality, but as a real optimization problem of introducing the market economy: proportionate ratio of various types of property, a combination of free and regulated pricing, a degree of the economy’s openness, etc., which did not happen.

\textbf{2.5. The synergic system of the market economy}

Back in 1990, Teodor Shanin, a professor at the University of Manchester, warned the Soviet leadership about the illusory nature of the absolutized free market concept. His concerns had to do with the emergence of “inverse Stalinism” among reformers, a totalitarian idealistic utopia of the self-regulated market. “Facts indicate,” the British researcher wrote, “that Western Europe (which is closer to the Soviet Union than other ‘Western’ countries in that it has both the same starting point of modern development—the devastation of 1945—and the same goal—“the affluent society”) is a bad example of the ‘free market.’

“For example, milk prices in Britain are clearly not a result of the market forces’ free operation. They are established by the government, the Commission of the European Communities, and national cartels. Construction of industrial facilities and residential building is governed in Britain (as well as in France, the Netherlands, and other countries) by state laws and municipal decisions, not just by demand and profit of construction companies. The “free market” may be found in textbooks written by monetarists, in campaign slogans of conservative parties, but in reality it exists only in Paraguay and Chile, not in Europe. In reality, successes and failures of our economic develop-
Development are determined by a combination of various economic and social forms, means and principles of their implementation. It is this free development of combinations, i.e., flexibility of interconnections, switching from one form to another, that makes our economic system strong, not the allegedly unlimited “freedom of the market” or any other deduction of the 19th century.”

Institutionalist James Galbraith was even more critical of the ideological myth about the self-regulated market. “Those who speak glibly and inconsiderately about a return to the free market of Adam Smith’s era are so wrong that their viewpoint may be regarded as clinical mental disorder,” he warned in an interview with Izvestiya. “It is a phenomenon that does not exist in the West, that we would not have tolerated, and that would not have survived.”

According to Galbraith’s analysis, for a modern economy to develop successfully, half of GDP should be controlled by the state. In the US, which is viewed as the flagship of the liberal idea, the share of government spending in GDP varies from 30% to 50%. Decreasing the state’s share in the economy increases development risks for the entire social system.

The concept of the self-regulated market has a disintegrating influence on all social systems in any of their administrative modifications. Karl Polanyi warned against its potentially catastrophic consequences long before economic neoliberalism has emerged. “To allow the market mechanism to be sole director of the fate of human beings and their natural environment, indeed, even of the amount and use of purchasing power, would result in the demolition of society,” he wrote in 1944.

Nobel laureate Lawrence Klein also warned Russian economists against the illusory nature of the free market. “Neither system functioned according to its best theoretical case,” he wrote about theoretic models’ inaccuracy. “In fact, each functioned in practice as a mixed economic system. There are planning and socialistic aspects to all economies that regard themselves as primarily capitalist. Similarly,

20 Izvestiya (1990, Jan. 31).
22 Karl Polanyi, The Great Transformation (Boston, 1944), 73.
there are market and private capitalist aspects of socialist planned systems. Both systems are imperfect in their real-world implementation, and it becomes a matter of judgment where they will end up in any transition process. The practical question facing the world economy at this time is where the former centrally planned economies will come to rest, as the transition process runs its course.”

Real economic systems, unlike theoretic economic models, are of synergistic nature. The notion of “heterogeneous economy,” which Vladimir Lenin referred to as a special feature of the capitalism in Russia, can in fact be applied to any national economy. Theories of “pure market,” as well as earlier theories of “pure capitalism” and “pure socialism,” were very speculative. Their modeling was based more on ideological considerations than on a realistic description.

2.6. A metaphysical market and a real market

It seems that neoliberal reformers in Russia had a vague idea of the true situation with the market economy in the West. What they used was mainly a theoretic, abstract concept of the free market that had nothing to do with economic reality. They used the free-competition market described by Adam Smith as their model for reformative plans. But market infrastructure has changed cardinally since the 18th century. Absolutely free competition, even it has been preserved in some places, is no longer the dominating economic pattern. Cooperative forms of capital interactions have emerged. Some even speak of their synthesis, of the so-called “coopetition.” The principle of *laissez-faire*, *laissez-passer*, which classical liberal economics was based on, is no longer relevant.

The phenomenon of oligopoly, which was ignored by neoliberals’ theories, has spread. The oligopolistic market has a limited number of sellers, who usually have a certain convention among them. Antitrust laws failed to prevent oligopolization. Oligopolies became the dominating format of major corporations’ market activity. In particular, this is absolutely true with regard to the modern Russian economy.

It would be interesting at this point to consider the evolution of the US car-manufacturing market. At the formative stage, more than 80

23 Lawrence Klein, “What Do Economists Know about Transition to a Market System?”, *The New Russia* (Stanford University Press, 2001), 77
companies actively competed against each other. Presently, 90% of the US car market has been distributed among the Big Three: General Motors, Ford, and Chrysler. The turning point in the history of explaining market relations came in 1933, when Edward Chamberlin introduced the concept of “monopolistic competition” into scientific usage. Prior to that, monopolies and competition were viewed as incompatible phenomena. But Chamberlin claimed that in the real market there is no such thing as pure competition. In practice, each seller of goods is a monopolist. Yet competition is not abolished; it is shifted from one product to the diversity of the buyer’s choice.\(^{24}\) Even Joan Robinson, one of the leaders and founders of the leftist Keynesian economics, wrote in her works back in the 1930s that in real economics oligopolies are much more widespread than the polar forms of monopolies and free competition.\(^{25}\)

Presently, the Western economic theory includes at least five market models: pure competition, pure monopoly, oligopoly, monopolistic competition, and monopsony\(^{26}\) (Table 2.1).\(^{27}\) Did Russian reformers know of such an abundance of theoretic options, when they set the goal of building a market economy in the 1990s but did not specify which variety they had in mind?

In reality, none of the market models has ever covered the entire macroeconomic field. As a rule, they co-exist within a national economy. Fernand Braudel wrote about the multi-level structure of the market economy, which existed in the 18th century and which became even more obvious in modern times.\(^{28}\)

The real market is heterogeneous by definition. It combines a multitude of levels and niches with intrinsically different market mechanisms. While free competition is more appropriate for some sectors (like retail street trade), monopoly is more appropriate for others (like railroad communications). Attempts to make the market homogeneous can only cause its crash.


\(^{26}\) Monopsony is a market system where sellers cannot influence the price of the sold good, which is determined by the buyer.


<table>
<thead>
<tr>
<th>Attribute</th>
<th>Free competition</th>
<th>Pure monopoly</th>
<th>Oligopoly</th>
<th>Monopolistic competition</th>
<th>Monopoly</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of sellers</td>
<td>Many</td>
<td>One</td>
<td>Few (no more than 10)</td>
<td>Many</td>
<td>Many</td>
</tr>
<tr>
<td>Seller's market power (Lerner index)</td>
<td>0</td>
<td>1,0</td>
<td>0,6–0,8</td>
<td>0,35–0,5</td>
<td>1,0 (for the buyer) The buyer determines prices</td>
</tr>
<tr>
<td>Sellers’ interaction</td>
<td>No strategic behavior</td>
<td>No strategic behavior</td>
<td>Strategic behavior</td>
<td>No strategic behavior</td>
<td>No strategic behavior</td>
</tr>
<tr>
<td>A firm’s market share</td>
<td>Insignificant</td>
<td>Significant</td>
<td>Significant</td>
<td>Insignificant</td>
<td>Any</td>
</tr>
<tr>
<td>Barriers for entering and leaving the market</td>
<td>No</td>
<td>Entrance is completely blocked</td>
<td>Yes</td>
<td>No</td>
<td>Maybe</td>
</tr>
<tr>
<td>Goods and services replacement degree</td>
<td>Absolute (standardized goods and services)</td>
<td>No replacements (unique products)</td>
<td>Various (standardized and differentiated goods)</td>
<td>High but not absolute (differentiated goods)</td>
<td>Absolute (standardized goods and services)</td>
</tr>
<tr>
<td>Information support for market transactions</td>
<td>Complete</td>
<td>Complete</td>
<td>May be complete or incomplete</td>
<td>May be complete or incomplete</td>
<td>The buyer has complete information about products</td>
</tr>
<tr>
<td>Attribute</td>
<td>Free competition</td>
<td>Pure monopoly</td>
<td>Oligopoly</td>
<td>Monopolistic competition</td>
<td>Monopoly</td>
</tr>
<tr>
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<td>-----------</td>
<td>-------------------------</td>
<td>----------</td>
</tr>
<tr>
<td>Typical industries</td>
<td>Agriculture</td>
<td>Pipeline transportation, energy processing systems, supplying resources for the municipal economy</td>
<td>Car manufacturing, electrical engineering, steel industry</td>
<td>Light industry, retail trade</td>
<td>Defense industry</td>
</tr>
<tr>
<td>Instruments for the state regulation of the market</td>
<td>Perfecting market infrastructure</td>
<td>Instruments for regulating natural monopolies</td>
<td>Progressive tax, antitrust measures</td>
<td>Progressive tax, antitrust measures</td>
<td>The state regulates prices for production factors; other measures</td>
</tr>
</tbody>
</table>

### 2.7. The challenge of TNCs

The opposite of the market self-regulation is not only state management but corporate management as well. It was monopolist corporations, not the state, that abolished niches of the pre-industrial free market. The historical alternative during the era of economic processes’ institutional transformation was not the “state—market” dichotomy; rather, it was along the “state—monopolies” line. This rivalry has now become particularly relevant because of TNCs’ global challenge. One may see transnational corporations behind the very phenomenon of neoliberal ideology spreading around the world. It would be naïve to think that neoliberal recipes may bring about a free market system. Once state regulation is subverted, TNCs have a clear field for their activities.

The administrative structure of transnational corporations is in many ways similar to that of a state. In major companies, unlike small and medium businesses, administrators do not own the company; they are officials, much like those in the public sector. Those companies have
as much bureaucracy, corruption, and red tape than the state. False reports, deceiving shareholders, speculations with securities—all this is what top managers of transnational structures regularly do. “Modern Western companies are cumbersome and extremely clumsy bureaucratic monsters,” Sergei Kara-Murza wrote in *V poiskakh poteryannogo razuma, ili Antimif-2*. “Western companies are even much more bureaucratic than the USSR during its last years.”

Assessing the quality of managerial services in TNCs is as difficult as among government officials. If we agree with the idea that the economic system of the USSR became stagnant because of inefficient government officials, we should also point out that “efficient American managers” played a similar role in the bankruptcies of major US private companies—Enron, WorldCom, and Arthur Andersen. On the other hand, in some cases managers are quite successful in running major corporations. But such cases can also be found when managerial functions are performed by the state. Thus, the regulation of economy performed by TNCs is in no way better than that performed by the state.

Yet there is at least one cardinal distinction between the two. Unlike the state, TNCs are not bound by social obligations. It is no accident that wherever attempts to implement neoliberal principles were made, society became more polarized with respect to people’s income. The tendency may be observed in the variation of the Gini index among those countries that have a social-democratic tradition (“Swedish socialism” model) and those that went through the neoliberal transformation of the first (Reaganomics and Thatcherism), second (neoliberal experiments in Latin America), third (Eastern Europe), and fourth (the former Soviet Union) monetarist waves (Fig. 2.3).

### 2.8. Causative relationship between economic freedoms and development

Can liberalization of the market be a factor of economic growth? All neoliberal development recipes are based on a positive answer to this question. To check this assumption, we need to compare the attributes of market liberalization with GDP dynamics.

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30 *Rossiya i strany mira* (2006), 105-106.
To carry out such a comparison, we may use a classification of countries prepared by Heritage Foundation and based on the economic freedom index. The index is based on the probability of restrictions, introduced by the government in the market’s economic sphere. The
combined index included the following elements: trade policy, taxes, currency policy, bank system, foreign investment rules, property rights, the amount of economic production consumed by the government, the policy of macroeconomic regulation, the size of “the black market,” price and wages control. Experts graded countries for each of these categories on a five-point scale. The less economic freedoms a country had, the higher was its rating.

Following that, we compared the list of countries with more economic freedoms against the list of countries with best and worst GDP dynamics over the last ten years. Out of 40 most free national economies in the world, only nine (22.5%) were among 40 leaders with the highest economic growth (Singapore, Ireland, Luxembourg, Estonia, Chile, Lithuania, Bahrain, Armenia, and Latvia); seven countries (17.5%) were in the group with the lowest GDP dynamics (Switzerland, the Netherlands, Austria, Germany, Belgium, the Bahamas, and Japan); whereas a vast majority, 24 countries (60%) were in the middle, intermediate category (Table 2.2).

Such a distribution indicates that there is no direct causative relationship between GDP growth and the level of economic freedom (the correlation coefficient is – 0.16).³¹

Table 2.2
Comparison between the economic freedom index and GDP dynamics

<table>
<thead>
<tr>
<th>Economic freedom index</th>
<th>Countries with highest levels of economic growth in 1994-2004, %</th>
<th>Countries with lowest levels of economic growth in 1994-2004, %</th>
</tr>
</thead>
<tbody>
<tr>
<td>#</td>
<td>#</td>
<td>#</td>
</tr>
<tr>
<td>1 Hong Kong 1.28</td>
<td>1 Equatorial Guinea 20.9</td>
<td>1 West Bank and Gaza Strip -2.8</td>
</tr>
<tr>
<td>2 Singapore 1.56</td>
<td>2 Bosnia 17.4</td>
<td>2 Zimbabwe -1.9</td>
</tr>
<tr>
<td>3 Ireland 1.58</td>
<td>3 Liberia 12.8</td>
<td>3 Sierra Leone -0.8</td>
</tr>
<tr>
<td>4 Luxembourg 1.60</td>
<td>4 Rwanda 10.2</td>
<td>4 Congo-Kinshasa -0.7</td>
</tr>
<tr>
<td>5 Iceland 1.74</td>
<td>5 China 9.1</td>
<td>5 Turkmenistan -0.4</td>
</tr>
<tr>
<td>6 United Kingdom 1.74</td>
<td>6 Myanmar 8.2</td>
<td>6 Burundi -0.1</td>
</tr>
</tbody>
</table>

³¹ Mir v tsifrakh (Moscow, 2007), 19-20.
<table>
<thead>
<tr>
<th>Economic freedom index</th>
<th>Countries with highest levels of economic growth in 1994-2004, %</th>
<th>Countries with lowest levels of economic growth in 1994-2004, %</th>
</tr>
</thead>
<tbody>
<tr>
<td>#</td>
<td>#</td>
<td>#</td>
</tr>
<tr>
<td>7</td>
<td>Estonia 1.75</td>
<td>7 Guinea-Bissau -0.1</td>
</tr>
<tr>
<td>8</td>
<td>Denmark 1.78</td>
<td>8 Haiti 0.1</td>
</tr>
<tr>
<td>9</td>
<td>Australia 1.84</td>
<td>9 Papua New Guinea 0.4</td>
</tr>
<tr>
<td>10</td>
<td>New Zealand 1.84</td>
<td>10 Barbados 0.8</td>
</tr>
<tr>
<td>11</td>
<td>United States 1.84</td>
<td>11 Jamaica 0.8</td>
</tr>
<tr>
<td>12</td>
<td>Canada 1.85</td>
<td>12 Uruguay 0.8</td>
</tr>
<tr>
<td>13</td>
<td>Finland 1.85</td>
<td>13 Venezuela 1.0</td>
</tr>
<tr>
<td>14</td>
<td>Chile 1.88</td>
<td>14 Argentina 1.1</td>
</tr>
<tr>
<td>15</td>
<td>Switzerland 1.89</td>
<td>15 Ukraine 1.1</td>
</tr>
<tr>
<td>16</td>
<td>Cyprus 1.90</td>
<td>16 Japan 1.2</td>
</tr>
<tr>
<td>17</td>
<td>Netherlands 1.90</td>
<td>17 CAR 1.3</td>
</tr>
<tr>
<td>18</td>
<td>Austria 1.95</td>
<td>18 Moldova 1.4</td>
</tr>
<tr>
<td>19</td>
<td>Germany 1.96</td>
<td>19 Switzerland 1.4</td>
</tr>
<tr>
<td>20</td>
<td>Sweden 1.96</td>
<td>20 Germany 1.5</td>
</tr>
<tr>
<td>21</td>
<td>Czech Republic 2.10</td>
<td>21 Macedonia 1.5</td>
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<tr>
<td>22</td>
<td>Belgium 2.11</td>
<td>22 Paraguay 1.5</td>
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<tr>
<td>23</td>
<td>Latvia 2.14</td>
<td>23 Italy 1.6</td>
</tr>
<tr>
<td>24</td>
<td>Malta 2.16</td>
<td>24 New Caledonia 1.6</td>
</tr>
<tr>
<td>25</td>
<td>Bahrain 2.23</td>
<td>25 Bulgaria 1.7</td>
</tr>
<tr>
<td>26</td>
<td>Barbados 2.25</td>
<td>26 Austria 2.1</td>
</tr>
<tr>
<td>27</td>
<td>Armenia 2.26</td>
<td>27 Colombia 2.1</td>
</tr>
<tr>
<td>28</td>
<td>Bahamas 2.26</td>
<td>28 Cote d’Ivoire 2.1</td>
</tr>
<tr>
<td>29</td>
<td>Japan 2.26</td>
<td>29 Denmark 2.1</td>
</tr>
<tr>
<td>30</td>
<td>Botswana 2.29</td>
<td>30 Eritrea 2.1</td>
</tr>
<tr>
<td>31</td>
<td>Norway 2.29</td>
<td>31 Macao 2.1</td>
</tr>
<tr>
<td>32</td>
<td>Portugal 2.29</td>
<td>32 Bahamas 2.2</td>
</tr>
<tr>
<td>Economic freedom index</td>
<td>Countries with highest levels of economic growth in 1994-2004, %</td>
<td>Countries with lowest levels of economic growth in 1994-2004, %</td>
</tr>
<tr>
<td>------------------------</td>
<td>---------------------------------------------------------------</td>
<td>-------------------------------------------------------------</td>
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<tr>
<td>#</td>
<td>#</td>
<td>#</td>
</tr>
<tr>
<td>33 Spain</td>
<td>2.33</td>
<td>33 Belize</td>
</tr>
<tr>
<td>34 Salvador</td>
<td>2.35</td>
<td>34 Ethiopia</td>
</tr>
<tr>
<td>35 Slovakia</td>
<td>2.35</td>
<td>35 Malaysia</td>
</tr>
<tr>
<td>36 Israel</td>
<td>2.36</td>
<td>36 Singapore</td>
</tr>
<tr>
<td>37 Taiwan</td>
<td>2.38</td>
<td>37 Tanzania</td>
</tr>
<tr>
<td>38 Slovenia</td>
<td>2.41</td>
<td>38 Benin</td>
</tr>
<tr>
<td>39 Latvia</td>
<td>2.43</td>
<td>39 Mauritius</td>
</tr>
<tr>
<td>40 Hungary</td>
<td>2.44</td>
<td>40 South Korea</td>
</tr>
</tbody>
</table>

Now, let us ask another question: does economic liberalization affect dynamics of the market itself, without considering gross figures? To answer this question, we put together two lists: that of 40 countries with the highest economic freedom index and that of 40 leaders in market capitalization.

Correlation between the two proved to be even lower than in the first case. Only seven countries (17.5%) from the group of economically most liberal states have high dynamics of market capitalization (Armenia, Iceland, Lithuania, Latvia, Austria, Slovakia, and Barbados). Thus, the factor of freedom has no decisive impact on the market’s development and capitalization (the correlation coefficient is -0.12)³² (Table 2.3).

### Table 2.3

**Comparison between the economic freedom index and market capitalization dynamics**

<table>
<thead>
<tr>
<th>Economic freedom index</th>
<th>Countries with the highest growth of market capitalization in 2000-2005, %</th>
</tr>
</thead>
<tbody>
<tr>
<td>#</td>
<td>#</td>
</tr>
<tr>
<td>1 Hong Kong</td>
<td>1.28</td>
</tr>
<tr>
<td>2 Singapore</td>
<td>1.56</td>
</tr>
<tr>
<td>3 Ireland</td>
<td>1.58</td>
</tr>
<tr>
<td>4 Luxembourg</td>
<td>1.60</td>
</tr>
</tbody>
</table>

³² Mir v tsifrakh (Moscow, 2007), 19, 56.
<table>
<thead>
<tr>
<th>Economic freedom index</th>
<th>Countries with the highest growth of market capitalization in 2000-2005, %</th>
</tr>
</thead>
<tbody>
<tr>
<td>#</td>
<td>#</td>
</tr>
<tr>
<td>5 Iceland</td>
<td>1.74</td>
</tr>
<tr>
<td>6 United Kingdom</td>
<td>1.74</td>
</tr>
<tr>
<td>7 Estonia</td>
<td>1.75</td>
</tr>
<tr>
<td>8 Denmark</td>
<td>1.78</td>
</tr>
<tr>
<td>9 Australia</td>
<td>1.84</td>
</tr>
<tr>
<td>10 New Zealand</td>
<td>1.84</td>
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<tr>
<td>11 United States</td>
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</tr>
<tr>
<td>12 Canada</td>
<td>1.85</td>
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<tr>
<td>13 Finland</td>
<td>1.85</td>
</tr>
<tr>
<td>14 Chile</td>
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<td>15 Switzerland</td>
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<tr>
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<td>1.90</td>
</tr>
<tr>
<td>17 Netherlands</td>
<td>1.90</td>
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<tr>
<td>18 Austria</td>
<td>1.95</td>
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<tr>
<td>19 Germany</td>
<td>1.96</td>
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<tr>
<td>20 Sweden</td>
<td>1.96</td>
</tr>
<tr>
<td>21 Czech Republic</td>
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<tr>
<td>23 Литва</td>
<td>2.14</td>
</tr>
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<td>24 Malta</td>
<td>2.16</td>
</tr>
<tr>
<td>25 Bahrain</td>
<td>2.23</td>
</tr>
<tr>
<td>26 Barbados</td>
<td>2.25</td>
</tr>
<tr>
<td>27 Armenia</td>
<td>2.26</td>
</tr>
<tr>
<td>28 Bahamas</td>
<td>2.26</td>
</tr>
<tr>
<td>29 Japan</td>
<td>2.26</td>
</tr>
<tr>
<td>30 Botswana</td>
<td>2.29</td>
</tr>
<tr>
<td>31 Norway</td>
<td>2.29</td>
</tr>
<tr>
<td>32 Portugal</td>
<td>2.29</td>
</tr>
<tr>
<td>33 Spain</td>
<td>2.33</td>
</tr>
<tr>
<td>34 Salvador</td>
<td>2.35</td>
</tr>
<tr>
<td>35 Slovakia</td>
<td>2.35</td>
</tr>
<tr>
<td>36 Israel</td>
<td>2.36</td>
</tr>
<tr>
<td>37 Taiwan</td>
<td>2.38</td>
</tr>
<tr>
<td>38 Slovenia</td>
<td>2.41</td>
</tr>
<tr>
<td>39 Latvia</td>
<td>2.43</td>
</tr>
<tr>
<td>40 Hungary</td>
<td>2.44</td>
</tr>
</tbody>
</table>
The third question arising is whether the development of market relations always causes economic growth, or what is the probability of it causing such a growth.

The results of comparing the group with the highest GDP growth rates and the one with the highest market capitalization growth proved to be even more discouraging for neoliberal stereotypes. The countries with high market capitalization dynamics were more often found among underdogs than among leaders with respect to GDP growth dynamics.

Seven of the most liberal economies were in the leading group (Armenia, Georgia, Iceland, Lithuania, Latvia, South Korea, and India), whereas ten were in the group with the lowest growth rates (Macedonia, Romania, Ukraine, Bulgaria, West Bank and Gaza, Colombia, Ecuador, Austria, Jamaica and Papua New Guinea). Most of the countries, 23 (57.5%), once again tended to take a middle, intermediate position.

The conclusion one may draw based on this comparison is that the market in itself is not a foundation for economic development (the correlation coefficient is 0.06). Unmanaged market may have an opposite effect and cause stagnation and decline in the economy. Economic growth is brought about not by any market but only by that which is managed by the state based on consolidated social interests (Table 2.4).  

Table 2.4  
Comparison between market capitalization dynamics and GDP growth

<table>
<thead>
<tr>
<th>Countries with the highest growth of market capitalization in 2000-2005, %</th>
<th>Countries with highest GDP growth rates</th>
<th>Countries with lowest GDP growth rates</th>
</tr>
</thead>
<tbody>
<tr>
<td>#</td>
<td>#</td>
<td>#</td>
</tr>
<tr>
<td>1</td>
<td>Macedonia 9129</td>
<td>1 Equatorial Guinea 20.9</td>
</tr>
<tr>
<td>2</td>
<td>UAE 3839</td>
<td>2 Bosnia 17.4</td>
</tr>
<tr>
<td>3</td>
<td>Armenia 2050</td>
<td>3 Liberia 12.8</td>
</tr>
<tr>
<td>4</td>
<td>Romania 1826</td>
<td>4 Rwanda 10.2</td>
</tr>
<tr>
<td>5</td>
<td>Qatar 1595</td>
<td>5 China 9.1</td>
</tr>
<tr>
<td>6</td>
<td>Georgia 1379</td>
<td>6 Myanmar 8.2</td>
</tr>
<tr>
<td>7</td>
<td>Russia 1309</td>
<td>7 Mozambique 8.0</td>
</tr>
<tr>
<td>8</td>
<td>Ukraine 1228</td>
<td>8 Ireland 7.9</td>
</tr>
</tbody>
</table>

33 Mir v tsifrakh (Moscow, 2007), 20, 56.
<table>
<thead>
<tr>
<th>Countries with the highest growth of market capitalization in 2000-2005, %</th>
<th>Countries with highest GDP growth rates</th>
<th>Countries with lowest GDP growth rates</th>
</tr>
</thead>
<tbody>
<tr>
<td>#</td>
<td>#</td>
<td>#</td>
</tr>
<tr>
<td>9</td>
<td>Kyrgyzstan</td>
<td>950</td>
</tr>
<tr>
<td>10</td>
<td>Saudi Arabia</td>
<td>862</td>
</tr>
<tr>
<td>11</td>
<td>Bulgaria</td>
<td>724</td>
</tr>
<tr>
<td>12</td>
<td>Kazakhstan</td>
<td>684</td>
</tr>
<tr>
<td>13</td>
<td>Jordan</td>
<td>661</td>
</tr>
<tr>
<td>14</td>
<td>Serbia</td>
<td>637</td>
</tr>
<tr>
<td>15</td>
<td>Pakistan</td>
<td>598</td>
</tr>
<tr>
<td>16</td>
<td>Iceland</td>
<td>526</td>
</tr>
<tr>
<td>17</td>
<td>Kuwait</td>
<td>526</td>
</tr>
<tr>
<td>18</td>
<td>West Bank and Gaza Strip</td>
<td>483</td>
</tr>
<tr>
<td>19</td>
<td>Sri Lanka</td>
<td>433</td>
</tr>
<tr>
<td>20</td>
<td>Iran</td>
<td>427</td>
</tr>
<tr>
<td>21</td>
<td>Lithuania</td>
<td>415</td>
</tr>
<tr>
<td>22</td>
<td>Kenya</td>
<td>398</td>
</tr>
<tr>
<td>23</td>
<td>Colombia</td>
<td>381</td>
</tr>
<tr>
<td>24</td>
<td>Croatia</td>
<td>371</td>
</tr>
<tr>
<td>25</td>
<td>Ecuador</td>
<td>357</td>
</tr>
<tr>
<td>26</td>
<td>Nigeria</td>
<td>357</td>
</tr>
<tr>
<td>27</td>
<td>Latvia</td>
<td>349</td>
</tr>
<tr>
<td>28</td>
<td>Oman</td>
<td>341</td>
</tr>
<tr>
<td>29</td>
<td>Austria</td>
<td>322</td>
</tr>
<tr>
<td>30</td>
<td>South Korea</td>
<td>319</td>
</tr>
<tr>
<td>31</td>
<td>Thailand</td>
<td>319</td>
</tr>
<tr>
<td>32</td>
<td>Zambia</td>
<td>319</td>
</tr>
<tr>
<td>33</td>
<td>Trinidad and Tobago</td>
<td>292</td>
</tr>
<tr>
<td>34</td>
<td>India</td>
<td>274</td>
</tr>
<tr>
<td>35</td>
<td>Jamaica</td>
<td>264</td>
</tr>
<tr>
<td>36</td>
<td>Slovakia</td>
<td>261</td>
</tr>
<tr>
<td>37</td>
<td>Czech Republic</td>
<td>249</td>
</tr>
<tr>
<td>38</td>
<td>Peru</td>
<td>241</td>
</tr>
<tr>
<td>Countries with the highest growth of market capitalization in 2000-2005, %</td>
<td>Countries with highest GDP growth rates</td>
<td>Countries with lowest GDP growth rates</td>
</tr>
<tr>
<td>---</td>
<td>---</td>
<td>---</td>
</tr>
<tr>
<td>#</td>
<td>#</td>
<td>#</td>
</tr>
<tr>
<td>39</td>
<td>Barbados</td>
<td>226</td>
</tr>
<tr>
<td>40</td>
<td>Papua New Guinea</td>
<td>220</td>
</tr>
</tbody>
</table>

References to the success neoliberal policies had in some countries of the postindustrial world when returning to free competition and market self-regulation (the phenomenon of Reaganomics) can usually be explained by inadequately representative information coverage of that experience. The reforms are presented in a truncated way. Only the first stage of reforms, that of liberalization, is usually emphasized. But there was also the second stage, which strengthened the institutions of state regulation. Thus, in New Zealand reforms started in 1984 in a classic way with monetarist control, cutting agricultural and consumer subsidies, etc. Yet the reform did not stop there. In 1988, the next stage was launched with a bill on the public sector. The emphasis this time was not on denationalization; on the contrary, the administrative power of remaining government institutions was strengthened. “Smaller but stronger,” said Francis Fukuyama, defining the goal of the Reaganomics reforms with respect to the state. Yet Russian neoliberals interpreted modernization of the state administration as its abolishment. Once again, it seems that behind the market-transformation rhetoric in Russia’s case there is an intention to undermine the statehood as such (this time, it is Russia’s statehood, not that of the USSR).

### 2.9. The market’s functional limitations

American economics textbook usually have sections about spheres where market mechanisms are ineffective. “Market failures” are a textbook concept for the Western economic theory. Yet in Russia, a different, metaphysical model of the market was offered for governance

and mass consumption, which had nothing to do with the way market really functions.

There is a number of socially crucial functions which market infrastructure is not capable of performing by definition. Modern society simply cannot exist for a long period of time without a state. Traditional social systems, dominated by natural economy, were much more autonomous with regard to the state authority. Extra-economic forms of coercion were necessary exactly because economic, market ties were minimal. As the market’s macroeconomics developed and strengthened, the administrative role of the government only increased.

This trend is often difficult to grasp because people confuse the concepts of democratization and economic administration. At the same time, a state being democratic does not mean its economy must be liberalized; similarly, political authoritarianism and regulativism are not the same thing. The combination of political dictatorship and economic freedoms in Chile during the Pinochet era demonstrates that the economic sphere is different from the political one. The confusion of the two concepts apparently originates from the disciplinary tradition of political economy, which goes back to Adam Smith. For economists in the USSR, that was the only methodological version of the economic theory (which meant that politics was condensed economics).

Even such outstanding theorists of the “new world order” as Francis Fukuyama now acknowledge the need for the state to manage the market. He has even entitled one of his last books \textit{State-Building}. “For individual societies and for the global community,” writes the American philosopher who has now reconsidered his former neoliberal view of the “end-of-history” problem, “the withering away of the state is not a prelude to utopia but to disaster. A critical issue facing poor countries that blocks their possibilities for economic development is their inadequate level of institutional development. They do not need extensive states, but they do need strong and effective ones within the limited scope of necessary state functions.…. Those who have argued for a ‘twilight of sovereignty’—whether they are proponents of free markets on the right or committed multilateralists on the left—have to explain what will replace the power of sovereign nation-states in the contemporary world. What has de facto filled that gap is a motley collection of multinational corporations, nongovernmental organizations, international organizations, crime syndicates,
terrorist groups, and so forth that may have some degree of power or some degree of legitimacy but seldom both at the same time. In the absence of a clear answer, we have no choice but to turn back to sovereign nation-state and to try to understand once again how to make it strong and effective.\(^{36}\)

The role of the state in the modern system of market economy is not limited to that of a night watchman, as defined by Adam Smith. It is not just the matter of intervening in economy in case of emergency; the state is involved in active, albeit indirect, management of economic processes.

The functions of a modern state have been traditionally defined by the economic theory as follows:

1) legal support;
2) providing money circulation;
3) producing social goods;
4) minimizing transactional costs of the economic system in general;
5) anti-monopoly regulation and promotion of healthy competition;
6) optimizing external factors: reducing negative effects and increasing positive ones in keeping with national political and economic interests;
7) income redistribution;
8) maintaining the optimal level of employment;
9) implementing regional policies to even out the living standards in various territories; and
10) advancing national interests in the international arena.\(^{37}\)

Even the world’s leading monetarist structures today admit that the government does have a special administrative mission with regard to the market economy. For example, the World Bank included in its 1997 World Development Report a list of the state’s indispensable functions in the modern situation of economic development. Despite the concept of the self-regulated market, the report names spheres where market mechanisms are ineffective. It even speaks of ways to counter the natural tendencies of the market. Russian government and political

\(^{36}\) Francis Fukuyama, op. cit., 120-121.

\(^{37}\) V.V. Perskaya, Globalizatsiya i gosudarstvo (Moscow, 2005), 120.
structures ought have remembered the state’s functions named by the World Bank and listed in Table 2.5. Interestingly, the World Bank published its ideas concerning the state’s administrative mission in 1997, i.e., a year before the ruble defaulted, demonstrating the illusory nature of the market self-regulation concept.\textsuperscript{38}

\textit{Table 2.5}

The state’s functions in the market economy situation

<table>
<thead>
<tr>
<th>Function complexity</th>
<th>Spheres where market self-regulation does not work</th>
<th>Functions of the state</th>
</tr>
</thead>
<tbody>
<tr>
<td>I. Minimal functions</td>
<td>Providing pure public goods</td>
<td>Defense</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Law and order</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Property rights</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Macroeconomic manage-</td>
</tr>
<tr>
<td></td>
<td></td>
<td>ment</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Public health</td>
</tr>
<tr>
<td></td>
<td>Protecting the poor</td>
<td>Antipoverty programs</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Disaster relief</td>
</tr>
<tr>
<td>II. Intermediate functions</td>
<td>Addressing externalities</td>
<td>Basic education</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Environment protection</td>
</tr>
<tr>
<td></td>
<td>Regulating monopoly</td>
<td>Utility regulation</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Antitrust policy</td>
</tr>
<tr>
<td></td>
<td>Overcoming imperfect information</td>
<td>Insurance (health, life,</td>
</tr>
<tr>
<td></td>
<td></td>
<td>pensions)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Financial regulation</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Consumer protection</td>
</tr>
<tr>
<td></td>
<td>Providing social insurance</td>
<td>Redistributive pensions</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Family allowances</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Unemployment insurance</td>
</tr>
<tr>
<td>III. Activist functions</td>
<td>Coordinating private sector</td>
<td>Promoting markets</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Cluster initiatives</td>
</tr>
<tr>
<td></td>
<td>Redistribution</td>
<td>Asset redistribution</td>
</tr>
</tbody>
</table>

One of the most typical myths about the self-regulated Western market economy has to do with the problem of the housing market. The Russian Federation set the goal to carry out privatization of the housing sector allegedly based on the Western experience. In reality, however, state-owned and municipal housing dominates in many developed countries of the postindustrial world. In many West European

countries, its ratio is significantly higher than in the post-privatization Eastern Europe. In the Russian Federation, 41% of the houses belonged to their residents by mid-1990s. Yet in Germany and Sweden, the figure was 37.8%; in Switzerland, 31%. The situation in former communist states was the opposite: in Bulgaria, 92.5% of the houses were privatized; in Albania, 94.8%; and in Macedonia, 95.1%. Incidentally, these countries have a higher percentage of rural population, which traditionally lives in private houses, as compared to Russia.\footnote{39 Trends in Europe and North America. UNECE annual statistics report, 2003.}

Neoliberalism views the state’s social burden as a factor that contradicts the market way of development. According to the neoliberal interpretation, this burden counters the effect of free competition. However, if we consider the structure of the leading Western countries’ budget, we will realize that this concept has nothing to do with economic reality (Fig. 2.4).

![Fig. 2.4. Social allocations in budget revenues](image-url)
If we consider a wide range of countries, we will see that the level of market development is on the whole proportionate with the rate of social allocations.

In keeping with the legal tradition, the expenditure part of the budget in Western countries is structured according to the revenue sources. For example, the Netherlands spends more than 2% of GDP on unemployment insurance and more than 3% on various programs to promote the labor market. Denmark spends even more, 4.5% of GDP, to promote the labor market. Thus, the market requires not only to be restrained by the state but also needs its support (including financial support). On the other hand, North American states are much less burdened socially as compared with European ones. But why did Russian reformers choose North America, not Western Europe, as a pattern to follow?

How strictly the state prosecutes economic crimes is one of the indicators of how much the state regulates the market. It would be useful to consider differences between countries as to the number of people charged with fraud annually. If we take a look at the figures for various European countries, we will see a clear difference between several regions (Fig. 2.5). When sorted in ascending order according to the number of fraud crimes recorded by law enforcement agencies, regions appear in the following order: former Soviet republics—Eastern Europe—Western Europe.

Does this mean Germany has 19.5 times more criminals than Russia, as the statistics seem to indicate? Obviously, the reason for the statistical disproportion is different: in more developed market systems, the state monitors people’s economic behavior more closely.40

***

Russian neoliberal reformers have more than once been likened to Bolsheviks. Despite their ideological differences, the similarity between them is obvious.

In both cases, the ultimate goal was utopian. The essence of the ideological inversion that has taken place is that the Communist utopia was replaced with a neoliberal one. Oswald Spengler called such visual transformation which do not affect the paradigm aspect of phenomena, “pseudomorphism.” While fighting against Communism, neoliberals acted as its followers as far as their values were concerned.

40 Ibid.
(the theory’s universalism, negative attitude to tradition, the economic imperative of polar forms, the determination to carry out the transformation at any cost).

<table>
<thead>
<tr>
<th>Country</th>
<th>Per 100,000 people</th>
</tr>
</thead>
<tbody>
<tr>
<td>Germany</td>
<td>1090.2</td>
</tr>
<tr>
<td>France</td>
<td>599.3</td>
</tr>
<tr>
<td>England and Wales</td>
<td>537.4</td>
</tr>
<tr>
<td>Sweden</td>
<td>491.8</td>
</tr>
<tr>
<td>Austria</td>
<td>402.2</td>
</tr>
<tr>
<td>Finland</td>
<td>344.4</td>
</tr>
<tr>
<td>Norway</td>
<td>268.7</td>
</tr>
<tr>
<td>Netherlands</td>
<td>112.2</td>
</tr>
<tr>
<td>Poland</td>
<td>389.9</td>
</tr>
<tr>
<td>Hungary</td>
<td>272.7</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>107.7</td>
</tr>
<tr>
<td>Romania</td>
<td>94.4</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>84.3</td>
</tr>
<tr>
<td>Croatia</td>
<td>70.1</td>
</tr>
<tr>
<td>Slovenia</td>
<td>32.8</td>
</tr>
<tr>
<td>Belarus</td>
<td>70.4</td>
</tr>
<tr>
<td>Russia</td>
<td>56.0</td>
</tr>
<tr>
<td>Moldova</td>
<td>37.8</td>
</tr>
<tr>
<td>Ukraine</td>
<td>35.0</td>
</tr>
<tr>
<td>Armenia</td>
<td>18.4</td>
</tr>
<tr>
<td>Azerbaijan</td>
<td>15.3</td>
</tr>
<tr>
<td>Georgia</td>
<td>4.2</td>
</tr>
</tbody>
</table>

Fig. 2.5. Fraud crimes in European countries (rate per 100,000 people)

Interestingly, Russian reformatory neoliberalism has been defined as “market Bolshevism.” The zigzags of the Russian economy’s development in the 20th century, when viewed through the prism of the history of economic teachings, look as a struggle between realistic economists and radical utopists. The experience of Russian reforms in the 1990s is a vivid lesson, which demonstrates the absolute need for proper goal-setting in strategic planning.
Chapter Three
Dead-ends of monetarism

As the Soviet system was being destroyed, the principle of de-ideologization was declared as one of the imperatives. A ban on having a state ideology was even incorporated in the 1993 Constitution. However, it proved impossible to do without an ideology in the actual practice of post-Soviet governance. In fact, this was impossible anyway.\footnote{Vladimir Yakunin, “Gosudarstvennaya ideologiya i natsionalnaya ideya: Konstitutsionno- tsennostnyi podkhod,” Konstitutsii stran mira o vysshikh tsennostyakh gosudarstva: Rossiyskaya refleksiya: Materialy nauchnogo seminara (Moscow, 2007), No. 4.} Presently, the philosophical concept of de-ideologization has become obsolete.\footnote{Daniel Bell, The End of Ideology (Glencoe, 1960); The End of Ideology Debate (New York, 1968); Seymour Martin Lipset, “Ideology and no End,” Encounter (1972, Vol. 39, No. 6); Edward Shils, “The End of Ideology?”, The Intellectuals and the Powers and other Essays (Chicago, 1974).} Already in the 1970s, de-ideologization was replaced with the concept of re-ideologization in the Western philosophy.\footnote{P.S. Gurevich and A.T. Semchenko, V poiskakh dukhovnoi opory: Obshchestopoliticheskiye i mezhdunarodniye aspekty burzhuaznoi konseptsiy “reideologizatsii,” (Moscow, 1981); Eugen Lemberg, Ideologie und Gesellschaft (Stuttgart, 1974); Lewis Samuel Feuer, Ideology and the Ideologists (Oxford, 1975); George C. Lodge, The New American Ideology (New York, 1975).}

Neoliberalism still remains the ideology of the Russian reforms. The teaching of monetarism, the economy’s openness, and minimization of the state’s involvement are key economic instruments of the neoliberal theory.

The idea that the monetarist (ideal) paradigm was deformed in the course of carrying out reforms in Russia became popular among monetarists post factum. They blame the reformers’ inadequate knowledge for their failure to achieve the expected goals. This is exactly how Marxists tried to justify themselves by shifting the blame from the teaching itself to its Russian followers.

Thus, the liberal monetarist experiment failed in Russia (if we consider its public goals, not the ulterior ones). Neoliberals demand it be continued, claiming conditions necessary for the experiment were not observed. Their opponents claim that it was the monetary theory itself that failed. The goal of the following analysis is to verify whether the
monetarist policy is sound outside the Russian context, which, neo-liberals claim, does not meet their standard. We are going to see if the monetarist policy can be effective in a wide range of countries.

3.1. Monetarism in the world economics

If we consider the genesis of the monetarist teaching in the mid-term perspective, we will see that it is the opposite of Keynesianism. Without considering the context of Milton Friedman’s indirect polemics with John Maynard Keynes, one cannot properly understand the essence of monetarism. The economic context of its emergence was characterized by the challenges of stagflation and slumpinglation, which affected Western society in the 1960s. It proved impossible to cope with these challenges through traditional Keynesian means, e.g., by regulating investment and interest rates. The general crises of 1969–1971 and 1974–1975 ensued. The artificial nature of the latter crisis, orchestrated by oil-exporting countries, was not properly taken into account by experts and general public at the time. The very fact of new depressions refuted the idea of deep crises being impossible in “mixed economies.” As a result, a conclusion was drawn about Keynesianism being ineffectual and about state management of economic processes being impossible.

“In reality, the seemingly ideal combination of market regulators and the state as a stabilizer, reconstructed according to modern ideas in the world economy of mid–1970s, failed to cope with spontaneous market forces, which were gaining more and more control over the situation. Moreover, it became obvious that the regulating methods the state used even make negative tendencies worse. More and more often, economists spoke not of market failures but of state failures.”

The main idea of the monetarist transformation was for the economy to return to the paradigm of the classic liberal theory. The “Keynesian revolution” was “aborted,” wrote Post Keynesian economist Sidney Weintraub. While Keynesianism, from the methodological point of

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4 Fridmen i Khaiek o svobode (Moscow, 2003).
5 Slumpinglation is a period of economic decline and inflation.
6 Ekonomicheskaya teoriya, Ed.: V.I. Kushlin (Moscow, 2006), 600–601.
view, could be compared to neo-positivism in philosophy, monetarism was similar to neoclassicism. Table 3.1 illustrates how the monetarist approach compares politically with the Keynesian theory.  

Table 3.1

<table>
<thead>
<tr>
<th>Problem</th>
<th>Keynesianism</th>
<th>Monetarism</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unemployment</td>
<td>The greatest evil for the economy, as it can cause social unrest and destabilize it</td>
<td>No government can be wiser than the market. State-funded social programs get cut.</td>
</tr>
<tr>
<td>Inflation</td>
<td>A lesser evil than unemployment. Inflation may be controlled and kept within reasonable bounds.</td>
<td>The biggest threat to any country’s economy. Deflation is the most effective method to fight inflation and its consequences.</td>
</tr>
<tr>
<td>Budget deficit</td>
<td>Deficit is caused by government expenditures’ rapid growth. It is permissible within reasonable limits.</td>
<td>Government expenditure should be minimized. Market self-regulation</td>
</tr>
<tr>
<td>Money supply growth</td>
<td>Money supply growth is used to cover budget deficit when it emerges</td>
<td>Money supply growth does not depend on the current economic situation and amounts to 3-4% annually. Money creation mechanism is repudiated.</td>
</tr>
<tr>
<td>Investment</td>
<td>Investment is an active factor; savings are a passive one. “Investment is the dog wagging the tail of savings.”</td>
<td>Savings are a prerequisite for investment. “Savings are the dog wagging the tail of investment.” Government expenditure decreases the prospects of private investment.</td>
</tr>
<tr>
<td>Role of government</td>
<td>Sporadic and indirect government influence on market economy is permitted. The main mechanism for state administration is through influencing interest rates</td>
<td>The concept of the night watchman state. Self-regulation of the free market. The state’s intervention in the economy is limited to the monetary sphere.</td>
</tr>
</tbody>
</table>

No matter how sharp polemics between monetarists and Keynesians may be, one has to admit that on the key issue, that of the state administration of the economy, monetarism and Keynesianism do not represent polar views. On the one hand, Milton Friedman spoke of minimizing the state’s influence but did not deny it completely. On the other hand, John Keynes pointed out that the state does need to perform regulating functions but thought these could be only indirect and extremely limited by market conditions.

One may even say that the contradiction between monetarism and Keynesianism is illusory. John Keynes was one of the main inspirational figures and organizers of the International Monetary Fund, which is associated with neoliberal economic policies. In the real practice of modern economic reforms, the dividing line between Keynesianism and monetarism is often erased. IMF recommendations include elements of both monetarist and Keynesian programs. By the way, the latter include the practice of influencing the interest rate.9

The statist reputation that was attributed to Keynesians was nothing else than a widespread stereotype. Therefore, the conclusion about the state administration of the economy as a means to prevent crises being ineffective, made in the 1980s, was incorrect. Keynesians could have been equally blamed for underestimating the role of the state in managing economic processes, for limiting its functions to merely indirect regulative measures. Incidentally, this was the approach to revising John Keynes taken by Neo-Keynesianism.10 The absence of polar opposition between monetarism and Keynesianism can be demonstrated by the relatively small fluctuation range of the US economic policy despite alternating between the Republicans and the Democrats in the White House, who use monetarism and

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Keynesianism, respectively, as a foundation for their economic programs.\textsuperscript{11}

As far as the issue of state regulation in economy is concerned, there are more polar alternatives to the monetarist approach in the world economic theory. What we have in mind is not only the Soviet economy of Gosplan. The theory of institutionalism presented a much wider range of possible state management solutions than the Keynesian tradition. For some reason, Russian statesmen limit themselves to the dispute between monetarists and Keynesians and ignore the institutionalist trend in the world economic thought.\textsuperscript{12}

The principles of the monetarist theory became the foundation of the world economy’s new global model with floating currency exchange rates. The concept of the money supply’s key role in economics was directly related to money losing its value nature, which was perpetuated by the Kingston system. The timeline of monetarism’s triumph is as follows: 1974–1975 — a global economic crisis; 1976 — Milton Friedman gets a Nobel prize “for developing monetary theory”; 1978 — the Jamaican (Kingston) Agreement on floating exchange rates is adopted; 1981 — the US begins to implement Reaganomics, a monetarist economic policy; mid–1980s — a number of developed and developing capitalist countries adopt monetarist recommendations promoted by the IMF and the IBRD; 1990 — John Williamson introduces the notion of the “Washington consensus” as the concentrated orthodoxy of monetarism; early 1990s — the monetarism-based policy of “shock therapy” is implemented in post-socialist countries, including Russia.

However, crises and a slowdown of economic growth in the countries which chose the monetarist strategy became a turning point and concluded the ascending phase of monetarism. Its popularity dropped. To follow the monetarist theory today is to lag behind the development of the world economic thought. Unfortunately, a number of Russian

statesmen responsible for the country’s economy still rely on Friedman’s strategies.\textsuperscript{13}

The development of monetarism was accompanied by the reanimation of Malthusianism, which took place simultaneously in the 1970s.\textsuperscript{14} The Neo-Malthusian concept became the basis of shock therapy’s social aspect, while the monetarist concept was the foundation of its economic aspect. Reformers believed in a trivial Malthusian formula: in free market competition, the fittest survive.\textsuperscript{15} In a sense, monetarism may be regarded as the economic application of Malthusianism.

To illustrate the logic of shock-therapy reformers, we may quote a response an Indian professor of medicine gave when confronted with Neo-Malthusian arguments. “You country is overpopulated,” a journalist told him. “Perhaps India needs an epidemic; then survivors will have a better life.” “Will you have a better life,” the professor answered, “if a train hits you and cuts off your legs? You’d be able to save on shoes!”

Core elements of monetarist recommendations are presented in the Washington Consensus. In an apparent analogy with the biblical Ten Commandments, it announces ten commandments of monetarism: fiscal policy discipline (minimal budget deficit); redirection of public spending toward health care, education, and infrastructure; adopting moderate marginal tax rate; interest rates that are market-determined and positive (but moderate) in real terms; competitive exchange rates; trade liberalization—liberalization of imports with low tariffs; liberalization of inward foreign direct investment; privatization of state enterprises; deregulation of the economy; legal security for property rights.\textsuperscript{16} Thus, it is obvious that the economic proposed to (or, rather, imposed on) the entire world and Russia today is the monetarist theory. How good it is?


\textsuperscript{14} Ya.I. Rubin, \textit{Nasledniki Maltusa} (Moscow, 1983); \textit{Teoriya narodonaseleniya (Maltuzianskoye i burzhuazno-antimaltuzianskoye napravleniya)} (Moscow, 1972).

\textsuperscript{15} \textit{Neravenstvo i smertnost v Rossii} (Moscow, 2000).

When considering the history of economic thought in retrospect, one may find elements of monetarism present long before 1968, when Karl Brunner coined the term. According to Lynn Turgeon, a Professor of Economics at Hofstra University, before Keynes the world economic theory and policy were predominantly monetarist. Thus, the criticism addressed to proto-monetarists of the past remains relevant with regard to contemporary monetarists as well.

Milton Friedman's idea of economic development being dependent on money supply is as old as it is unfounded, Turgeon believes. The position of mercantilists was close to that Friedman. Such a succession, if recognized, means the amplitude and frequency of crises in the world economy during the pre-regulation period may be viewed as a key argument against modern monetarist transformations. Granted, the system of state regulation saw some crises as well, but these had a much smaller scale than those of previous eras; on the practical level, their negative effect was limited to slowdowns in growth dynamics. At the same time, monetarist deregulation has caused negative economic dynamics around the world (including the Russian Federation).

The presidency of Franklin Roosevelt affords an excellent opportunity to compare the practical effectiveness of the rival concepts proposed by liberal protomonetarists and advocates of state regulation. His economic policy was not entirely consistent. The New Deal, in reality, was not uniform throughout Roosevelt’s rule. Behind the scenes, a fierce battle between groups advocating the two strategies was raging in the White House, and for a time protomonetarists were even dominating in this struggle. As we know, after Franklin Roosevelt, who chose the policy of state regulation, came to power, the United States overcame the unprecedented crisis in a very short time.

The Federal Reserve Bank under the leadership of Marriner Eccles doubled the reserve requirements in 1936. This may be considered as a monetarist rollback. The monetarist rhetoric used to explain that step resembled that used by Stabilization Fund managers in Russia today. The gold which was flowing into the United States was regarded as inflationary and a great deal of it was “sterilized.” As a result, the American economy did not receive the inflow of investment it needed badly at the time.

In 1937, the United States entered a new crisis. Industrial production reduced by 36%. Unemployment, which had been minimized during previous years, grew to 10.5 million people. Again, the crisis was overcome thanks to tested Keynesian methods. After the World War II started, the United States put a cap of 2 percent on nominal interest rates. (Earlier, the same measure was taken by Germany and Japan.) This produced a spurt in the American economy, which accumulated military orders. The effectiveness of this approach made John Keynes a widely popular figure.\textsuperscript{18}

\textbf{3.2. The danger of a global crisis of the world economy}

Monetarist policies pose a threat not only to the national economies of “peripheral” and “semiperipheral” nations. Implementation of Washington consensus principles endangers the entire world economic system. Many analysts indicate that the contemporary economic model, based on the Kingston floating exchange rates agreement, is highly unstable. Back in 1971, Lyndon LaRouche warned that attempts to denounce the Bretton Woods system and sever currencies from the gold equivalent may cause uncontrolled growth of fictitious capital, which eventually may cause a collapse of real economy sectors (“the physical economy”). Disproportionate development of the service sphere in the last few decades, which in the US accounts for 80% of the economically engaged population, conceals dangerous growth of speculative and non-producing niches. LaRouchists regard monetarism as “an ideology that serves the political purposes of usury,” not as an economic teaching.\textsuperscript{19}

The increasing share of services among other sectors is a trend typical of the entire Western world. Structurally, Russia’s economy is developing in the same direction. The frantic speed of its servicization is extremely alarming. The share of service in the Russian economy grew from 34% in the mid–1990s to 57% in the early 2000s. The swiftness of


\textsuperscript{19} Lyndon H. LaRouche, Jr., “The Science of Physical Economy as the Platonic Epistemological Basis for All Branches of Human Knowledge,” \textit{Executive Intelligence Review} Vol. 21 (No. 9–11, 1994); Denis Tukmakov, “Upodobleniye Bogu (Fizicheskaya ekonomika Larusha kak preodolenie entropii),” <www.zavtra.ru>.
this structural change is unprecedented. While the share of service in Russia increased by 23%, the increase in Western countries amounted only to 2–4%. The level of servicization in the Russian Federation has approached the lower level among West European countries. (For instance, it has exceeded the 56% share of service in Portugal’s economy). Yet it is doubtful that the direction of the restructurization, which decreases the share of economic sectors traditional for Russia, has been chosen correctly.\textsuperscript{20}

The phenomenon of “service society” is not universal. It is geographically limited to countries which belong to the world’s “golden billion” elite. Growth of the service sphere in the West is related to its “de-industrialization.” It is characteristic of modern international economy to move infrastructure of manufacturing industries to Third World countries. The current level of wages in Asian and Latin American countries makes it more profitable to locate industrial production in Asia or in Latin America than in North America or in Europe. Such a relocation affords an opportunity to reduce the cost substantially by saving on wages. As a result, real production of goods in the West is rapidly reducing. The paradigm of modern export restructurization of industry does not affect only unique technologies—for instance, American aerospace industry is still located within US geographical borders. As for standard, non-exclusive mass produced goods, it is more profitable to place production, say, in Kuala Lumpur than in New York. That is where almost half of all microchips sold today are produced. Being released from the manufacturing sphere, Western industrial workers re-train for non-producing sectors.

Thus, the intense development of service infrastructure in the West is a direct consequence of its “de-industrialization.” An American, who has retrained to be a broker, is replaced at the production line by a Malaysian. Thus, the high level of service in the West is based on the external factor of the entire world. Therefore, one should not refer to the Western system of service with regard to Russia. The definition of service should be adjusted not only historically but nationally as well. For Western postindustrial communities, service is presently an economic paradigm. For the new industrial societies of the Third World it is still an activity that supports industrial production. For countries which supply raw materials, both agricultural and extracted, service

is merely luxury which serves a limited group of people who receive profit from exports. The rest of the population has to take care of their daily needs by using archaic forms of natural economy.\textsuperscript{21}

To ensure its national economic security, Russia needs to reconsider the direction of the service-oriented restructuring it is undergoing and emphasize manufacturing industries. This strategic choice will help Russia reduce its economic dependence on external factors, creating a strong foundation for stable development.

The notion of an apocalyptic global economic crisis becomes more and more popular in the modern public discourse. Indeed, there were cases in history when civilizations disappeared or waned for economic reasons. The way the Roman Empire lost its economic dynamism is a classic example. (Many analysts believe this process started after silver mines were exhausted.)

Will the collapse of the US dollar take place in the nearest future or not is arguably the main subject of the world economic reflection at the moment. It goes without saying that a drop in the dollar exchange rate will be a catastrophe for economy of the whole world. It remains the world’s leading reserve currency. For instance, approximately half of Russia’s Stabilization Fund is in dollars. If the dollar rate collapses, the value of Russian assets will drop too. The dollar system resembles a bubble which is about to burst, Lyndon LaRouche prophesied. If one pricks the bubble with a needle, a devastating explosion will happen. Thus, we live at a time when one’s will or even preference may play a key role in history. What makes things worse is that all European governments without exception are unmanageable.\textsuperscript{22}

It has long been noted that Americans’ real income grows faster than labor efficiency. Thus, the United States gets richer not through labor. American prosperity is built on printing a vast amount of dollars, not supported with real value. In circulation outside the US, there are billions and billions of money which are not backed with anything. Since it costs no more than seven cents to print a dollar bill, we can definitely say what the true source of American prosperity is. The entire gold reserve of Fort Knox does not provide for even 20% of US money bills.

\textsuperscript{21} Problemy istorii servisa. Zdravookhraneniye, kultura, dosug (Moscow, 2004).

\textsuperscript{22} “Amerikansky guru predryok krizis v SShA,” http://www.km.ru/magazin/view.asp?id=B142810D3E054EB2A39ECBF1BCC66931
Because of this, back in 1968, after Charles de Gaulle took steps to discredit the American bank system, Lyndon Johnson abolished the practice of exchanging dollars for gold. Well-known Serbian geopolitical analyst Dragoљ Kalajiћ called this production of dollars “a great bluff.”

The policy of overrating the dollar is supplemented with equally artificial underrating of other currencies, including the ruble.

Even Jacques Attali, a leading theorist of mondialism, wrote that “America's dramatic somersault from the world’s largest creditor to its largest debtor is almost certainly without precedent.”

Both individuals and the American nation as a whole live on credit, i.e., at the expense of the future, and thus has no future. Permanent brinkmanship will sooner or later cause the country to fall into the abyss. Eighty percent of Americans live on credit, their debt amounting to a trillion dollars. The American government, in turn, finances military and other programs mostly on credit from its people, its debt exceeding three trillion dollars. In addition to that, there are external debts. If even in 1929, panic on the New York Stock Exchange caused a global crisis, the collapse of dollars expected today may cause mankind to face unprecedented devastating consequences.

3.3. The monetarist vanguard: scientific analysis of the international monetary fund

The International Monetary Fund is validly considered the world’s leading monetarist center. Its recommendations are limited mostly to the monetarist concept of deflation. To countries with transition economies, the IMF always offers the same set of Friedman's universal recommendations: reducing the public sector through privatization, making up the budget deficit, cutting subsidies and increasing real interest rates. Extention of loans was conditioned on adopting the recommended program.

Many leading contemporary economists have pointed out that recommendations and programs of the International Monetary Fund are fundamentally fallacious. “This advice should sound familiar to Russians and

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23 Literaturnaya Rossiya, 8 January 1993.
their friends since they have been encouraged to follow IMF advice along the same lines over the past four years,” American professor Lynn Turgeon wrote in 1995. “As in most of the Third World, their economies are virtually ‘dead in the water’. Monetarist advice may work for a time in countries that are less developed than the Russian economy (Chile, for example), but the Russians should be capable of coming up with an alternative domestic policy, one that is more Keynesian or non-monetarist.”

Joseph Stiglitz is an established critic of the IMF and the IBRD. In this case, his opinion is important not only because he is a Nobel prize winner but also because he is at the top level of international economic organizations; for instance, he has worked as the World Bank’s Chief Economist and Chairman of the Council of Economic Advisors in the Clinton administration.

Having spent long time in studying the experience of implementing the free market model in Latin America, Africa, Southeast Asia and Eastern Europe, he concluded that wherever the state decreased the level of its administrative intervention in economy, a crisis ensued. On the other hand, those countries which declined to follow recommendations of international financial organizations experienced swift economic growth. “The stance taken by the IMF,” Stiglitz said, “has never had anything to do with economics and real market economy; it was mostly ideological. This model is based on faith in the market’s ability to solve its problems by itself. The market does play a crucial role; it is at the heart of any successfully developing economy. But markets involve many serious problems. To have successful growth and stable society, a balance between the market and the state is necessary.”

Stiglitz criticized the IMF not only for its ideas but also for the way it was organized. He pointed out that the institution was very corrupt. While advancing its project, the IMF substantially expanded the field of corruption in Third World countries.

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Yet antimonetarists like Joseph Stiglitz are not the only ones criticizing the International Monetary Fund.

Even George Soros, who personally did a lot to promote monetarist policies, declared: “The IMF is now a part of the problem and not part of the solution.”29 Ian Vőszquez, an expert of the Washington-based Cato Institute, a non-profit organization which seeks to limit state intervention in economy and promotes the market’s self-regulation, said after the devaluation of the Brazilian real, “One would have thought that the fall of the Russian ruble in August 1998 would have put to rest the notion that the IMF can prevent financial crises by providing bailouts before turmoil erupts…. New IMF lending has served as a sort of financial morphine for the Brazilian political system, allowing it to continue postponing reforms.”30 Indeed, an obvious contradiction is apparent: while the IMF is fundamentally against increasing government spending, it offers loans for the purpose of carrying out liberal reforms, which naturally implies increased spending.

Milton Friedman himself was extremely critical of the IMF. “If there had been no IMF, there’d have been no East Asian crisis,” he said.31 However, the founder of the monetarist theory criticized the fund mainly for its departure from the principle of market self-regulation. He thought its error was in trying to save private investors from their own mistakes. Also, he said it was a mistake to save Mexico when it faced a severe crisis in 1995. According to Milton Friedman, Mexicans, once in the element of the free market, should have found their own way out of the economic downfall.

### 3.4. Latin America as a monetarist testing ground

Under certain conditions (which were absent in Russia), monetarist reforms may create an illusion of economic success. But international experience demonstrates how transient such success is. The

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mechanism of partial de-nationalization of the economy is effective as a means to stimulate entrepreneurial initiative. Yet even in the mid-term run deregulation results in a crisis. De-nationalization measures should not be structured as a strategic policy. Their positive effect is extremely limited in time.

Reaganomics was successful because it was a short-term program. In Argentina, on the other hand, the monetarist policy was not dropped after immediately after it dynamized the national economy. During the first few years of neoliberal reforms, which started in the early 1990s, GDP growth reached 5.5%. By the mid–1990s, the tide turned and negative dynamics set in. By 1998, the country already faced a systemic crisis.

Comparing economic development of Latin America in various periods affords an opportunity to assess the effectiveness of various policies. The following chart (Fig. 3.1) helps draw a clear conclusion about effectiveness of the state-regulated mixed economy, which was practiced in Latin America mostly in the 1960s and 1970s, and about ineffectiveness of the neoliberal system of self-regulated market economy, which was implemented later.\(^{32}\)

![Fig. 3.1. Average annual GDP growth in Latin America](image)

In the 1980s, Latin America became one of the first testing grounds for monetarist policies. Statistics clearly indicate that the neoliberal experiment failed. Latin America suddenly had worst GDP growth in the world (except for postsocialist countries), although prior to that the region had been rapidly developing. Even Black Africa, which is permanently in the state of crisis, had better results. As a result, the share of Latin American economy in the world’s GDP reduced from 9.87% in 1980 to 7.74% in 2005. The situation did not improve in the last few decades. Seven of the twelve South American mainland states were among countries with lowest economic growth in 1994–2004.

Now that Latin American countries have denounced monetarism and returned to government regulation, they regained high economic growth. The state is beginning to purposefully regulate the economy. In the region’s leading countries, the government is strengthening its efforts to coordinate the financial, insurance, pension, health care and other spheres. De-privatization is underway, ranging from partial restoration of state property, as in Chile, to a large-scale nationalization in Venezuela (Fig. 3.2–3.4).

The extremely high level of unemployment is Latin America’s chronic social disease after the monetarist transformation. In the region’s nine countries it grew from 5% in 1990 to 9.5% in 2000. Some countries broke records for seasonal unemployment: Argentina, 21.5%; Colombia, 17.7%; and Uruguay, 14.5%. In such an industrial giant as Buenos Aires, the number of the unemployed among the able-bodied exceeded 60%. Interestingly, most of the unemployed are public servants and processing industry workers.

Workers are leaving in large numbers for the countryside. The percentage of poor families and families below the poverty line remains at the 1990 level, 44% and 18% respectively, while the absolute number of the poor has increased by 11 million. According to the monetarist

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34 Mir v tsifrakh. 2007 (Moscow, 2007), 20.
Fig. 3.2. Regions of the world by GDP growth in the 1980s

Fig. 3.3. GDP growth per capita in various regions of the world in the 1980s
approach, all these problems should have been taken care of by market self-regulation.\textsuperscript{36}

The failure of neoliberal reforms made Latin America a leader of the antiglobalist movement. Venezuela and Bolivia are openly challenging US policies. Leftist ideologies are becoming increasingly popular among Latin Americans.

Brazil

Unlike Russia, Brazil has been long and deeply integrated in the international system of the capitalist world. One would expect the longstanding tradition of US businesses operating there should preserve the country from financial calamities. More than 2,000 American companies had business ties with various Brazilian enterprises. Yet this did not save the Brazilian economy.

Chronologically, the Brazilian crisis coincided with the Russian one. The devaluation of the real caused a downfall on all stock markets in the Western hemisphere, from Toronto to Santiago, Chile. This

raised concerns that Brazil might use its currency reserve to support its national currency and thus go bankrupt. Foreign capital was rapidly fleeing from the country. It is estimated that the Brazilian economy lost $38 billion in this flight. On January 14, 1999, $5 billion left Brazil in one day. As a result of ensuing sale of Brazilian companies’ shares, their average rate dropped by 10%. The turnover on the stock market reduced by $50 billion. The monetarist reform stepped up the process of social differentiation. Ten percent of Brazil’s wealthiest people own 51% of the national income, while the poorest 10% own merely 2%. In the agricultural sector, 20 landowners own 20% of arable land. At the same time, 11 million agricultural workers own no land at all.\(^{37}\)
Numerous enterprises shutting down, unemployment growth, social cataclysms expected—all of this reminds of the post-default Russia. The task of saving the Brazilian economy required that the IMF make a decision to give Brazil an unprecedented $41.5 billion loan.

Experts believe there were geopolitical motives involved in the Brazilian crisis. Brazil has enough resources to be one of the world’s economic leaders. GDP growth rate of 9.6% in the 1970s supported such expectations. Were the rate maintained, Brazil in time could have become a rival for the United States.\(^ {38}\) The monetarist policy essentially stopped the country’s development. GDP growth reduced to 1.5% in the 1980s and improved insignificantly to 2.7% in the 1990s. Eventually, the Brazilian economy is currently occupying the nineth place, the same it had in 1980.\(^ {39}\)

**Argentina**

There was a time when Argentina was recognized as Latin America’s most developed and rich nation. Monetarist policies have essentially brought to nought all its economic achievements. The Argentine economy’s strength was in its powerful public sector, the biggest one in Latin America. Yet by the time the crisis set in in the late 1990s, most state-run enterprises had been either privatized or transferred into private ownership through a concession. No country in the modern world

\(^{37}\) G.N. Tereshchenko, M.Kh. Almayev, T.A. Mironova et al., op. cit.

\(^{38}\) *Mirovaya ekonomika*, ed. A.S. Bulatov (Moscow, 2005), 593.

has ever had a longer period of negative GDP dynamics as Argentina (Fig. 3.5).

![GDP of Argentina](image)

**Fig. 3.5.** Argentina’s GDP in the late 1990s and the early 2000s

The level of earlier development allows Argentina to retain the highest per capita income in Latin America, higher than that of Russia today. Yet the average level conceals the fact that social differentiation has worsened because of the reforms. More than a third of the Argentines (39.3%) belong to the category of the poor. The rollback of government spending for social needs, recommended by the IMF, brought about degradation of the education system. Development of private pension funds could not rectify a sharp drop in pensioners’ income.

Speculative growth of the stock market practically had no effect on the real sector. The damage caused by capital flight was estimated at $75 billion. The foreign debt increased from $60 billion in 1990 to $110 billion in 1999. After regulatory functions of the Argentine Central Bank were limited, most deposits became short-term and most loans were drawn for private consumption, not for investment. The process of privatization significantly increased the level of corruption among Argentine officials.

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40 Rossiya i strany mira. 2006, 79.
In the early 2000s, the ideological platform of economic policies changed; in particular, government supervision over financial activities was intensified. Simultaneously, the process of economic rehabilitation started, with statistic fundamentals significantly improving.\(^{41}\)

**Mexico**

The neoliberal press has traditionally cited Mexico as an example of a nation consistently and thoroughly following recommendations of the Washington consensus. When East European countries were in transition to market economy, they were given Mexico as a pattern to follow.

The crisis of 1994–1995 dispelled the 12-year illusion of the monetarist paradise. What brought about the downfall was the openness of the Mexican economy, which contradicted national interests, and its being oriented towards external ties. Adoption of the monetarist program was a condition on which the IMF and the US Treasury gave Mexico a loan, when it entered a crisis in the early 1980s. The critical condition of the Mexican economy was caused but its disproportionate development of export-oriented industries. The reorientation from the import-substitution model of economic policy to emphasizing export was caused, as in the USSR, by a sharp increase in oil prices. A mass inflow of investment gave Mexican statesmen an illusion of prosperity. When oil prices expectedly dropped, the Mexican economy, which was by that time export-dependent, was doomed.

IMF recommendations on economic rehabilitation demanded that Mexico be even more integrated in the world market, which would reinforce the factors which had caused the 1982 crisis. Yielding to the Fund's pressure, the Mexican government published a letter of intent, which included the following obligations: liberalization of prices; achieving macroeconomic stability; minimizing government intervention in economy; promoting free market competition and abolishing all forms of government subsidies; open foreign trade policy; and the same conditions for foreign and domestic capital. Granted, the huge loan allowed Mexico to overcome the crisis for a time. But sooner or later loans get exhausted. The need to pay off the debt literally paralyzed the Mexican economy. By the time another crisis started in 1994, the

\(^{41}\) N. Ivanov, “Kak Argentina,” *Nash sovremennik*, 2003, No. 1; G.N. Tereshchenko, M.Kh. Almayev, T.A. Mironova et al., op. cit.
debt payments amounted to 46% of Mexico’s GDP. Presently, Mexico is among the world’s eight largest debtors.

Surprisingly, the 1994 crisis coincided with creation of Canadian-American-Mexican free trade economic zone—NAFTA (North American Free Trade Association). Tariffs for trade between Mexico and the United States were reduced by 65%. Naturally, Mexican goods could not compete with American ones. The only factor that could make Mexican goods competitive was their low cost based on cheap labor. While in the US the average cost of one hour of work was $4.5, and in Canada, $5.75, in Mexico it was merely 50 cents.

After NAFTA was established, the quantity of imports in Mexico sharply increased: from $12 billion in 1987 to $50 billion in 1993. There was little demand for goods manufactured in Mexico; as a result, businesses that worked for the domestic market began to shut down. Already in the early 1990s, import exceeded export in Mexico. As a result of Mexico’s integration into the world market, the country’s traditional industries: metal processing, textile industry, tanning, paper industry, and agriculture—were in critical condition. By the mid–1990s, the balance became positive again, and in the 2000s reverted back to negative. Hardly any economy in the world can survive this kind of import-export seesaw.

GDP growth concealed rapid social differentiation caused the liberalization of the national economic system. Forty million Mexicans, almost half of the country’s population, found themselves below the poverty line. Three hundred richest families accounted for approximately half of Mexico’s national income. Thus, the crisis which started in late 1994 was inevitable. Mexico was saved only by an unprecedented loan of $51.8 billion. (It was more than what Europe received under the Marshall Plan.) The loan package was collective: the US gave $20 billion; the IMF, $17.8 billion; central banks of the Old World, $10 billion; commercial banks, $3 billion; and Latin American countries, $1 billion.42

Yet again, as in the 1980s, this failed to make the Mexican economy stable. Its GDP growth is unstable. Mexico is the only country in the world which had negative dynamics of gross product two separate times within one decade (Fig. 3.6).43

43 Rossiya i strany mira. 2006, 79.
Why is it important to consider this Latin American picture? Because Russia has been developing of late according to the Latin American scenario. For Latin American countries, accepting monetarist recommendations does not look that striking. To a large degree, they have never had a policy independent of the United States. But for Russia, which has traditionally followed its own economic model, following in the steps of Latin America would be a deadly choice.⁴⁴

3.5. Failures of monetarist policies in the west

The notion of monetarist policies’ effectiveness is linked to promoting the system of Reaganomics (or its British version, Thatcherism). It is generally considered that the economic policy of Ronald Reagan in the US and Margaret Thatcher in Great Britain most closely represented the ideal model of neoliberalism. Privatization policies of Japan, France, and some other European countries in the late 1980s are also recognized as monetarist.

In reality, Reagonomics was to a large degree an ideological construction. The ideology of "free market" was proposed during Ronald Reagan's first presidential term, at the time the Cold War entered a new phase. Implementation of neoliberal principles was viewed as the opposite of "evil empire"'s planned economy.

Actually, there was no systemic denationalization of the economic sphere in the US. Reagonomics was more a declaration about returning to fundamental principles of liberalism than a real economic policy. This is quite provable.

During Ronald Reagan's presidency, government spending was not reduced; on the contrary, it drastically increased. The new phase of the arms race which started in the early 1980s required substantial government subsidies and government orders. To illustrate the government's increased burden, it would be sufficient to mention the Strategic Defense Initiative (SDI). "A neoconservative reform," contemporary experts on foreign economies emphasize, "does not mean the government denounces state regulation and completely reverts to free market relations. It shifts the emphasis from the government's direct intervention in economic life to indirect economic methods like monetary accommodation." Essentially, instead of being abolished, government regulation of the economy was being perfected. Russian reformers did the opposite: declaring the state a monster, they stripped it of its functions one by one.

In reality, Ronald Reagan's economic policy cannot be regarded as completely successful. Despite the stated goal of reducing budget deficit, it steadily increased. By 1983, it increased by 2.6 times, compared to the pre-Reagan period. Government spending exceeded revenues by 25%. During the first year of Ronald Reagan's presidency, for the first time in American history the US foreign debt exceeded $1 trillion. By the end of Reagan's rule, it reached $2.6 trillion. It was during the 1980s that the world's largest creditor became its largest debtor. Under Reagan, unemployment reached an all-time high for the post-war period. 10.8% of able-bodied Americans were unemployed. The dollar rate with respect to other main currencies was decreasing. Economists even started to use a special term, "Reagan dollar." Just in 1985 and

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1986, the American currency lost 50% of its value in comparison to West Germany’s mark and Japan’s yen.

A cut in social programs, performed according to monetarist formulas, had an extremely negative effect on many Americans. Subsidies for the elderly and for families with children were reduced. More than a million Americans lost their food subsidies (the so-called food stamps). The number of the homeless increased drastically, emerging as a national problem. Yet, Ronald Reagan viewed it according to monetarist standards, saying those people chose to be unemployed.⁴⁶

The American administration did not follow recommendations of its monetarist advisors for too long. Already by the mid–1980s the White House initiated the process of de-monetarization. Monetarists’ predictions failed to come true, and the government became disillusioned with the monetarist concept itself. An embarrassing incident that involved Milton Friedman himself was perhaps the last straw. Based on reports about a significant increase of money supply, he predicted in 1983 that inflation will reach a double-digit figure by the end of 1984. In reality, though, instead of increasing dramatically inflation even decreased.

The monetarist generation of the US Federal Reserve officials was replaced with new people, who were anti-monetarist. These included Vice Chairman of the Federal Reserve Alan Blinder, who maintained that government spending “crowds in” investment as opposed to “crowding it out,” as assumed by monetarists.⁴⁷

The success of Reaganomics is usually associated with Ronald Reagan’s second term in office in 1985–1988, i.e., with the time he partially abandoned Friedman’s program. Yet even during those four years the US economy had rather modest achievements. GDP growth fluctuated between 3.2% and 4.5%. By way of comparison, in 1988, during Reagan’s last year as US president, Russia also had 4.5% GDP growth. Per capita, Russia’s statistics were even better: 3.6% versus 3.5% in the US. So, if we speak of stagnation with regard to the Soviet Union, it would be just as true to speak of stagnation in the American economy. The US economy under Ronald Reagan was in no way more dynamic than that of the USSR. Yet the same propaganda piece is repeated again and again!


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One of the main arguments in favor of monetarist reforms was that the private sector is more productive, since people there are interested in working harder, unlike those in the public sector. But if we compare labor productivity in the US during the Reaganomics era and in Russia, with its planned system of economic regulation, the comparison will be not in favor of the liberalized American system (Fig. 3.7). On the whole, the United States were on a par with Russia as far as GDP growth, industrial output and agriculture were concerned—despite its widely advertised system of private farms (Fig. 3.8). The agricultural sector even so a decline during the last three years of Reagan's presidency (Fig. 3.9).

![Fig. 3.7. Labor productivity in the US and in Russia (percent of the previous year)](image)

After George H. W. Bush replaced Ronald Reagan, declaring that he would continue with Reagan’s policies, American GDP growth became even more stagnant. In 1991, gross product was even lower as compared to the previous year (in 1989, 102.8%; in 1990, 100.9%; in 1991, 99.6%). It was only during the presidency of Bill Clinton, who de-

49 Ibid., 152, 154, 312, 314.
50 Ibid., 8.
Fig. 3.8. Industrial output in the US and in Russia (percent of the previous year)

Fig. 3.9. Gross agricultural product in the US and in Russia (percent of the previous year)
nounced the principles of Reaganomics and turned to a modification of Keynesian government regulation policy, which is traditional for the Democratic Party, that US economic indices stabilized.

After a new, Kingston economic model was adopted and the monetarist transformation was implemented, economic fundamentals in all Western developed countries started decreasing. Partial involution of the real sector took place in the US as well. For instance, according to pre-Kingston predictions made in the 1960s and the 1970s, in 2000 the United States should have produced 8 trillion kilowatt hours of electricity and 250 million tons of steel. Yet actual results were much different from these predictions. By 2000, the United States produced two times less electricity than expected and 2.5 times less steel. The number of manufactured cars even reduced as compared to the 1970s. Overall output of the American processing industry, according to Pentagon estimates, remained at the same level as 20 years before. GDP in the US, as in most Western countries, continues to grow solely because of the service sector.\(^51\)

The charts below demonstrate the economic crisis leading West European countries entered in the 1980s. Their growth started to slow down significantly. In many industries, their output even reduced. What is of utmost interest, though, is the time the decline started. It coincides perfectly with the switch from the regulatory concept of economy to the monetarist one. Thus, the economic crisis in the West is related to its adoption of neoliberal development strategies, which indicates how inefficient they are (Fig. 3.10–3.11).\(^52\)

### 3.6. The new “miracle” of the Japanese economy: neoliberalism as a factor of stagnation

The Japanese “economic miracle” is a world-famous brand. However, Japan’s current economic decline is a “miracle” no less. GDP growth in the Land of the Rising Sun has been one of the worst in the world throughout the 1990s and 2000s. The average growth for 1994–2004 was merely 1.2%. None of the developed countries had worse in-

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51 *Russkaya doktrina (Sergiyevsky proyekt)*, A.B. Kabakov and V.V. Averyanov (eds.), (Moscow, 2007), 434–435.

Fig. 3.10. Output of steel in selected European countries

Fig. 3.11. Motor vehicles produced in selected European countries
indices than Japan. The Japanese economy is now listed among 20 least dynamic national economies. In 2000, Japan had negative output growth: a unique situation for the “bicycle economy” (where to stop means to fall) of developed countries. The decline of economic indices affected the living standard of the Japanese people. The growth of wages in Japan is one of the lowest among developed countries. In the 2000s, wages of Japanese employees even have a tendency to decrease. In all the other developed countries, this figure steadily grows. Over the last few years, even the average number of calories the Japanese consume daily with their food has decreased—an unprecedented phenomenon for postindustrial economies. The drop in Japan’s indices of the physical retail trade turnover, when compared to other G8 countries, may be regarded as a catastrophe (Fig. 3.12–3.15).

![GDP Growth in Japan](image)

**Fig. 3.12. GDP growth in Japan (percent of the previous year)**

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Fig. 3.13. The average monthly employee salary in Japan

Fig. 3.14. Daily consumption of calories per capita in the G8 countries
What are the reasons for the economic metamorphosis in Japan? Chronologically, the neoliberal reforms of the late 1980s definitely were the turning point which transformed an extremely dynamic economy into a stagnating one. The reforms were based on the same monetarist recommendations: denouncing protectionism and state intervention in economic processes.

### 3.7. Monetarism and the “new world order”

New geo-economic trends became perhaps one of the factors that made monetarism less relevant. The image of rapidly developing China seems to have contributed to the decrease of monetarist concepts’ popularity among the Western establishment. In the situation of the free world market, China’s economy will in time (supposedly by 2020) become the No. 1 economy. Some analysts predict that approximately half of the world’s production will be concentrated in China.

Thus, there may be a Chinese version of globalization, not only the American one. Realizing this, Western theorists of the “new world order” make significant amendments to globalization concepts. More and more often, the model of uniform global world is replaced with
concepts of a multidimensional one, with one of its sector (identified with the Western world) being in a special preferred position.\textsuperscript{55} Instead of the monetarist world free market in the format of the WTO, a system of customs barriers is being constructed to protect the West against exports from Southeast Asia.\textsuperscript{56} Even such an adherent of the open society as George Soros is somewhat skeptical in his latest works about the prospects of liberal and monetarist globalism.\textsuperscript{57}

\* \* \*

The analysis above proves that in most cases monetarist policies produced negative results. Developing Russia’s economy according to the monetarist rationale has no future and will inevitably bring it to yet another crisis, which may prove to be the last one.

\textsuperscript{55} Samuel P. Huntington, \textit{The Clash of Civilizations and the Remaking of World Order} (Touchstone, 1997).

\textsuperscript{56} Russkaya doktrina (Sergiyevsky proyekt), 450.

\textsuperscript{57} George Soros, \textit{The Crisis of World Capitalism: Open Society Endangered} (Perseus Book Group, 2000).
Chapter Four
Foreign economists about Russian economic reforms

Back in 1909, Russia’s best philosophers pointed out in Vekhi a peculiar trait of Russian intelligentsia: they perceive Western teachings in extremely deformed ways. Ideas of Hegel, Darwin, and Marx were fundamentally warped when extrapolated to Russian reality. The tradition of such deformation, of warping foreign teachings to bring them in line with one’s predetermined ideology, manifested itself again in the 1980s and 1990s, when Western economic theories became popular in Russia and attempts to implement were made. Complex and variegated strategies were reduced to plain, oversimplified statements.

Therefore, it is particularly important what foreign economists say about Russian reforms. It is important not only because it is an impartial assessment but also because these are the world’s leading experts who can verify the methodological foundations of neoliberal reforms in Russia’s economy. Thus, the goal of the following analysis is to see if the current version of Russia’s economic policy has a sound foundation in scientific theory.

It is noteworthy that practically no one among leading Western economists speaks positively of the Russian economic reform. When neoliberals from the Gaidar team make attempts to vindicate themselves, their words contradict even the neoliberal discourse. The conclusion of Boris Yeltsin’s economic policy being fallacious has been widely accepted in the Western economic thought. But where was it wrong? There may be several answers to this question; hence, there are several approaches of critique which are covered below.

4.1. Open letters from by the world’s leading economist to Soviet and Russian leaders

It is possible that the Russian government chose to trust radical reformers because it was ignorant of alternative reformist theories. Yet this cannot justify its choice. The government cannot blame its lack of
theoretic knowledge, as there were a number of open letters, written by well-known Western and Russian economists—first to the Soviet, and then to the Russian, government.

Back in 1991, 30 leading US economists wrote an open letter to the Soviet president. There were four Nobel laureates in economics among the authors: William Vickrey, James Tobin, Franco Modigliani and Robert Solow. Essentially, the letter pointed out the need to introduce a rent for using land and natural resources while in transition to market economy. Americans themselves warned Mikhail Gorbachev against idealizing the Western economic system. Among its defects, they mentioned the fact that the rent of land, which belongs to all the people, is usurped by the private sector. To substantiate their proposals, they offered the following arguments: “First, it guarantees that no one dispossesses fellow citizens by obtaining a disproportionate share of what nature provides for humanity. Second, it provides revenue with which governments can pay for socially valuable activities without discouraging capital formation or work effort, or interfering in other ways with the efficient allocation of resources. Third, the resulting revenue permits utility and other services that have marked economies of scale or density to be priced at levels conducive to their efficient use.”

Western economic theorist viewed introduction of the land rent as a measure to avoid an oligarchic scenario.

As we know, the government did not listen to recommendations from this group of American scientists, preferring advice from experts like Jeffrey Sachs and Anders Eslund instead. Eventually an American court demanded that Harvard University pay $120 million because its employees used economic reforms in Russia for personal gain.

In 1994, a number of well-known Russian and American scientists, concerned about the way reforms in Russia were proceeding, created a joint Economic Transition Group. They declared their goal was to develop alternative proposals with regard to the economic policy pursued by Russia. The group’s mission statement, signed by 39 scientists, including five Nobel laureates, said it was “vital to steer clear of the

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1 Nicolaus Tideman, Mason Gaffney, William Vickrey, James Tobin, Franco Modigliani, Robert Solow et al., “Open Letter to USSR President Mikhail Gorbachev.”
2 A.V. Gorshkov, Rossiiskie reformy i zapadniye ekonomisty (Chelyabinsk, 2001), 4.
“shock therapy” being one of the most radical versions of such extremes.³

On the eve of the 1996 presidential election, two days before the run-off vote, an open letter, entitled “A New Economic Policy for Russia,” was sent to the future president. Nobel laureates Lawrence R. Klein, Wassily Leontief, and James Tobin and members of the Russian Academy of Sciences Leonid Abalkin, Oleg Bogomolov, Valery Makarov, Stanislav Shatalin, Yury Yaryomenko, and Dmitry Lvov signed the letter.

The measures they proposed included the central government playing a more important role in regulating economic processes. The letter condemned as erroneous the policy of non-intervention in the economy, associated with the general ideology of “shock therapy.” As a pattern to follow, the experts referred to mixed economies, including not only Sweden but Germany and the United States as well. During the new stage of reforms, they proposed to shift emphasis from the private sector to the state sector.

De-criminalization of the economy was the next goal presented to the future president. The reforms of the early 1990s were a transition “not to a market economy… but rather to a criminalized economy,” the letter said. “The government must reverse and stop this cancer of criminalization and corruption in order to provide a stable business climate and thereby stimulate investment and production,” the authors urged.⁴

The third group of problems had to do with the need to bring Russia out of a state of permanent depression. A new macroeconomic policy was defined as a transition from the stabilization strategy to the development strategy. Interestingly, already in 1996, as if anticipating today’s temptation of the Stabilization Fund, Russian and American scientists warned the Russian government that unless money supply is available to the people, there will be no consumer demand and thus no economic growth. The analysts suggested the government use the international trade earnings from gas and oil exports to upgrade Russia’s fixed assets.

A need for adjustment in the social sphere was emphasized as well, with proposed adjustments being contrary to the policy Mikhail Zurabov pursued later. For instance, the economists suggested wide use of government aid and subsidies for the people. The letter pointed out that priority should have been given to promoting competition, not to private ownership per se. Finally, the authors urged the Russian government to be patient and to refrain from taking radical steps in attempts to accelerate the process of forming a market system.5

For years later, another letter from the Economic Transition Group, entitled “New Agenda for Economic Reform in Russia,” was sent to Russia’s new president, Vladimir Putin. This time, the document was signed by Nobel laureates Lawrence R. Klein, Franco Modigliani, and Douglass North, well-known US economists Marshall I. Goldman, Michael D. Intriligator, Marshall Pomer, Lance Taylor, and Irma Adelman, and Russian academics Leonid Abalkin, Georgy Arbatov, Oleg Bogomolov, Viktor Ivanter, Dmitry Lvov, Valery Makarov, Aleksandr Nekipelov, Nikolai Petракov, Stepan Sitaryan (all being members of the Russian Academy of Sciences), and Natalya Rimashevskaya.

The letter’s preface spoke of the need for a strengthened state to play a more active role in the economy. Recommendations were divided into five strategic groups:
1) institutional infrastructure;
2) fight against crime;
3) growth-oriented policy;
4) restructuring and competition; and
5) social contract.

The letter said it was the government’s responsibility to eliminate deep distortions in Russia’s market mechanism. As a special goal for the institutional sphere at the new stage of development, it said it was necessary to create conditions to channel savings into investment. The letter was even stronger than the previous one in assessing the degree of criminalization in the economy. One of the problems mentioned in the section on crime was the need to ensure proper standards of recruitment of government officials.

The letter criticizes monetarism indirectly, speaking skeptically of attempts to bring inflation to near zero levels. Instead, the authors

5 Ibid.
called for increasing production and investment as a foundation, not a consequence, of low inflation. A number of administrative decisions must be taken by the government, the letter said, to achieve stable economic growth: “Concerted action should be taken against illegal capital flight. Within economically justified limits, the government should bolster purchasing power through payment of increased pensions and restoration of a portion of the savings that were lost as a result of sustained inflation and the financial collapse of 1998. It should pay more attention to rebuilding social overhead capital. A substantial program to upgrade roads and other physical infrastructure would boost demand for Russian goods while enhancing the private sector’s competitive potential. Cleaning balance sheets of mutual overdue debts would greatly improve the financial position of the real sector. To increase investment in new facilities and technologies the government must help develop mortgages and create conditions for industrial firms to pursue the policy of accelerated depreciation. Judicious subsidizing of interest payments to help finance private investment would also increase the rate of growth.”

Clearly, seven years later the above-mentioned recommendations remain relevant. Time has confirmed their accuracy.

In dissonance with the earlier neoliberal strategy, the letter spoke of the need for industrial and pricing policies. The very terms of “industrial policy” and “pricing policy” were missing in Russian reformers’ lexicon. The subject of regulating prices is still a bugbear for Russian neoliberals today.

Another matter brought up by the authors is equally shocking for Russian reformers: the need to reconsider privatizations that have been carried out in violation of the law. Mind you, the proposal comes from respectable American economists, not from some Russian Communists. The section dedicated to the social contract contained specific legislative initiatives: a law on minimum subsistence and progressive taxation. Other proposals included substantial real estate taxes on personal residencies with high market value and high taxes on extractive industries. All the Russian people, the authors said, should benefit from the export of natural resources.

7 Ibid.
4.2. Joseph Stiglitz: Russian reform in the Neo-Keynesian discourse

Nobel laureate Joseph Stiglitz is deservedly considered to be the leading opponent of the neoliberal trend in the economic theory. He believes the key reason for the Russian reform’s failure was that its development concept was based on advice from the International Monetary Fund. He pointed out three fundamental mistakes made during the initial stage of the reform.

First, instant liberalization of prices. It caused hyperinflation, which destroyed savings and current assets, thus preventing the emergence of small and medium businesses. The anti-inflation policy, in turn, resulted in increased interest rates.

Second, low prices for natural resources. The American economist viewed this as an invitation for speculative enrichment. Russian oligarchy was formed through purchasing raw materials cheap and then selling them abroad. The oligarchs did not develop new enterprises; they were parasites, getting rich through mistakes made by the government.

Third, the deadliest mistake was rash privatization. Given the situation where most people had lost their savings and interest rates were high, the oligarchs could be the only ones who benefited from it. In reality, Stiglitz wrote, privatization resulted in many assets being stolen. Such capital has an innate tendency to flee from the country. Anyway, oligarchs were not interested in investing money in a depressive economy. Stiglitz wrote about the unique situation that existed in Russia by 1998: “It had an abundance of natural resources, but its government was poor. The government was virtually giving away its valuable state assets, yet it was unable to provide pensions for the elderly or welfare payments for the poor. The government was borrowing billions from the IMF, becoming increasingly indebted, while the oligarchs, who had

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received such largesse from the government, were taking billions out of the country.” In keeping with the Keynesian theory, the Noble laureate believes Russia can save itself by restoring people’s trust for the state. During his visit to Moscow in April 2004, Stiglitz encouraged the Russian government to learn to exact 90% of raw materials exporters’ superprofits.

The unjustifiably high tempo of the Russian reform was criticized by all Western economists, both Neo-Keynesians and monetarists. Instead of shock reforms Stiglitz proposed the principle of incrementalism (gradual transition). He explained the differences between the two approaches by using a number of metaphors (“battle of metaphors”), which reflected the Nobel laureate’s Keynesian views (Table 4.1).

**Table 4.1**

<table>
<thead>
<tr>
<th>Economic metaphor</th>
<th>Shock Therapy</th>
<th>Incrementalism</th>
</tr>
</thead>
<tbody>
<tr>
<td>Continuity vs. Break</td>
<td>Discontinuous break or shock—razing the old social structure in order to build the new.</td>
<td>Continuous change—trying to preserve social capital that cannot be easily reconstructed.</td>
</tr>
<tr>
<td>Role of Initial Conditions</td>
<td>The first-best socially engineered solution that is not “distorted” by the initial conditions.</td>
<td>Piecemeal changes (continuous improvements) taking into account initial conditions.</td>
</tr>
<tr>
<td>Role of Knowledge</td>
<td>Emphasizes explicit or technical knowledge of end-state blueprint.</td>
<td>Emphasizes local practical knowledge that only yields local predictability and does not apply to large or global changes.</td>
</tr>
<tr>
<td>Knowledge Attitude</td>
<td>Knowing what you are doing.</td>
<td>Knowing that you don’t know what you are doing.</td>
</tr>
<tr>
<td>Chasm Metaphor</td>
<td>Jump across the chasm in one leap.</td>
<td>Build a bridge across the chasm.</td>
</tr>
</tbody>
</table>

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<table>
<thead>
<tr>
<th>Economic metaphor</th>
<th>Shock Therapy</th>
<th>Incrementalism</th>
</tr>
</thead>
<tbody>
<tr>
<td>Repairing the Ship Metaphor</td>
<td>Rebuilding the ship in a dry dock. The dry dock provides the Archimedean point outside the water so the ship can be rebuilt without being disturbed by the conditions at sea.</td>
<td>Repairing the ship at sea. There is no “dry dock” or Archimedean fulcrum for changing social institutions from outside of society. Change always starts with the given historical institutions.</td>
</tr>
<tr>
<td>Transplanting the Tree Metaphor</td>
<td>All-at-once transplantation in a decisive manner to seize the benefits and get over the shock as quickly as possible.</td>
<td>Preparing and wrapping the major roots one at a time (<em>nemawashi</em>) to prevent shock to the whole system and improve chances of successful transplantation.</td>
</tr>
</tbody>
</table>

**4.3. Kenneth Arrow: “Shock therapy” policy in the theory of economic expectations**

Stiglitz was not the only who considered the “shock therapy” theory fallacious. Kenneth Arrow thinks the economic crises former Soviet republics and East European nations experienced were due to the economy of the late Soviet period being unprepared for transition. The Nobel laureate believes gradual restructuring of the Russian economy would be the optimal scenario. The state should assume the function of preparing mechanisms for transition. Using the concept of economic expectations (the dependence of investment plans on future prospects) to explain transitional processes, Arrow claimed the reason for the crisis in post-socialist nations was the discrepancy between expected (low prices and available resources) and real consequences of economic activity.

The American economist with a reputation of a liberal thought it was possible even to use “market socialism” as a universal model for economies in transition. He explained it was difficult for enterprises to adapt to new economic reality because they did not believe reforms were being implemented purposefully. In line with mentality acquired during the socialist era, companies’ managers expected the government would give them a subsidy or a loan rather than see them go bankrupt, as required by the market system.
Acknowledging the important role of the privatization process, Arrow referred to the example of Russia and warned against thinking it was possible to lawfully privatize state property in a short period of time. He said it was reformers’ illusion that state property could be sold at a fair price in a situation where people did not have enough purchasing capacity to buy fixed assets. Even the procedure of determining a market price took some time.\(^\text{12}\)

**4.4. Lawrence Klein: “Polarization” of the Russian reform’s model**

The trajectory of Russia’s economic development includes a number of zigzags, which have to do with a change of the systemic paradigm, with an abrupt switch from one model principle to another, opposite one. Cycles of the Western economic history did not have such amplitude. Contemporary historians agree that of all possible scenarios in 1917 the most radical one was chosen. Many researchers believe this tendency for radical choices is a peculiar trait of Russian mentality today as well. The reform of the Russian economy in the early 1990s followed the paradigm of extremism as well. Again, of all possible ways to carry out reforms, the most radical was used—“shock therapy.” In this sense, Gaidaronomics is similar to the policy of wartime communism. Unwarranted radicalism of the Russian reforms is emphasized by Western economists too.

“The irony of it all,” wrote Stiglitz, “is that the modern critique of utopian social engineering was based particularly on the Bolshevik approach to the transition from capitalism to communism, and the shock therapy approach tried to use many of the same principles for the reverse transition. It is almost as if many of the Western advisors just thought the Bolsheviks had the wrong textbooks instead of the whole wrong approach.”\(^\text{13}\)

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Another Neo-Keynesian Nobel laureate Lawrence Klein also blames Russian reformers for following stereotypes of “polar extremes.”¹⁴ Their policy was based on a theoretic model of market economy they created metaphysically. In reality, both this model and its opposite, the system of centralized planning, have never existed and cannot exist.

It would be more realistic, Klein believes, to adopt the concept of “market socialism.” The American economist viewed mixed economy as the only acceptable way for Russia to develop. Unlike monetarists, he viewed market socialism not as a transitional form but as an ultimate system of reformist goal-setting. But despite common sense, adherents of the liberal capitalist utopia prevailed in Russia. This is how Klein described them: “They do not want to modernize or liberalize socialism; they want to remove all socialist aspects during the transition period and aim for a system that resembles typical OECD countries as much as possible. To them, one of the most important steps in the transition period is to convert state enterprises to capitalistic enterprises owned by individuals or groups of individuals, either domestic or foreign. They are simultaneously introducing a market system and selling or distributing state enterprises to private persons. It is their opinion that privately run enterprises are always more efficient than state-run enterprises. Issues of social equality, justice, or wealth distribution play little role in their thinking.”¹⁵

4.5. Michael Intriligator: The “ICG” approach versus the “SLP” approach

Analysis by UCLA Professor of Economics Michael Intriligator further developed the critique of “shock therapy” recommendations. According to him, the “shock therapy” policy by definition could not produce a market system. While proclaiming principles of free market, Gaidaronomics was pushing the economy in the opposite direction.

Michael Intriligator called Yegor Gaidar’s economic policy the “SLP” approach: stabilization, liberalization, and privatization. Attempts to implement these three elements eventually resulted in their negation. An attempt to stabilize the Russian economy by reducing budget defi-

¹⁵ Ibid., 78.
cit resulted in unprecedented stagnation. Its scale, according to Intriligator, exceeded that of the Great Depression in the United States (55% versus 35%). The Russian economy, which was the second largest in the world prior to the reforms, occupied the 11th or the 12th place by the mid–1990s. The fact that inflation eliminated people’s savings prevented the middle class from being formed in Russia, and without the middle class there can be no viable economic system. Intriligator thought the lesson of Russia’s failure to stabilize its economy was that it is impossible to stabilize an economy without providing the cabinet with enough authority.

The second element, liberalization of prices, was linked to reformers’ desire to do away with the administrative pricing method. In reality, though, the American economist pointed out, it were monopolists, or even criminal rings and corrupt officials, not markets, who determined prices. The second lesson, according to Intriligator, was that if prices are liberalized prior to privatization, those in power benefit from it, not manufacturers.

Reformers expected the third element of the “SLP” approach, privatization, to provide positive stimuli for a new social stratum of owners to labor. In reality, though, enterprises became property of their former managers. The formula used to de-nationalize the economy was “privatize your own enterprise.” Essentially, new companies were private monopolies, which behaved as monopolies do. A new type of manager emerged—one whose priority is achieving personal short-term gains.

The third lesson, according to Intriligator, was that without proper legal regulations and an efficient judicial system privatization leads to criminalization of the economy instead of making it more effective.

Instead of the “SLP” approach, the American professor proposed the “ICG” approach: institutions, competition, and government. He referred to the Chinese model of transitional economy as an example of the “ICG” approach.

Intriligator naively believed that, following the failure of “shock therapy,” the West had moral obligations before Russia and should have helped Russia to overcome its economic crisis. The help, in keeping with the “ICG” approach, should have involved forming the institutional structure for competitive environment and efficient governance. Another way he wanted the West to support reforms in Russia was for
the West to open its markets for Russian exports. By way of comparison, Joseph Stiglitz harbored no such illusions, believing that the crisis in Russia was the result of intentional activities by a number of leading Western financial structures.

4.6. Lynn Turgeon and Jacques Sapir about reformer’s inflation phobia

Contemporary Keynesians actively use the negative experience of Russian reforms to criticize the monetarist theory of inflation. They have proved conclusively that reduction of money supply by itself does not lead to the economy’s rehabilitation. Moreover, in some situations such a policy may deter economic growth. Apparently, the Ministry of Economic Development and Trade and the Ministry of Finance are not familiar with these works. They still use the obsolete and widely criticized monetarist policy promoted by the IMF, which calls for reducing “excessive” money supply in Russia’s economy.

Lynn Turgeon, Economics Professor at Hofstra University, is a leading Keynesian critic of the deflation policy. He believes that, by reducing its money supply by 70–80%, Russia has overstepped the limit of what is necessary. As a result, instead of getting a seller’s market as intended, it got a buyer’s market. Turgeon criticized the monetarist theory of inflation for being limited to demand inflation (“excess of money in pursuit of insufficient quantity of goods”). In Russia’s case, he believes, a totally new variety of inflationary processes, unknown to monetarists, has emerged. What took place in Russia was supply inflation, not demand inflation. It resulted from reducing loans and decreasing prices, which reflected the real balance. The danger of hyperinflation in Russia, according to Turgeon, was nothing else than a bugbear used by monetarist propaganda.

The key recommendation the American professor gave the Russian government was to return to a fixed exchange rate. The ruble rate,
Turgeon wrote, should depend more on the purchasing power parity; it should not be determined by the stagnant Moscow market, which is affected by speculative factors.¹⁸

French economist Jacques Sapir, chief of the Centre d’études des modes d’industrialisation (the Center for Studies on Forms of Industrialization), also maintained that Russian reformers had misinterpreted the monetarist strategy of combating inflation. He pointed out that the traditional monetarist views on the effect inflationary processes have on economy confuses cause and effect. Chronologically, the French researcher indicates, economic decline preceded inflation in all transition economies, not vice versa. Thus, by fighting inflation, the government would fight the effect, not the cause. Sapir concludes that economic decline by itself is the cause of inflation.

Based on this, he recommended to shift the emphasis in the Russian economy from fighting inflation to increasing production and investment.

The anti-inflation policy of the Russian government resulted, according to the French economist, in the demonetization of the Russian economy—“the most spectacular, and probably the most corrosive, phenomenon from the point of view of the standard macro-economic theoretical bases.” While inflation slowed down, some companies stopped using the ruble in their transactions. The rapidly spreading use of barter was another indication of the critical condition. By 1997, according to Sapir, 40 Russian regions were demonetarized, while another 13 were demonetarized partially.

Thus, the researcher concluded, we are dealing with “a particular monetary dynamic which by all accounts has been induced by policies which have excessively reduced the economy’s level of liquidity. Lower inflation has not, therefore, resulted in a wider use of currency. This directly involves a purely transactional view of currency.”¹⁹

If inflation was a consequence of the economic decline, not its cause, then what was the cause? In answering this question, Sapir was not original: first, it was the reduction of the military-industrial

complex; second, it was the disorganized state caused by the dissolution of the Comecon and the USSR; third, it was the loss of trade ties between ex-Soviet sovereigns. Yet, all these factors were predictable. Strategic mistakes made during reforms are a different story. The overrated ruble had extremely negative consequences for the Russian economy. Its downfall during the 1998 crisis was only natural. During the period from January 1993 to November 1996, Sapir said there was even a negative relation between GDP decrease and changes in the ruble’s real rate.20

4.7. James Galbraith: Russian reforms in the institutionalist discourse

While with Keynesians, the main question was the optimal speed with which to carry out reforms, institutionalists questioned the strategy of transition itself. Galbraithianists replaced the limited orthodox Keynesian approach with a model which allowed for non-market methods of government regulation. James Galbraith believed that instead of slowing the transition down, Russian reformers should have entirely reconsidered its ideology.21

Reforms in Russia, he told a Russian newspaper said in an interview, yielded mostly negative results. Nonetheless, their authors continue to claim they have not done enough yet. At some point, they should have said, “Stop! It’s enough. The worth of a policy is in whether it affords stable growth now, not in what it promises in the distant future.”

Comparing Russia’s and China’s national economies, James Galbraith concluded that they were immanently incomparable. He thought Latin American countries, primarily Brazil, were much closer to Russia’s economic system. He considered the Chinese experience as useful for study but unfit for direct extrapolation. For example, he indicated

that since Russia had much more resources than China, it should have exercised much stricter control over the use of natural resources.

Also, James Galbraith could not ignore Russian social disparities. “On the one hand, a small, fully integrated with the West group of people controls all the main capital flows; on the other hand, there is a enormous number of the poor,” he said of the situation in Russia.23

James Galbraith paid special attention to the foreign debt, considering it an obstacle for economic growth. He referred to Germany’s experience in paying off debts after two world wars as a historic example for Russia. When the German government was paying unbearable reparations in the 1920s and 1930s, this caused economic instability (which had catastrophic consequences for entire Europe). On the other hand, when the West paid the German debt in the second scenario, this removed potential obstacles for an economic miracle.

James Galbraith promoted the idea of writing off Russia’s debts as well. Earlier, in 1989, he was successful in pursuing the same goal with regard to Brazil. Galbraith explained the negative effect of debts not only as the need to pay the interest but, more importantly, as a factor that makes the country less attractive for investors. This is what he said of the need to write off Russia’s foreign debt—the idea which appalled adherents of free market: “The IMF speaks of Russia’s large debt as an outstanding liability. That’s why investors who are thinking about Russia cannot be certain that their new loans will be paid. This is the main obstacle for long-term investment. In order to improve the investment climate, it is necessary to write off a significant part of the old debt. If the debt is large, there is a danger that the Russian government may impose a tax on new investments to pay for old loans.”24

However, Galbraith harbored no illusions concerning the West’s willingness to help Russia. He saw the reason for many odd decisions made by reformers in some Western countries’ desire to get rid of a dangerous rival on the world market. The West itself would never allow the kind of reform it tried to impose on Russia, a leading theorist of institutionalism said.25

24 Ibid.
4.8. Peter Reddaway on the IMF universalistic recommendations

It is amazing how many leading experts in the United States, the country where the International Monetary Fund is headquartered, criticize the Fund’s policies. One of them, Peter Reddaway, a professor of the Institute for European, Russian and Eurasian Studies at the George Washington University, described the results of Russia following IMF recommendations as by saying that, no matter how the situation may develop, any future government in Russia definitely will never listen again to the Fund which has discredited itself. Peter Reddaway thought the main error in IMF theories was their pretension to universality. Russia was encouraged to reorganize its economy according to the same “shock therapy” model as was used in Poland. In addition to ignoring economic differences, IMF recommendations overlooked the difference in mentality between Russian and Poles and communism being a “homegrown phenomenon” in Russia. This was the reason, according to Reddaway, for success in the case of Poland and failure in Russia’s case.

Reddaway thought Russia’s disillusionment with the IMF’s policy was due not only to the fact that with most Russian people their living standard drastically decreased, but also to the IMF’s determination to “push through” its neoliberal policy. As reforms progressed, the regime was becoming more and more authoritarian, which contradicted the initial goals of the reforms. Lacking popular support, Yeltsin’s administration formed a concordat with the oligarchs. In 1995, in exchange for financial and political support, leading bankers and businessmen received a permission to “acquire major state assets at little or no cost to themselves.”

“Did the West realize the negative essence of the processes in Russia?” Peter Reddaway asked. Another way to ask the same question would be to choose an explanation between ill will and thoughtlessness. Peter Reddaway believed the West failed to foresee disastrous

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consequences of radical reforms. He hoped the West could offer financial assistance for Russia to overcome economic dead-end.\textsuperscript{27} However, conspiracy theories regarding Russian reforms are also well-represented in the contemporary Western public thought.\textsuperscript{28}

### 4.9. Lyndon LaRouche: Russian reforms in the theory of “physical economy”

Lyndon LaRouche, the author of the “physical economy” concept, is a particular figure among outstanding Western economists. Being a persona non grata for the Western establishment, he is often ignored in the Russian economic science as well (as indicated by the absence of his name in reference and educational publications). A man who predicted the 1998 default should get more attention.\textsuperscript{29}

What makes LaRouche’s analysis of the Russian reforms particular is that he perceives them in the light of a global megahistorical approach. He views the crisis in Russia not as a systemic deviation in development but rather as a symptom and a harbinger of a global economic crisis. LaRouche is confident that the world’s currency system is on the edge of a global collapse. This outcome was sealed when a new monetary system was with a floating exchange rate was adopted in the 1970s. A “bubble” economy was formed, which, according to its imminent logic, should sooner or later burst. LaRouche explains the onset of the critical phase in Russia’s history by Russia’s “almost exhausted ability to meet the demand of Western financiers’ predatory interests.” Ineffectiveness of monetarist recommendations in Russia, according to him, is not a sign of weakness on the part of the system being reformed but rather a proof of unsoundness on the part of proposed recommen-

\textsuperscript{27} Ibid.
dations. Some think, said LaRouche, that the Russian economy is sick because it did not follow the principles of the more prosperous Western economy. This, he said, reminded him of story about a man who asked a doctor to help him treat a cold. But when he started taking the medicine the doctor gave him, the cold developed into pneumonia. Then the doctor suggested he take an increased dose of the same medicine. The man followed his advice and died. But that was not the end of the story. Relatives of the deceased invited the doctor to the funeral but the doctor was unable to attend, because he happened to take the same medicine and was at his own funeral at the time.”

But the problem was not limited to fallaciousness of the monetarist theory. LaRouche associated Russia’s economic collapse caused by the reforms with the geopolitical pressure from the Atlanticist West. Interestingly, he believed the main destabilizing force was not the United States but rather the British monarchy, acting in the format of Halford Mackinder’s theory. He pointed out London’s initiating role in the “shock therapy” policy in Russia. On the whole, LaRouche thinks the Russian reforms were one of largest cases of theft in history.

4.10. Marshall Pomer about “open” economy

Western theorists criticized not only the internal but also the external economic policy of the post-Soviet Russia. With regard to the internal sphere, the basic concept was, as indicated above, the fact that government regulation in the country’s economy was radically reduced without proper reasons. In the external economic activity, another fundamental principle of classic liberalism, that of free trade, was criticized. More precisely, the critique was directed against absolutizing the “open society” ideology. For instance, critics pointed out the difference between neoliberalism’s ideal model and the actual practice of national economies with its custom duties and tariffs and all sorts of protectionist measures.

Marshall Pomer, the president of the Macroeconomic Policy Institute in the US, was one of those whose research sought to find the op-

timal degree of openness for the Russian economy. He viewed Russian reformers’ imperative, “the more open the economy is, the better,” as theoretically erroneous.

According to the American researcher, the crisis in Russia could have had a smaller scope, had the country’s transitional economic system been more regulated by the government and protected against external influence. He emphasized that, of course, what he had in mind was not an autarkic model but rather a reasonable degree of openness. He believed the benefits of an open economy included development of international competition as a necessary condition for a dynamic market environment; diversification of needs and thus raising the living standard; reducing corruption and bureaucracy among government officials, who can no longer control trade; and speeding up democratic processes in the political sphere. However, Pomer indicated, all these benefits are brought to naught if the process of economic integration into the world market is forced to proceed too fast.

When Russia exceeded the optimal level of openness, this brought about catastrophic consequences in 1998. The devaluation of the ruble as a result of the crisis was tantamount to partially closing the Russian economy. Thus, the system restored the necessary balance automatically. The same result could have been achieved in a less painful way through an appropriate government policy.

Today, the American researcher believes, Russia’s economy is vulnerable because it is dominated by short-term investment, which can cause a collapse in case of any shock in the financial system. The conclusion he made was that Russia’s economy was in the straitjacket of ideology. It is the neoliberal ideology, Pomer believes, that is the main obstacle for Russia’s economic development.32

4.11. The Russian reforms: key assessment by foreign experts

The assessments of the Russian reforms we presented so far come mostly from US economists. This situation reflects the existing Ameri-
can domination in the economic theory. To confirm it, it would be sufficient to take a look at the list of countries Nobel laureates in economics represent.

However, European schools of economics offer critique of the Russian reforms similar to that of the Americans. For example, leading experts of the French school of economic analysis (Jacques Sapir, Jean-Pierre Pagé, Françoise Renversez, Hélène Clément-Pitiot, Michel Aglietta, Frédéric Lordon, etc.) considered as the key factor with regard to Russia the need to regulate exchange transactions and monitor capital flows. They explain that one of the key problems in transition, capital flight (estimated at over $100 billion from 1992 to 2000), was due not merely as a consequence of Russia’s market unattractiveness, but rather to the criminal origin of a large part of major businesses’ income. Thus, to counter the process the government should strengthen its regulation, not liberalize the market.

French economists believe a policy that combines restrictions and incentives is a key to success. Also, they believe that regulating exchange transactions and capital flows will afford an opportunity to protect the country’s economy against financial shocks and speculations on the part of international financial markets. This is particularly relevant in Russia’s case, they emphasize, because its financial and banking system is relatively weak. The Russian Federation, they say, should have a monetary policy of its own. Such a program (in particular, measures proposed with regard to currency control) would be fully legal in terms of international law, they emphasize, and would not contradict the IMF Articles of Agreement. They refer both to the experience of West European countries, which regulated their exchange rates from 1948 to the mid–1960s, and to the opinion of John Keynes, who played a major role in drawing up the Bretton Woods Agreement.33

The “inspiring and stimulating” role of the International Monetary Fund in the Russian reforms is well-known. Thus, it would be particularly interesting to see how the IMF views the reforms in Russia. Interestingly, its assessment disagrees entirely with conclusions drawn by Russian neoliberals. Unlike the latter, the Fund’s analysts acknowledge strategic mistakes they made. They even question applicability of monetarist reforms to Russia’s peculiar conditions.

33 “Frantsuzskiye eksperty rekomenduyut: Rossii nuzhno regulirovaniye obmennykh operatsii i kontrol za dvizheniyem kapitalov,” Bankovskoye delo (Moscow, 2000).
For example, new views on the Russian reforms were presented in a book first published in 2003 by University of Chicago professors Raghuram Rajan and Luigi Zingales, *Saving Capitalism from the Capitalists: Unleashing the Power of Financial Markets to Create Wealth and Spread Opportunity.* Several months after the book was published, Raghuram Rajan became the IMF’s Chief Economist, the position previously occupied by Kenneth Rogoff.

In contrast with their former optimism, IMF analysts now admit their expectations of Russia’s swift advance to free market and democracy were unfounded. They are making substantial adjustments to the monetarist theory by introducing the factor of political context. Capitalism cannot be built without achieving an appropriate ideological landscape through public consensus.

The authors consider the fact that a vast majority of the Russian people, 72%, currently support the idea of de-privatizing property as a crucial obstacle to implementing free market principles in Russia. One may recall that in the past, radical monetarists in the IMF used to brush off such considerations as insignificant.

The key mistake of the economic reforms in Russia, according to the American professors, was that the government allowed superconcentration of property. The most profitable Russian companies were acquired by people with “connections” in the government. The authors believe it would be wrong to assume that Russia’s natural monopolies identify their own interests with those of the country in general. The famous words by General Motors president Charles Wilson, “What’s good for General Motors is good for the country,” does not reflect neither the American nor Russian (with the name of the concern replaced with another one) reality. The current struggle in Russia between the president and the oligarchs for control over super-profits from extracted natural resources, whatever its outcome may be, will have extremely negative consequences for the future free market, the Chicago experts believe. If the oligarchs win, their property will be legally protected and the prospects of competition as a prerequisite for market relations will be minimal. On the other hand, if the oligarchic groups are defeated, another fundamental institution of free market, private property, will be endangered.

Of course, we should be careful when listening to IMF analysts who criticize the system of Russia’s natural monopolies the critique, since our geo-economic rivals, naturally, would love to see them divided into
smaller companies. Yet when they admit that liberal reforms failed in Russia, it is perhaps the most important opinion of Western experts with regard to objective results of the economic experiment.\footnote{Raghuram G. Rajan and Luigi Zingales, Saving Capitalism from the Capitalists: Unleashing the Power of Financial Markets to Create Wealth and Spread Opportunity (Princeton University Press, 2004).}

\section*{4.12. Neoliberal orthodoxy in Eastern Europe}

It is interesting to trace the differences in assessments of the Russian reforms between contemporary economists of the Western world and those of Eastern Europe. East European economists are still deluded by the same theoretic illusions as neoliberals in Russia. While the West European economic thought has admitted the high speed of reforms in transition economies as clearly erroneous, East Europeans continue to view radical transformations as the only possibility when making a transition to the market.

For example, well-known Hungarian economist Jónos Kornai (who became widely known during the early years of the reforms as the author of \textit{The Road to a Free Economy}) defends the “shock therapy” policy.\footnote{Jónos Kornai, The Road to a Free Economy: Shifting from a Socialist System: the Example of Hungary (Norton, 1990).} The professor of economics at Collegium Budapest and Harvard University is still confident that his recommendations concerning making the transition in one leap were correct. “Even today,” Kornai writes, “I do not reject the notion of a radical adjustment package in which several measures are taken simultaneously. A well-compiled package of properly calibrated measures can restore equilibrium in several important dimensions of the macroeconomy all at once, or at least bring the economy much closer to a tolerable degree of disequilibrium (for instance, reducing the current account deficit or the budget deficit to a sustainable level).”\footnote{Jónos Kornai, “Ten Years After The Road to a Free Economy. The Author’s Self Evaluation,” in \textit{Annual World Bank Conference on Development Economics 2000} (World Bank Publications), 59.}

Accordingly, the Hungarian economist thinks the radical policy Yegor Gaidar pursued to save Russia from hyperinflation was strategically correct. Kornai attributes its ineffectiveness not to the strategy’s fallaciousness, but to the lack of constitutional support for the macroeconomic equilibrium.
When giving a report at the World Bank’s annual conference in 2000, the liberal professor attempted to vindicate the reformers’ radical policies by referring to the effectiveness of Stalin’s policy of “mass collectivization.” “Stalin,” he said at the end of his address, “did not want to spend much time bothering with voluntary collectivization. Using merciless violence, he imposed collective ownership on the peasantry within two to three years. I do not want to exaggerate the comparison—no gulags or brutality were required in the 1990s. The forcing of change was milder. Still, there were similarities: the subordination of ownership reform to political purposes, the horror felt toward gradual change, the impatience, and the obsession with speed.”\(^{37}\) In connection with this quote, we have to point out that indeed there were similarities with Stalinism. The extremely high death rate, the near-zero birth rate, the shortening of life expectancy during the year of the Gaidar reforms, which József Kornai seeks to justify,—all this has caused the loss of approximately 28 million human lives.\(^{38}\) Is it possible to ignore this? Is it possible not to think about this? Is it fair that in one case, when millions of lives were lost (in 1945), mankind condemned the authors of the “new order,” yet in another, similar case today it ignores the cause-and-effect relation between the shock reforms and their demographic consequences?

Kornai suggested two alternative strategies in the theory of transition economies. Strategy A, according to the Hungarian economist, emphasizes developing the private sector. In Strategy B, the policy of swift denationalization is the priority. Kornai clearly preferred the first scenario, while citing the failure of reforms in Russia as a vivid example of possible negative consequences when following the latter of the two strategies.

Leszek Balcerowicz, one of the senior theorists of economic transition in Poland, made similar attempts to justify the results of the reforms. He referred to emotions underlying negative assessments of the reformist activities. In particular, he protested against what he called “unsound” examples of successful economic reforms in China. The Polish economist even refused to trust official statistics, which allegedly lowered development rates in reformed countries—as if reformers in power were interested in discrediting their own activities by tampering with statistics. In short, neoliberals in Eastern Europe, just like

\(^{37}\) Ibid., 60.

\(^{38}\) V.I. Yakunin, S.S. Sulakshin, V.E. Bagdasaryan et al., Gosudarstvennaya politika vyvoda Rossii iz demograficheskogo krizisa (Moscow: Nauchny Ekspert, 2007).
their colleagues in Russia, continue to insist they were right, once again confirming their reputation of modern Bolsheviks.39

* * *

The role of Western advisors in the negative outcome of Russian reforms is universally recognized. Der Spiegel claimed that the total number of such transition experts in Russia was up to 30,000.40 Yet one may say that there was also reverse influence the Russian reforms had on the Western economic theory. The negative experience of the Russian reforms caused economists to reconsider some orthodox principles. The theory of monetarism was practically repudiated. While it was very popular in the late 1980s, currently it has practically been removed from the forefront of the world economic thought. Teachings that emphasize government regulation in the economy, like institutionalism and Neo-Keynesianism, are experiencing a new birth. Perhaps Jacques Sapir gave the most clear description of the transformation that took place in the economic theory.

To confirm the scientific theory of the monetarist thought, it was necessary to conduct an experiment, and the Russian reforms were such an experiment. Thus, their failure should have become grounds to denounce the erroneous hypothesis. The results of the macroeconomic reforms in Russia did not meet the forecast given when programs and recommendations were prepared, Jacques Sapir wrote. The authors changed their statements when consequences of following these recommendations became obvious. Since we recognize the importance of such phenomena as the state and institutions, it is necessary to critically analyze all recommendations of the Washington consensus. If we compare standard macroeconomics with reality, this will put adherents of this economic paradigm in an extremely difficult position. It is necessary to revision its core theoretic foundations.41

Thus, new generations of Russian politicians and statesmen should take into account these assessments and realize that a change of economic policy’s paradigm in Russia is inevitable.

40 A.V. Gorshkov, Rossiiskiy reformy i zapadniye ekonomisty (Chelyabinsk, 2001), 3.
Chapter Five  
The Government’s Role in Managing Economic Development

The concept of denationalization, which reformers zealously instilled in public opinion, was one of the basic theoretic foundations of the liberal transition in Russia. They presented non-intervention in the economy as a universal method of modernization. On the other hand, neoliberals explained that examples of statist modernization (the effectiveness of which would be hard to deny) were historical deviations. In keeping with this challenge, the purpose of the following analysis is to perform a country-by-country comparative historical analysis and to determine the government’s role in managing the economy.

5.1. Intervention and non-intervention in economics in the theory of the civilization pendulum

The ideological myth concerning state non-intervention as the key factor of economic success became popular not only among Russian people. American historian Arthur Schlesinger pointed out that most Americans fully believe it as well.\(^1\) Historically, the idea of America’s economic wealth being a result of unfettered individual enterprise has played not only the role of an economic recommendation but even that of the ideological self-identification for the “free American society.” Russian reformers of the monetarist generation accepted the Western world’s ideology as a true expression of its economic system. This was perhaps the main mistake when choosing benchmarks for economic reforms.

Comparing ideological positions with actual economic mechanisms of America’s development, Arthur Schlesinger came to the following conclusion: “The tradition of affirmative government is quite as authentically American, quite as deeply ingrained in our national history, quite as strongly identified with our greatest statesmen, quite as expressive of American ideas and character, as the competing tradition of self-interest and scrambling private enterprise.”\(^2\)

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\(^2\) Ibid., 255.
The economic history of the United States—and of other Western countries as well—may be presented as a series of cyclic oscillations between the two poles of government regulation and market self-regulation. Whenever bureaucratic “red tape” started hindering economic development, the government would somewhat relax its grip and give priority to private enterprise. Yet once temporary innovative breakthrough was achieved, the economic system, re-oriented for entrepreneurs’ interests, would become unbalanced. Then the government would strengthen its regulatory mechanisms again. Whenever the government waited too long to carry out such a re-orientation, an economic crisis would ensue. This is exactly what happened in 1929, when orthodox liberals, who were in power at the time, waited too long. Catastrophic consequences of the economic crisis could have been much less, had the government taken preventive measures.

The concept of economic systems’ pendulous development allows creating a more complex model of long-term planning than before. A linear scheme can now be replaced with a program that includes periodic re-orientation within the framework of a general strategic platform of the economic policy. Methodologically, the suggested approach opposes any form of economic orthodoxy, both neoliberal and statist. The need to emphasize the state’s administrative functions in Russia’s economy today has to do with the prior phase of non-intervention. The next stage of pendulous oscillation will probably see another strategic paradigm, that of expanding economic freedoms in private enterprise. But this, we repeat, is not the priority strategy at the present stage of the general cyclic movement. The priority is to find the right measure, to be able to find optimal administrative solutions.

5.2. Traditions of state intervention in economy in the United States

How true is the statement that the national wealth of the United States is a result of the state’s consistent non-intervention in economic matters? Considering the history of the United States, we come to conclusions of the opposite nature. Even during the era of British dominion, state intervention was a common practice.

3 V.I. Yakunin, S.S. Sulakshin, V.E. Bagdasaryan et al., Gosudarstvennaya politika vyvoda Rossii iz demograficheskogo krizisa (Moscow, 2007), 246–250.
Republicanism, interpreted as the imperative of personal interest being inferior to public ones, was the philosophical foundation for the policy of state intervention in economic processes. When Adam Smith’s Wealth of Nations was first published in America in 1789, it was sharply criticized as a purely theoretic work which had nothing to do with economic reality. A Founding Father, the first Secretary of the Treasury and the leader of the Federalist Party, Alexander Hamilton dismissed the “reveries” of Adam Smith. Instead, he regarded the policy of Jean-Baptiste Colbert as a pattern to be followed in the economic sphere. \(^4\) The “spirit of enterprise,” he wrote, when “unbridled,” leads to “outrages, and these to reprisals and wars.”\(^5\)

Alexander Hamilton’s great program of the 1790s was built on the definition of the national government as the main force which can transform an agricultural country into a great industrial power. Interestingly, Hamilton’s program offered government support only to those Americans who would employ it under public guidance to stimulate national productive energies. “In the United States,” E. A. J. Johnson, one of the first students of American economic policies wrote, “it is difficult to find any thoroughgoing, eighteenth-century proponents of laissez-faire, and even harder to find much explicit evidence of legislative acceptance of a theory of economic freedom.”\(^6\) If government restrictions were not introduced at the federal level, they were implemented at the state level. Numerous inspection laws regulated not only the quality of goods offered for sale, but even the prices at which they could be sold. “A weird tangle of state law,” Johnson wrote, “circumscribed and limited entrepreneurial freedom. … Nor does the annual crop of state laws regulating enterprise show any signs of abating in the 1790s; if anything, the legislative harvest increases.”\(^7\)

In the 19th century, when the United States became the world’s largest economy, the share of the public sector in its economy was bigger than, say, in Great Britain. While in Great Britain most canals and all railroads were built by private capital, in the US they were built largely through government investment. In the United States government

\(^7\) Ibid., 305.
was responsible for 70 percent of the investment in canals and 30 percent of the investment in railroads. In the southern states public authorities furnished nearly three quarters of the capital for railroads. In many cases state governments bought shares in corporations and installed their representatives on boards of directors. In Virginia the state government subscribed three fifths of the equity capital in the state’s railroad companies. The state of Pennsylvania owned stocks in over 150 such mixed corporations. Many of American private corporations were started in the 19th century with administrative methods. The difference between them and government institutions were often merely outward. “The extent of government intervention” was “striking,” Schlesinger wrote about the situation in the United States in the middle of the 19th century.8

The way the American agriculture developed was far from market ways. It was based on the trivial practice of settlers occupying lands in the Wild West. Squatters’ idea that all the lands belong to God and thus cannot be bought or sold denounces the myth of the Western society having particular respect for property rights. Because of the lack of government control, might made right in the Wild West. World history teaches us that freedom of economic relations, with the state’s regulatory mission minimized, leads to lawlessness, not to a civilized market. Eventually, the United States adopted a law in 1862, according to which each person could get about 70 hectares of land (a homestead) for the purpose of cultivation.9

Economic crises have never and nowhere been overcome by the government’s refusal to get involved in the economy. When the Russian government did exactly this in the critical situation of the 1990s, this looked like an act of a madman. The way another countries overcame the largest crisis in world history in the 1920s and 1930s may be helpful to state leaders.

The Roosevelt era in the United States

When panic broke out at the New York Exchange in 1929, the United States was developing economically in the mainstream of liberalism. As a result of the crisis, industrial output was reduced by more than 50%

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8 Arthur M. Schlesinger, Jr., op. cit., 226.
(i.e., the reduction was similar to that Russia experienced as compared to the USSR level). The number of the unemployed in the US rapidly grew from 2 million to 17 million. Those who retained their jobs saw their salaries cut by 35–50%. Forty percent of American banks went bankrupt. Eventually, all banking institutions were closed. The dollar lost 40% of its value against gold. Private ownership of gold was declared illegal. (The punishment for hiding it was extremely harsh: ten years in prison.) The lack of crisis management may be illustrated with absurd cases when millions of tons of grain, coffee, sugar, and rice were destroyed; wheat was used for heating purposes; 10 million acres of cotton fields were re-plowed; 6 million pigs were slaughtered, etc.

The essence of Roosevelt’s New Deal was to increase state intervention in the economy. The classical, Manchester capitalism finally ceased to exist after the Roosevelt reforms. “I am not speaking of an economic life completely planned and regimented. I am speaking of the necessity, however, in those imperative interferences with the economic life of the Nation that there be a real community of interest, not only among the sections of this great country, but among its economic units,” Roosevelt said in 1932, explaining the gist of his program as opposed to that of Herbert Hoover.10

Instead of the economy being self-regulated, he spoke of “the concert of interests.” “Each unit…,” Roosevelt explained, “must think of itself as a part of a greater whole; one piece in a large design.” 11

The government established the National Recovery Administration (NRA), which was entrusted with the function of comprehensive regulation. The entire industrial sector was divided into 17 industries, with a special administrative body set up for each group. These groups created “codes of fair competition.” The administration sanctioned 750 such codes. Along with setting rules for professional ethics, the codes even defined prices and output quantities.

Large government projects were another major element of Roosevelt’s policy. More than $3 billion were spent on new roads, airports, hospitals, etc. These large construction projects used the labor of numerous unemployed Americans, who were distributed among 2,500 tent camps, established specifically for this purpose.

10 Public Papers and Addresses (1928–1932) of Franklin D. Roosevelt (Random House, 1938), 632.
11 Ibid., 784.
In agriculture, the government defeated the crisis by purchasing farms. Interestingly, the bill on agricultural reforms was called the Agricultural Adjustment Act. “It seems to me that what is taking place in the United States is a profound reorganization, the creation of planned, that is, socialist, economy,” H.G. Wells said about the New Deal.\footnote{M.V. Konotopov, S.I. Smetanin, op. cit., 187.}

Indeed, the statist steps taken Franklin Roosevelt to save the US economy contradicted abstract principles of free enterprise. Based on this contradiction, the US Supreme Court ruled in 1934 that many of the New Deal initiatives were unconstitutional.\footnote{Vladimir Sogrin, “Novy kurs F.D. Ruzvelta: Yedinstvo slova i dela,” \textit{Obshchestvenniye nauki i sovremennost}, 1991, No. 3; A.I. Utkin, \textit{Ruzvelt} (Moscow, 2000); N.N. Yakovlev, \textit{Noveishaya istoriya SShA. 1917–1960} (Moscow, 1961), 138–289.}

It is noteworthy that the steps the Russian leadership took to overcome the economic crisis were exactly the opposite of what Franklin D. Roosevelt did with the New Deal. As a result, in less than five years the United States returned to the pre-crisis level, whereas the Russian economy is still below the Soviet-era level. On the whole, judging by the scope of catastrophic consequences for the national economy, Russia managed to break the sad record of the 1929 economic crisis, which is thought to be the largest one in the history of the Western world (Table 5.1).\footnote{Russkaya doktrina (Sergiyevsky proyekt), A.B. Kabakov and V.V. Averyanov (eds.), (Moscow, 2007), 472.}

Table 5.1

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5.3. Western Europe: democratic regimes

In dealing with the crisis, the British “National Government” established guaranteed prices for main goods manufactured in the country. The peculiar attribute of emergency measures taken by Britain was that state-run mixed companies, partly public and partly private, were established. This type of a company was particularly popular in the manufacturing and power consumption sectors, radio broadcasting (BBC), etc.\(^\text{15}\)

In France, the Popular Front government introduced a package of socially oriented measures, such as the 40-hour working week, paid holidays, and collective agreements. The General Council, with most members appointed by the government, was put in charge of the Banque de France. The military industry was partly nationalized. The government established Société Nationale des Chemins de fer Français, the French National Railway Company, with a 51% stake owned by the state. In agriculture, the Popular Front government intervened by establishing the National Wheat Office.\(^\text{16}\)

In Belgium, the “national unity” government adopted the “work plan,” which included nationalization of leading industries and major banks as well as a number of social programs.

In Scandinavian countries, the state took control over the niches of foreign trade and capital export. Keynesian recommendations with respect to influencing the interest rate were implemented.\(^\text{17}\)

5.4. Keynesian transformation in contemporary states

It is obvious that make progress one needs at least an administrative body to set goals and objectives for the nation to achieve. The liberal economic theory is still based on historical reality of the early 20th century at the most. The state’s role in managing the economy has cardinaly changed since then.

The term “state-monopolist capitalism,” which has been widely used by critics of the capitalist system, has changed its meaning to al-

\(^{15}\) Istorii noveishego vremeni stran Evropy i Ameriki: 1918–1945 gg. (Moscow, 1989), 284–286.

\(^{16}\) V.P. Smirnov, Frantsiya v XX veke (Moscow, 2001), 110–111, 131–136.

most the opposite. Formerly, the state-monopolist capitalism was interpreted (mostly within the framework of the Marxist-Leninist theoretical paradigm) as monopolies’ control over the government. Now priorities in this dual relationship have changed. Government institutions managed to bring major businesses’ interests and ambitions in subjection to national objectives. In some cases, the government itself assumes the role of a monopolist in a certain industry. This transition to the model of government regulation was caused by the problem of civilization survival, which became urgent because of world economic crises. On the other hand, those states that remained under monopolies’ control (like Russia during the “Seven Bankers” period) are still in a state of permanent crisis. Incidentally, we should commend a number of steps taken by the Russian authorities to rein in the oligarchs and their ambitions.

The state’s domination over major national businesses was one of the key factors in the economic breakthrough of the new “Asian dragons.” This is exactly how the South Korean “economic miracle” was produced during Park Chung-hee’s rule. Unlike most minor developing countries, in South Korea the dictatorship affected not only common people but oligarchic alliances as well. This is how A.S. Selishchev, an expert on East Asian economies, describes the administrative transition in South Korea: “After Park came to power, he summoned Korea’s leading businessmen. He put them in a line, sorting them according to their wealth, and began to give them orders. The goal was to create an effective economy, which would be able to compete with Japan and other economic powers. Let’s say, for example, Mr. Choi is the first in the line.

‘What do you do, Choi?’
‘Rice and gambling.’
‘Now you will build ships! We need to beat Britain and Norway!’
‘But I can’t! All I can do I is rice and roulette!’
‘I’ll help you. The government will help you. At first, it may be hard. But we will overcome. The main thing is you need to help Korea become a powerful nation. Then we’ll make you rich. If you refuse, I’ll be offended. Is it clear?’
‘Will do.’

‘Kim will manufacture TV sets and tape recorders. Kwak will make footwear and clothes. Cho will make cars… Every five years, we have a new set of goals. The objective for the first five-year period is to beat Norway in ship-building. Any questions?’

‘Yes, Mr. Park. This is undemocratic.’

‘Shut up! Those who refuse will lose all they have! Those who agree will become super-rich! Any more questions?’

‘No.’

‘You’re dismissed.’”19 “That’s the entire secret of the South Korean miracle,” the researcher concludes. “Park figured out correctly that businessmen generally didn’t care how to make money. Businessmen can make money not only to make their country richer. They can make money by devastating their country. For example, Russia has lots and lots of such businessmen. Thus, Park was a dictator not only with respect to his own destitute people, like Pinochet, but with respect to businessmen as well.”20

The functions of a modern state are much wider as compared with a capitalist state of the early industrialization era (a night watchman state). For instance, they include regulating and managing economic development of macroeconomic programming and social support. Interestingly, the United States was the first country where the government clearly spoke about the need to limit the influence of major corporations. Back in the 1900s, President Theodore Roosevelt, who shared Alexander Hamilton’s views, warned against the threat corporate power posed for American democracy.

“Only the National Government,” the president claimed, could exercise the “needed control” over the industrial order. “This does not represent centralization. It represents merely the acknowledgement of the patent fact that centralization has already come in business. If this irresponsible outside power is to be controlled in the interest of the general public, it can be controlled in only one way—by giving adequate power of control to the one sovereignty capable of exercising such power—the National Government.”21 For the first time in the US economic history, Theodore Roosevelt used government regulation

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19 A.S. Selishchev and N.A. Selishchev, Kitayskaya ekonomika v XXI veke (St. Petersburg, 2004), 164–165.
20 Ibid., 165.
21 Arthur M. Schlesinger, Jr., op. cit., 237.
measures against the depression America was facing. As if anticipating John Keynes’ ideas, back in 1907, when panic started among banks, the American government ordered interest rates reduced and increased money supply.

The works of John Keynes made some adjustments to the orthodox classical theory of free capitalist competition. The need for government intervention in the market economy is now itself regarded as classic. Neo-Keynesians (Evsey Domar, Roy Harrod) speak not joust of sporadic and indirect regulation, as was the case with Keynes, but of systemic intervention.

Some may object that Keynesianism emerged due to peculiar characteristics of the early industrial era, whereas in a post-industrial society its core elements are no longer relevant. In reality, post-industrialism strengthens the meritocratic element and thus only expands the state’s managerial role, simultaneously making it more complex. The following analysis of the way modern national economies of developed post-industrial countries function confirms this hypothesis.

**United States**

As is known, the US economy experienced the fastest growth in modern history during the Second World War. From 1938 to 1948, the United States more than doubled its industrial output, whereas in the previous 20 years of peaceful economic development, it achieved merely 38% growth. Whereas before the war the United States accounted for 40% of output in the capitalist world, after the war its share grew to 62%. The chief factor of the economic breakthrough was the system of wartime government orders. Lend-Lease ($46 billion) became a panacea for the American post-crisis economy. The government owned 2,500 new, technologically advanced factories, built in the US during the war. Later they were all sold to private businesses at prices 3–5 times lower than the initial cost. Thus, the government provided a good start for the US in the world economic race.

The US budget, being the largest one in the world, is an important factor of the US economic policy. Formerly, it was an insignificant frac-
tion of the national income. Presently, approximately a third of gross national product is used as government capital. The mechanism of government orders remains a means for regulating the US economy. More than 20% of the American industry is based on it. More than 60% of the electronic industry, which is a hallmark of the United States, works on government orders.

Construction is another administrative niche the government occupies in the US economy. The public sector covers more than 20% of the industry. Finally, the US government bear the main financial burden for scientific research. Approximately 60% of all research and development projects are financed by the state. A stimulating tax policy is another means the American government uses as a managerial tool. Its principles are well-known: high taxes on personal consumption and low taxes on investment. This stimulates businessmen to increase investment. Charity foundations are tax-exempt, which is an incentive for supporting culture and education financially. Also, the American government continues to use the Keynesian method of adjusting the interest rate through the Federal Reserve System.24

United Kingdom

Many researches explain that the United Kingdom’s economic development went faster after the war than before the war because it rejected the liberal theory of British Tory in favor of government regulation. Winston Churchill’s liberal economic policy was one of the main objects of John Keynes’ critique. (One of Keynes’ books was entitled The Economic Consequences of Mr. Churchill).

As in the US, the Second World War became a turning point for Great Britain, which caused it to switch to government regulation. To make sure military orders were filled, the government took control over the fuel and energy sector. The government purposefully pursued a policy which stimulated industrial concentration. Many minor companies were either incorporated into larger companies or eliminated. The high degree of monopolization in the British economy today is the main consequence of that policy. By the early 1980s, three of the five largest monopolies in the world were American and two were British: Royal Dutch Shell and British Petroleum.

The need to restore economic infrastructure elements destroyed by Luftwaffe during the war strengthened the need for government intervention even more. Private businesses did not have enough resources to carry out the recovery, and the job was not profitable enough to interest them. The forced renewal of production facilities was carried out on a new technological base, which ensured high innovative dynamics.

In 1945, the Labour Party came to power in Britain. It set the goal of making a transition to socialist economy. The party considered industry nationalization as a way to achieve socialism. Indeed, since 1946 through 1951 some sectors of the British economy were nationalized. These included the Bank of England, coal and gas industries, power stations, radio, television, railways and some other kinds of transport.

In 1967, after the Labour Party won another election, it nationalized the metallurgic industry. As private companies were transferred into state ownership, their shares were exchanged for government bonds. Incidentally, in keeping with statist principles, energy, raw materials, and transportation services were provided to British consumers at discount prices. Such a diversification of prices, which was acceptable for Britain, for some reason seemed unacceptable to Russian liberals.

To be fair, we should mention that each time the Conservative Party came back to power, it would start the process of post-Labour de-nationalization of the economy. Yet the pendulous (Labour—Conservative) development of the British economic system only strengthened its dynamism, adding more and more resources. But even after the large-scale liberalization under Margaret Thatcher the state retains a key role in the British economy.

The public sector produced approximately 20% of industrial goods, whereas in Russia, as we have already mentioned, it accounts for only 6.7%. On the whole, up to 40% of gross domestic product goes through Britain's budget. This discrepancy indicates that “in Britain, as also in the US, the budget, not the public sector, is the main tool of government regulation.”

Speaking about government regulation in the British economy, we should mention 100% subsidy-based development of British agriculture. The government covers up to 25% of farmers’ production costs. The produce of the agricultural sector is purchased at fixed guaran-

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25 Ibid., 201.
teed prices, market principles notwithstanding. The government offers bonuses for increasing crop capacity, increasing efficiency in animal husbandry, and other achievements. As a result, agriculture, which had been degrading prior to that, tripled its output. Britain, which does not enjoy favorable climatic conditions, currently supplies 60% of its food needs, whereas in the early 20th century it supplied only 30%.^26

**France**

The positive attitude to concepts of government regulation coincided in France with the stable popularity of leftist parties. Already in the first post-war cabinet, five ministers were Communists.

As was also the case in the Labourite Britain, the initial stage of economic reforms involved nationalization. Five largest banks (60% of French bank capital), leading insurance companies, the coal industry, the gas industry, the defense industry, the aircraft-manufacturing industry, part of the car-manufacturing industry, transportation, and power stations—all this became public property. The public sector produced up to 20% of industrial goods. The state controlled 35–40% of all capital investment. It is noteworthy that property of those who collaborated with Nazis (and there were many of those) was requisitioned without any compensation. For example, this was the case when Renault car factories were nationalized.

Of all the measures the French government took, nationalization of the largest banks perhaps affected the world economy the most. Traditionally, France was known for its high level of capital concentration with relatively low industry concentration. Among the world’s ten largest commercial banks, four are French: Banque nationale de Paris, Crédit agricole, Crédit lyonnais, and Société générale.

One should keep in mind that by starting the process of nationalization, the French government got itself in a fight with powerful oligarchic clans, like Rothschilds, Lazards, and Schneiders. (Russian oligarchs, albeit quite powerful, are still nowhere near Rothschilds). On the whole, government intervention in the French economy was actually closer to the Soviet economic system than to the capitalist model of Keynesian regulation. Yet nobody called the economic policy of the Fourth Republic “totalitarian” on these grounds.

^26 Ibid., 196–201.
The waves of re-privatization came in France each time rightist parties came to power. As was the case with the economic history of the United States and Great Britain, we see that cycles of statism may be found in the French history as well, which proves that this principle is universal.

Nationalization took place not only during Europe’s post-war socialization. The French economy had a big wave of nationalization in 1982, at the same time the conceptually opposite strategies of Reaganomics and Thatcherism were being implemented.

According to the Nationalization Act adopted by the Senate, 36 largest banks (with the capital of more than one billion francs each), two leading financial companies (the Suez Canal Company and Banque de Paris et des Pays-Bas), and five financial and industrial groups became public property. Their owners received compensation according to the shares’ maximal market price. The government assumed control over the aircraft and missile industries (84%), steelmaking (80%), the non-ferrous metallurgy (63%), the chemical industry (54%), and electronics and electrical engineering (44%). As a result of the 1982 reform, the public sector in France almost doubled. It produced 32% of industrial goods, which is a high figure, given the dispersion typical of the French industry. The system of loans almost entirely was in the government’s hands. The state provided up to 95% of all loans. Among capitalist European countries, France had the second largest public sector (the largest being that of Austria).

Although the policy of de-nationalization in 1986–1987 made some adjustments, the basic structure of the French economy remained the same. Approximately 40% of the national income in modern France goes through the budget. But the French public sector consists today not of socialist-type enterprises but of mixed corporations, where the state has a controlling stake.

The system of indicative state planning is a crucial element of the French economic policy. Since 1946, France has the Plan Commission (Le Commissariat général du Plan), which wields ample administrative authority.

Unlike Soviet Gosplan, its plans and projects consist mostly of recommendations and notifications for businesses. Public sector enterprises have “long-term agreements” with the government, whereby they receive indicative development plans. Non-incorporated public
companies receive specific plans with specific objectives, expressed in figures, to be achieved. For incorporated companies, there is a softer option of planned economy: recommendations on development strategy. Indicative plans are prepared for private companies as well. Although they are not required to comply with government plans, they use these plans as guidelines, because they include various incentives: tax exemptions, subsidies and loans.

The special role the public sector plays in the French economy is due to the fact that historically it has been dominated by small and medium businesses. A large-scale expansion for such companies purely based on their profits was unlikely. This is why the French government assumes responsibility for most of investment, whereas in some other countries major corporations take care of this. While the British experience demonstrates the need for government intervention in a situation where large businesses dominate the economy, the French experience demonstrates the same need in a situation where the same is true of small and medium businesses. Thus, essentially, any of the existing market systems makes the state’s administrative mission necessary.²⁷

Germany

It would seem that the German post-war “economic miracle” may serve as a historical foundation for vindicating the liberal model. Indeed, Ludwig Erhard’s policies were based on following fundamental principles of classical liberalism: no administrative distribution of goods, self-regulated prices, promotion of private property, free competition, independent supervision over monopolies.

However, Germany’s rapid economic growth was due to an altogether different factor: unprecedented investment and credit from the United States. America financed West Germany’s economy according to the Marshall Plan because of political reasons of the Cold War’s initial stage, not because of free market principles.

According to researchers, Ludwig Erhard’s “market experiments” could have failed even despite the US aid. By the end of 1949, unemployment doubled and reached 11%. The average monthly salary was below 400 marks. The Korean War, which broke out in 1950, saved West Germany’s economy. It generated a flow of industrial orders,


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which West Germany was better positioned to fill due to high production capacity and cheap labor.

Notwithstanding Erhard’s theoretic model, the government played an active administrative role in the process of Germany’s economic modernization. It was actively involved in modernizing industrial facilities. Modernization in West Germany took place at a later time and on a larger scale compared with other Western countries, which gave West Germany a better opportunity to introduce advanced technology. Many elements of Erhard’s liberal reform remained on paper. What kind of economic self-regulation in West Germany we can talk about, if the system of ration card remained in effect until March 1, 1950? In the Soviet Union, which had suffered from war at least as much as Germany, food rations were cancelled already in late 1947. Also, the tax system of Erhard’s Germany completely disagreed with the classical liberal approach. Taxes for major corporations reached 90–94%. The government spent revenues for targeted industrial reconstruction.

At the Potsdam conference, a decision was made to eliminate German monopolies to prevent Germany’s re-militarization. The plan was to break up the corporations into smaller companies. For example, Vereinigte Stahlwerke was divided into ten companies; the Krupp concern, into seven companies. Yet artificially divided enterprises soon restored their former organizational unity. Presently, the German economy is dominated by the same firms which dominated it during the Nazi period.

A large package of social obligations that the German government took upon itself also contradicts the liberal orthodoxy. As a typical example of the German social policy, we can mention Lastenausgleichsgesetz, the 1952 Equalization of Burden Law, which was to compensate war losses. By 1981, payouts under this law exceeded 104 billion marks. West Germany’s social policy would be a good example for Russian reformers with respect to the government’s responsibility for people’s wellbeing.

Later, after adjustments made by the Social Democrats, West Germany adopted a motto: “Competition as much as possible, planning as much as necessary.”

The German government adopted the concept of “global regulation,” which was based on Keynesian ideas. “Social symmetry” was de-

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28 A.I. Patrushev, Germaniya v XX veke (Moscow, 2004), 332.
clared the goal of economic development. A “concerted action” by the government, unions, and businessmen produced agreements on salary levels. The government provided significant subsidies for metallurgy, construction, and electrical engineering.

Indicative planning is as important in the economic policy of Germany today as it is in France. There are two kinds of government plans: anti-cyclic and structural. The former are short-term and depend on the cycles of growth and downturns. Whenever a downturn is expected, the government turns on the mechanism of additional investment in industry infrastructure and subsidizes industrial companies. On the other hand, when economic growth starts, financial support is reduced. Structural planning pursues long-term goals. Its goal is stimulate those industries which seem promising for the German macro-economy. At the same time, the government subsidizes a number of less profitable yet socially significant industries and infrastructures.

Presently, Germany’s public sector accounts for about 20% of Lands’ capital stock. In some industries, state-run companies have a major share: in power generation, 95%; in iron ore extraction, 80%; in coal extraction, 75%; in aluminum extraction, 50%; and in car manufacturing, 40%. Also, the German public sector plays a dominant role in the credit system. As in the US and UK, government regulation is mostly through the budget, not through the public property. Currently, about 40% of Germany’s gross national product goes through the budget.29

Japan

Post-war economic liberalization in Japan, like in Germany, was mostly fictitious. The primary goal was to convince the Western world that it was being implemented. The 1945 law on elimination of zaibatsu (which were based on the clan principle of Japanese monopolies) was enforced along the same lines as the breaking-up of German corporations.

Once the United States got involved in the Korean War and somewhat turned its attention away from Japan, zaibatsu restored their organizational structures. Only leading holdings (mochikabu gaisha) were eliminated during the anti-monopoly reorganization. Yet the spe-

cial structure of zaibatsu was not taken into account. Each of them included a leading bank, which managed companies. After the pseudoliberal reorganization, all the Big Four zaibatsu: Mitsui, Mitsubishi, Sumitomo, and Yasuda (later renamed Fuji) retained their positions.

Spontaneous market self-regulation typical of orthodox liberalism has never developed in the Japanese economy. Initially, economic development was based on a system of corporate regulation. Government control gradually regained its significance. (Its role increased significantly after the mandate of occupational authorities expired.)

Already in 1947–1949, an agrarian reform clearly demonstrated the Japanese government’s intention to intervene in the national economy. The essence of the reform was a compulsory, compensated requisition of landowners’ property. If a landowner lived in a village, he could retain no more than three hectares; otherwise, his entire estate was seized. In the situation of permanent inflation, compensations amounted only to 5–7% of the real market price. Then the government leased requisitioned lands to farmers with delayed payments spread over 24 years. Obviously, such a practice is a glaring contradiction to liberal ideas.

Presently, the public sector in Japan accounts for more than a third of production facilities. Twenty percent of gross domestic product is produced under government orders. Almost a third of GDP is produced through the budget. Economic regulation is mostly indirect, in keeping with the Keynesian strategy. “Contemporary economists consider Japan as a country with the strong economic policy implemented without the government’s direct involvement in economic activities.”

Fiscal and credit mechanisms, tariff-based regulation of foreign trade, and regulated supervision over natural monopolies are the main administrative methods.

The planning system in Japan is not purely the government’s responsibility. Representatives of financial groups and corporations take part in designing economic development plans along with government officials. The dominating point of view is that “making plans for the economy should be the responsibility of those who actually run the economy.” From the side of the government, this function is assigned to a special government agency, the Department of Economic Planning. It designs plans both on the national level and for individual industries.

30 Mirovaya ekonomika, Ed.: A.S. Bulatov (Moscow, 2005), 498.
The goal of general national plans is to ensure a certain level of economic growth. This implies determining the amount of investment each industry should receive from corporations. Plans for individual industries are to eliminate defects of the national economy, remove disparities, help those companies which by definition cannot do without certain help. General national plans are implemented mostly through private investment, whereas industry-specific plans rely on investment by the government.

For today’s generation of Russian statesmen, the very thought of planning brings to memory the scare of Gosplan. The system of indicative plans is practically unknown in Russia, whereas it may be helpful to learn from the example of a number of developed countries, which successfully combine planning principles with market economy.

Thus, spontaneous and sporadic self-regulation cannot be found in any of the world’s developed countries which are usually regarded as liberal. In any of these countries, government regulation plays an important role.

The path of total non-intervention chosen by Russian liberal reformers contradicts the economic policies of those countries which they seem to have chosen as examples to be followed.

5.5. The modern tendency to increase the role of the government

The neoliberal position is that a modern government should more and more refrain from regulating economic processes. But this concept can be easily proved wrong by considering statistics for budget spending. If the government is to stay away from the economy, its spending should naturally reduce. Yet the opposite is true. Year by year, government spending increases. Not one of the countries we have statistics for has ever had an extended period of decrease in spending. To illustrate this trend, we will use the most developed, economically and technologically, countries, which are traditionally regarded as liberal democracies


In those countries which have reached the post-industrial phase of development, the role of the government only increased, because administrative problems it has to tackle have become more complex. Figure 5.1 demonstrates that developed Western countries are now world leaders in large-scale government intervention in economy. The government’s involvement in the life of Western social systems, judging by its share in GDP, more than doubled over the last third of the 20th century. The economic breakthrough some countries of Southeast Asia have experienced of late also shows correlation with the increasing role of the government in them. On the whole, increasing government intervention in national economies may be described as a trend of the world’s development today.33

Table 5.2

<table>
<thead>
<tr>
<th>Total government spending in some economically developed countries (in billions of national currency)</th>
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<tr>
<td><strong>Country</strong></td>
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<td>United Kingdom</td>
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<td>Germany</td>
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<tr>
<td>Italy</td>
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<tr>
<td>France</td>
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<td>United States</td>
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<tr>
<td>Canada</td>
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<tr>
<td>Japan (trillion)</td>
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Russia is the only country moving in the opposite direction, notwithstanding the above-mentioned tendency in the world. The syndrome of unreasonable non-intervention has not been overcome to this day. While industrial output grows, the share of the public sector continues to shrink34 (Fig. 5.2).

33 Otchot o mirovom razvitii. 1997. Gosudarstvo v menyayushchemsya mire (Moscow, 1997), 26; V.V. Perskaya, Globalizatsiya i gosudarstvo (Moscow, 2005), 114.
34 Promyshlennost Rossii. 2005: Statistichesky sbornik (Moscow, 2006), 42.
Fig. 5.1. Central governments’ spending (percent of GDP) according to the World Bank

Fig. 5.2. Types of property in Russia’s industrial production
The level of government withdrawal from the economy is even more striking in the most profitable sector of the Russian economy, the fuel industry. The share of the state in its output is minute\textsuperscript{35} (Fig. 5.3).

![Fig. 5.3. Types of property in Russia’s fuel industry](image)

Thus, comparative analysis of various countries’ history shows that the notion of government non-intervention in economy in successful Western countries is but an ideological myth. The model of pure capitalism as described by Adam Smith is a metaphysical phenomenon which has not been confirmed by practice in any of national economies. Nowhere in the world is it implemented without the government playing a key administrative role, which has a definite tendency to increase. It is wrong to refer to successful countries’ experience to justify a rash withdrawal of the government from the Russian economy.

\textsuperscript{35} Ibid.
Chapter Six
Stimulated economic development

Neoliberals interpret the crisis and the following collapse of the USSR as a proof of the utopian nature of the very idea to organize economy based on the principles of government administration. According to adherents of the conservative, statist approach, disintegration processes, on the contrary, were triggered by weakening the reins of state control. Indeed, in the late socialism period, the Soviet system was becoming more and more stagnant. Yet, the slowdown should not be exaggerated. It took place simultaneously with a drop in GDP among developed countries. In this respect, the American economic model was no better than the Soviet one (Fig. 6.1).\(^1\)

Transition to the post-industrial phase of development meant a more sophisticated system of administrative mechanisms, not abolishing administration at all. Instead of directive drives, invisible strings now play the role of administrative levers. The main idea of this transformation was to switch from directing to stimulating. This task was much more difficult to perform than the traditional administrative mode. It was no longer sufficient to present the will of the government in the form of decrees and orders; a situation where an economic man would be prompted to take the desired action had to be created. Economic agents were stimulated, no longer forced. From the forefront, the government moved behind the scenes, at the same time expanding the scope of its functions.

This is the strategic transformation of the system for managing economic development which was carried out in the West towards the end of the second millennium. As is known, Russia took a completely different route: not only did it fail to build an administrative model appropriate for a post-industrial society; it destroyed the system which was typical of industrialism. Since Western countries have accumulated much experience in organizing stimulated economic development, it will be helpful to analyze existing mechanisms for its institutional implementation.

6.1. Stimulating development as a method of government management of economy

The system of national economies of modern Western countries is very far from both direct dirigisme and self-regulation. Mechanisms of government administration are incorporated in market economy structures. Memories of the directive socialist model may create an illusion that the government’s administrative functions are minimized in Western countries. In reality, though, the seeming absence of control is due to significant increase in the quality of administration in the post-industrial world. The highest manifestation of administrative art is not to force a man to take steps in a certain directions; it is to create conditions which will cause the man to think such steps are desirable and to consider the decision to take them as his own. The West has switched from direct administration to stimulating.

Now incentives, not directives, are the main administrative tool. The concept of the “invisible hand,” which Adam Smith used with re-
gard to self-regulated market, may now be applied to modern Western nations.\textsuperscript{2}

The theory of government administration of economy divides administrative methods into three main categories of regulative influence: administrative, direct, and indirect\textsuperscript{3} (Table 6.1).\textsuperscript{4} The concept of “stimulated development” is associated with the second and third categories of regulation. The difference between the two is that the former implies strictly targeted regulation whereas the latter is more indirect. Direct regulation is normally used when market instruments are not sufficient to solve the problems the economy is facing. Indirect methods normally use market mechanisms themselves as a foundation.\textsuperscript{5}

\begin{table}[h]
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\begin{tabular}{|l|l|l|}
\hline
\textbf{Category of regulation methods} & \textbf{Group of methods} & \textbf{Method} \\
\hline
Administrative methods & Legal regulation & Laws and other legal regulations \\
 & Standards and licensing & Environmental standards \\
 & & Type of activity licensing \\
 & & Export licensing \\
 & Anti-monopoly regulations & Monopoly markets supervision \\
 & & Maintaining unlimited competition in industries other than natural monopolies \\
 & State property management & Managing state enterprises \\
 & & Production of socially significant goods and services \\
\hline
\end{tabular}
\caption{Government regulation methods in market economy}
\end{table}

\textsuperscript{2} Postindustrialny mir i Rossiya (Moscow, 2001).
\textsuperscript{3} F. Shamkhalov, Osnovy teorii gosudarstvennogo upravleniya (Moscow, 2003).
\textsuperscript{5} S.A. Khavina, “Osnovniye tendentsii razvitiya gosudarstvennogo regulirovaniya ekonomiki za rubezhom i v Rossi,” Gosudarstvennye regulirovaniye ekonomiki: Mirovoi opyt i reforma v Rossi (Teoriya i praktika) (Moscow, 1996).
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<tr>
<th>Category of regulation methods</th>
<th>Group of methods</th>
<th>Method</th>
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<tbody>
<tr>
<td>Direct economic regulation</td>
<td>Targeted non-repayable financial support for certain social groups</td>
<td>Benefits</td>
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<td>Subsidies from various funds</td>
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<td>One-time pay-outs</td>
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<td>Targeted non-repayable financial support for enterprises</td>
<td>Lax credit</td>
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<td>Subsidies</td>
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<td>Tax benefits (e.g., for investors)</td>
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<td>Targeted non-repayable financial support for industries</td>
<td>Social sphere industries</td>
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<td>National industries</td>
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<td>Tax benefits for industries</td>
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<td>Targeted non-repayable financial support for territories</td>
<td>Subventions</td>
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<td>Indirect regulation methods</td>
<td>Fiscal regulation</td>
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<td>Government orders</td>
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<td>Defining and changing the tax structure</td>
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<td>Changing tax rates</td>
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<td>Changing taxation forms</td>
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<tr>
<td></td>
<td></td>
<td>The system of differentiating benefits and discounts</td>
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<tr>
<td></td>
<td></td>
<td>Delays for tax payments</td>
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<tr>
<td></td>
<td></td>
<td>The procedure for remitting tax debts</td>
</tr>
<tr>
<td></td>
<td></td>
<td>The procedure for the case-by-case approach to taxation</td>
</tr>
<tr>
<td></td>
<td>Financial regulation</td>
<td>Changing the interest rate</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Changing reserve requirements</td>
</tr>
<tr>
<td></td>
<td>Foreign trade regulations</td>
<td>Exchange rate regulation</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Customs regulation (quotas, tariffs)</td>
</tr>
</tbody>
</table>

In the USSR history, the Kosygin reforms may be considered as a missed opportunity to switch to the stimulated development system. The absence of material incentives for labor was one of the main objects of criticism in the socialist economy. The Kosygin reforms in
the late 1960s afforded a real opportunity for the USSR to switch to the stimulated economic development model. The chairman of the Council of Ministers believed it was possible to enhance the system of governance by introducing self-financing. On Oct. 4, 1965, the Central Committee of the Communist Party and the Council of Ministers adopted a decree on “enhancing the system of planning and promotion of economic incentives for industrial production.” This decree is generally regarded as the starting point of the reforms. It clearly said that the socialist economy is based on “a combination of centralized administration and economic independence and initiative of individual enterprises.” Market incentives were not regarded as the opposite of planned economy; on the contrary, they were viewed as one of its fundamental elements.

Stimulated development, Kosygin believed, may be planned. Nothing of that kind existed in the world at the time. The Yugoslavian experience, where socialist planning was reduced mainly to forecasting and became a formal appendix of market competition, was critically analyzed. In Kosygin’s model, government planning and investment from the Union budget retained the role of the main economic regulators.

The program for expanding enterprises’ operational independence included such elements as using part of the income to reward workers, enhancing social and cultural conditions, developing infrastructure, purchasing modern equipment, setting production goals (according to the government-approved plan), independently interacting with consumers and suppliers of intermediate goods, and independently determining the enterprise’s organizational structure and staff. It was planned that enterprises would start spending more of their money on new equipment: 4 billion rubles instead of 720 million rubles in 1964. Financial interactions with the government were to be limited to making payments for funds, which were usually at 6%. A special, rent form of payment was developed for those enterprises which could get income regardless of their efforts due to their favorable position.

At first, in 1966, the reform was tested at 43 leading factories. A mass transition to stimulated model of administration took place in 1967, and by the end of the five-year period, 90% of enterprises worked according to new administrative format. This result clearly demonstrated that the Kosygin model of economic administration was more
efficient. During the eighth five-year period, income of industrial enterprises increased by 2.5 times (Fig. 6.2). The average annual increase was 20%, whereas during the previous ten years it was only 10%. Interestingly, it was in 1967, when new administrative mechanisms were widely implemented, that industrial output grew particularly fast. The statistic difference with the previous year was due to the stimulating factors.  

![Fig. 6.2. Industrial output growth during the eighth five-year period (percent of the previous year, 1965 = 100%)](image)

As is known, Kosygin’s project of switching the Soviet economy to stimulated development was terminated even before the eighth five-year period was over because of the political situation (primarily, the Prague Spring). Yet the very fact that such a project was developed by top Soviet leaders indicates that the problem of modernizing economic administration to develop stimulating mechanisms became urgent back in the mid–1960s. Aleksei Kosygin was now allowed to complete his reform, and now we know that this delayed the necessary transformation for 40 years.  

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6 Narodnoye khozyaistvo SSSR v 1970 godu (Moscow, 1971), 132.  
7 R.A. Belousov, Ekonomicheskaya istoriya Rossii: XX vek (Moscow, 2006), 34–55.
6.2. Tax and credit stimulation

Tax policy was one of the earliest mechanisms used to stimulate economic development. Elements of this approach may be found even in the Russian Empire, with its widespread practice of indirect taxation. In the classical political economy, a tax was nothing else than a system of collecting part of an economic agent’s income. Adam Smith’s canons of taxation included the principles of proportionality, certainty, convenience, and cheapness. Keynesianism presented theoretic explanation of using taxes as a stimulating regulator. Progressive taxation, John Keynes pointed out, collects excess savings and transforms them into investment. He described taxes as flexibility mechanisms built into the economic system. Taxation cannot be used for stimulation purposes directly. Tax benefits create economic zones and niches, which yield more profit than other similar areas.

As is known, Keynesianism traditionally recommends regulating interest rates as an instrument of state economic policy. To stimulate growth of gross economic indicators, the government should pursue the policy of decreasing the rates, John Keynes believed. This is what Western Europe does now by minimizing the interest rate. In Russia, everything is vice versa. The interest rate in the Russian Federation is higher than in any EU country, except Hungary (Fig. 6.3). If we compare statistics for various countries, we will see that this indicator shows amazing correlation with economic development. Russia’s interest rate is higher than in the EU yet lower than in other CIS countries (Fig. 6.4). Interest rates of rapidly developing economies in the Asia-Pacific region are relatively low, at least when compared with the Russian Federation (Fig. 6.5). On the other hand, in Brazil, which over the last few years has been in a state of permanent crisis, the interest rate is 4.8 times higher than in Russia.

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<table>
<thead>
<tr>
<th>Country</th>
<th>Interest Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ireland</td>
<td>2.57</td>
</tr>
<tr>
<td>Netherlands</td>
<td>2.75</td>
</tr>
<tr>
<td>Sweden</td>
<td>4.00</td>
</tr>
<tr>
<td>Spain</td>
<td>4.31</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>4.40</td>
</tr>
<tr>
<td>Finland</td>
<td>4.82</td>
</tr>
<tr>
<td>Italy</td>
<td>5.03</td>
</tr>
<tr>
<td>Portugal</td>
<td>5.19</td>
</tr>
<tr>
<td>Luxembourg</td>
<td>5.27</td>
</tr>
<tr>
<td>Austria</td>
<td>5.64</td>
</tr>
<tr>
<td>Estonia</td>
<td>5.66</td>
</tr>
<tr>
<td>Lithuania</td>
<td>5.74</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>6.03</td>
</tr>
<tr>
<td>Malta</td>
<td>6.04</td>
</tr>
<tr>
<td>France</td>
<td>6.60</td>
</tr>
<tr>
<td>Belgium</td>
<td>6.70</td>
</tr>
<tr>
<td>Greece</td>
<td>6.79</td>
</tr>
<tr>
<td>Denmark</td>
<td>7.10</td>
</tr>
<tr>
<td>Latvia</td>
<td>7.45</td>
</tr>
<tr>
<td>Poland</td>
<td>7.56</td>
</tr>
<tr>
<td>Cyprus</td>
<td>7.66</td>
</tr>
<tr>
<td>Slovenia</td>
<td>8.65</td>
</tr>
<tr>
<td>Slovakia</td>
<td>9.07</td>
</tr>
<tr>
<td>Germany</td>
<td>9.70</td>
</tr>
<tr>
<td>Russia</td>
<td>11.40</td>
</tr>
<tr>
<td>Hungary</td>
<td>12.82</td>
</tr>
</tbody>
</table>

Fig. 6.3. Interest rates in EU countries and Russia
Given such credit situation, businessmen naturally prefer to deal with foreign banks and, by investing their money there, they support another country’s economy. Within Europe, the criterion of the interest rate clearly divides traditional capitalist economies from transition...
economies. The lowest interest rate is in Ireland, which has long had the highest growth ratio in the EU. Since the mid-1990s, the interest rate in Irish banks has dropped by 2.6 times, which shows correlation with the simultaneous increase of the annual GDP indicators.\(^\text{13}\)

### 6.3. Government regulation and stimulation on the labor market, in the energy sector, and in innovations

The trend of increasing demographic burden, which is due to the tendency of the population becoming older, is one of the things that threaten the prospects of long-term stable development of the EU economy. The increasing share of pensioners in society objectively reflects the increasing labor burden, which economically active age groups have to bear. At present, every fifth European is more than 60 years old. In Germany, this age group constitutes 24% of the population; in Italy, 25%. Today’s Russia, which has declared the demographic policy one of its national priorities, is definitely not the first country which uses material mechanisms for stimulating the birth rate.

The package of administrative measures designed in EU countries to stimulate reproduction includes a wider range of methods to affect the demographic situation than in Russia: maternity allowances, family allowances, lower income taxes for parents, maternity leaves with up to 90% of the wages retained, including the maternity leave in the working record, subsidies and targeted lax credit for families, etc. It is noteworthy that, in addition to national governments, supranational structures of the European Union are quite active in pursuing this policy.\(^\text{14}\)

At the same time, the methods EU countries use to solve the problem of the increasing demographic burden are not limited to stimulating the birth rate. They emphasize using economic incentives for the rational use of labor resources. The key concept for decreasing the demographic burden is to increase economic employment. Europe has made a strategic transition from stimulating demand on the labor

\(^{13}\) Rossiya i strany mira. 2006: Statistichesky sbornik (Moscow, 2006), 296–297.

\(^{14}\) V.P. Klavdiyenko, Ekonomicheskoie stimulirovaniye ustoichivogo razvitiya v YeS (Natsionalny i nadnatsionalny uroveni). Avtoref. diss. ... d-ra ekon. nauk, (Moscow, 2007), 23–25; Gosudarstvennaya politika vyvoda Rossii iz demograficheskogo krizisa (Moscow, 2007), 395–488.
The new criterion for measuring governance effectiveness is the number of created jobs.

The EU policy for stimulating people’s economic activity includes the following administrative elements: enhanced job placement system, economic sanctions against those “unemployed on a principle,” proactive job placement for women through flexible arrangements like working at home, engaging pensioner who are still physically able to work, and dynamic work schedule. These measures were taken within the framework of national employment programs implemented by a number of European countries. The Stable Development Strategy, adopted by the EU integrated leadership in Lisbon in 2000, set the goal of reaching the 75% level of employment for economically active age groups by 2010. Already by 2005, some European countries had successfully reached this objective, which indicates how effective the measures they took were. As for Russia, since the mid–1990s employment remains at the same, albeit relatively high, level and has even dropped for the age group of 15–24 years (Fig. 6.6).

![Fig. 6.6. Employment for ages 15–64 in some EU countries and Russia for 1995–2003 (1995 = 100%)](image)

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16 V.P. Klavdiyenko, op. cit., 25–27.
17 *Rossiya i strany-chleny Yevropeiskogo soyuza. 2005: Statistichesky sbornik* (Moscow, 2005), 47.
Another serious challenge for the EU economy is its increasing dependence on imported energy resources. A surge in energy prices may cause a crisis in the economies of some leading European countries. Thus, from the viewpoint of global strategy it is clear why EU countries have started stimulating technologies which involve new energy sources. The system of administrative incentives for promoting a transition to new energy sources includes the following elements: substantial reduction of subsidies for technologies based on using organic energy resources, higher tax rates for industries and sectors which use traditional energy sources, environmental taxes, a special energy tax for energy-consuming companies, different tax rates according to the type of energy sources used, focused subsidies, price and tax benefits for using renewable energy sources, support for scientific research designing technology for non-traditional energy resources and energy-saving systems, and information services and advertisement promoting a transition to new energy resources.\(^{18}\)

Different countries use different methods for stimulating the development of renewable energy sources. This means it is quite possible to adapt administrative mechanisms to the national context (Table 6.2).\(^{19}\)

### Table 6.2

**Main economic incentives for developing non-traditional energy in EU countries**

<table>
<thead>
<tr>
<th>Forms of economic stimulation</th>
<th>Countries</th>
</tr>
</thead>
<tbody>
<tr>
<td>Compensations for tariffs</td>
<td>Austria, Belgium, Denmark, Finland, France, Germany, Greece, Hungary, Luxembourg, Portugal, Spain, Sweden</td>
</tr>
<tr>
<td>Tenders and “green certificates”</td>
<td>Austria, Belgium, Denmark, France, Ireland, Italy, Sweden, United Kingdom</td>
</tr>
<tr>
<td>Exemption from environmental taxes</td>
<td>Austria, Czech Republic, Estonia, Germany, Lithuania, Netherlands, Slovakia, United Kingdom</td>
</tr>
<tr>
<td>Exemption from environmental taxes invested in non-traditional energy sources</td>
<td>France, Hungary, Netherlands, Sweden</td>
</tr>
<tr>
<td>Compensations for tariffs from a special fund, which gets money by selling emission quotas</td>
<td>Austria, Belgium, Italy, Sweden, United Kingdom</td>
</tr>
</tbody>
</table>

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\(^{19}\) V.P. Klavdiyenko, op. cit., 30.
The effectiveness of the administrative policy for switching to new energy sources is confirmed, for example, by energy contracts at fixed prices for 20-year periods guaranteed in Germany for investors. As a result, Germany has the most powerful wind farms in the EU. In 2003, they produced about 12,000 MW, which is 15 times more than similar farms in Ireland, United Kingdom, Estonia, and France, where climate is more favorable. At present, Germany’s share in the world energy production by wind farms constitutes 36%.

Over the last 25 years, the policy of stimulating energy saving reduced average industrial energy consumption in Europe by almost 50%. There is a tendency to switch from oil to more environment-friendly gas. The EU occupies the first place in the world in energy production from renewable clean sources.

If we compare statistics on the share of non-traditional energy sources in general energy production, we will see that Russia lags far behind all European countries (Fig. 6.7). In Denmark, practically 20% of consumed energy comes from non-traditional sources. At this pace, it is quite probable that soon Europe will no longer depend on Russian oil and gas to such an extent.

It is well-known that economic progress has always been based on innovations. Presently, in all countries that view themselves as developed, there is a trend for the share of innovations in GDP growth to increase (Fig. 6.8). By the beginning of a new millennium, the factor of innovations accounted on the average for half of the GDP increase. In Germany and Austria, it has recently reached 67%, which is two times more than in the United States, which is regarded as a leading country in innovations. Thus, it was not the market, which is equally operative in both US and EU economies, but rather efficient administrative measures that produced the innovative effect in Western Europe (and especially in Germany).

It is noteworthy that in Europe the public sector offers a smaller percentage of financing for scientific research than in Russia, which makes relevant the use of stimulating, not directive, mechanisms for

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20 Rossiya i strany-chleny Yevropeiskogo soyuza. 2005: Statistichesky sbornik (Moscow, 2005), 113.
managing innovations. However, this should not be interpreted as a recommendation to move scientific orders from state-run institutions to private companies. For example, in New Zealand the share of the public sector in internal spending on scientific research is higher than in Russia. Yet New Zealand designs and implements more innovative technologies. In China, the public sector consumes the same share of research spending as in Russia, yet Chinese scientists manage to solve most challenging scientific problems.\textsuperscript{22}

Fig. 6.7. The share of non-traditional energy sources in energy production in EU countries and Russia (geothermal and solar energy, wind power, tidal energy, renewable fuels and waste treatment)

Back in the 1960s, science in the West was practically independent from economy. It did not work on the problems of developing economic sectors, except for the defense industry. In those years the gov-

\textsuperscript{22} Rossiya i strany mira. 2006: Statistichesky sbornik (Moscow, 2006), 309.
ernment policy treated science much like culture. Since the late 1960s, scientific research in Western countries began to emphasize practical demands and challenges of economy. Now science became a factor of economic growth. In keeping with this approach, research that helps increase output and enhance competitiveness of manufactured goods is stimulated the most. Since the mid–1970s, the concept of government policy with respect to science changed again. Now it was viewed not only as a factor of GDP growth; it was considered as a foundation of the economy in general. Initially, integration was taking place around environment-related problems, but since the late 1980s the concept of stable development became its core. Finally, by the late 1990s, science policy in the West was completely transformed into innovative policy.

Fig. 6.8. Innovations’ contribution to GDP growth

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24 *Ekonomika SSHA*, Ed.: V.B. Supyan (St. Petersburg, 2003), 233–251.
Unlike business, the government supports R & D with a view to a long-term economic effect. As an example, we may refer to the above-mentioned program to support research in non-traditional energy sources. The German 100,000 Solar Roofs program includes 0.51 billion euros of government subsidies for research in solar energy. Special attention is given to financing early, “sowing” phases of developing and implementing innovations, which usually account for up to 30% of the total project cost. The Western system of stimulating innovations includes a range of traditional elements, such as targeted subsidies, grants, mortgage, etc. The practice of government purchases of innovative products creates an atmosphere of certainty that the product will be sold and helps to speed up its implementation. Such purchases account for 16% of gross domestic product in EU countries.\(^{25}\)

### 6.4. Environment protection as a factor of development

Western countries are presently using a new approach in their economic policies, which is to stimulate innovations indirectly by introducing environmental restrictions. Environment protection, which once was a hindrance, according to the Club of Rome, has now become a stimulating factor of development. Companies which face environmental restrictions are stimulated to implement “green” technologies, zero-emission equipment, clean energy sources. “You pollute it, you pay for it,” is one of the basic principles of environmental stimulation in the West. Environmental damage is compensated by fines which then are spent of targeted development of environment-friendly technologies. Administrative measures for environmental stimulation include environmental licensing, emission and production standards, compensational fines, payments for using natural resources, taxation of harmful discharges, tax benefits for environment-friendly products, price compensations (e.g., for companies using non-traditional energy sources), etc.\(^{26}\)

The US economy is mostly stimulated by recently adopted bills like the Alternative Motor Fuels Act, the Clean Air Act, the Energy Policy Act, etc.\(^{27}\) American laws set the minimal numbers of environ-

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\(^{25}\) V.P. Klavdiyenko, op. cit., 33–38.

\(^{26}\) Ibid., 39–43.

\(^{27}\) Ekonomika SShA, Ed.: V.B. Supyan (St. Petersburg, 2003), 252–265.

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ment-friendly cars to be purchased annually. In 1993, the United States banned production of engines working on leaded gasoline, and three years later banned this type of fuel itself. Simultaneously, it banned diesel fuel with sulfur levels over 0.05%. Fines for “dirty” automobiles were introduced.

At the same time, various financial benefits (subsidies, lax credit, delayed payments, tax benefits, etc.) for using cars with less harmful fuels: natural gas, methanol, ethanol, etc. It is enough to consider the names of some US federal programs, like *Natural Gas Vehicles: National Security Prospects, Clean City Cars, Less Polluting Fuel*, etc.\(^\text{28}\)

Japanese environmental laws have two types of standards: some are absolute, directive decrees, while others are stimulating development. The latter usually cause significant one-time spending by companies to install pollution control equipment. Essentially, the government motivated the private sector to invest money in appropriate industries. Thus, when Japan introduced new standards for air quality in the mid–1970s, air purifying equipment accounted for up to 30% of all production costs in thermal power generation.\(^\text{29}\)

### 6.5. A “subsidiary” sector: stimulated development of agriculture

Since the start of the industrialization era, the agrarian sector has always been viewed as traditionally unprofitable in Western countries. In many of them, agriculture is a mostly subsidiary sector of the economy. In the situation of a self-regulated market, the agrarian sectors of the US and some other countries would probably perish. Because it is necessary for supplying the country with food, such a scenario would pose an immediate threat to national security and could not be allowed by the government.

The 1933 law on farm loans was one of the basic elements of Franklin Roosevelt’s New Deal. Market economy and civil liberties make it impossible to force people to work in agriculture by directive methods. The only method available to the government is stimulating labor in agriculture by creating favorable conditions in the sector. Government

\(^{28}\) V.V. Glukhov and T.P. Nekrasova, *Ekonomicheskiye osnovy ekologii* (St. Petersburg, 2003), 298–301.

\(^{29}\) Ibid., 301.
policy of subsidizing agriculture in the West includes subsidies for young farmers, environment-friendly companies, companies working in areas with unfavorable climatic conditions, etc.

Promoting modernization and diversification in agriculture is another aspect of subsidizing in EU countries. At present, most of government subsidies promote biotechnology. Emphatic support of biotechnology produced the phenomenon of the “biotechnology revolution.” Perhaps, Russian neoliberals will be surprised when they learn that the government regulates prices on the agricultural market of Western Europe. Almost 70% of agricultural products are purchased at fixed prices. Also, there are special compensations for exporters of agricultural products.

American farmers receive loans from the government based on their harvest estimate. In case the real market price is higher than the fixed price, farmers may get their produce back. If prices drop, a farmer may refuse to repay the loan without incurring any fines.

Compensations are used in the US to remove a part of land from actual agricultural use. This mechanism prevents the market from being flooded with agricultural products and thus prevents prices from dropping. Historically, it goes back to the Great Depression era, when prices for agrarian products collapsed. Compensations for farmers are limited to $50,000 per year. Also, prices are maintained through the mechanism of market quotas. For instance, there are direct restrictions on selling citrus fruits on American markets. The American system of farm loans has no equal in the world. It is structured around three groups of federal banks, which provide loans for purchasing property, for purchasing agricultural equipment and seeds, and for cooperative marketing, respectively. Such a bank triad is present in all 12 of American economic zones.30

The fact that a sector is subsidized does not mean that it is unprofitable for the national economy in general. Today, the US produced 50% of all soybeans and corn and 10–25% of cotton, wheat, molasses, and vegetable oils. “One farmer feeds 75 people,” says a popular slogan of American agricultural advertisement. In today’s Russia, one agricultural worker can feed only 18 people employed in other economic sec-

Russian agricultural subsidies absolutely cannot compare with those in the US. Why does not the neoliberal Russian doctrine follow the example of the leader of market economies in this case?

6.6. Modernizing the remuneration system

Stimulated economic development requires a response to incentives at the basic level. In this matter, corporate management works towards the same goals as the government. What they have in common is the policy of stimulating individual results.

Quite recently, not only the Soviet Union but even the West faced an acute problem of leveled remuneration. Not only the socialist economy was accused of wage-leveling. The critics’ main objection was that people are paid not according to their work but according to their past achievements and work record. In this system, incentives affect remote career prospects and are relatively ineffective.

Currently, the United States and other Western countries are reforming their systems of wages and bonuses. The keynote of this reform is to offer material incentives which can motivate the worker to produce better results. Such incentives as free meals, covering transport expenses, medical treatment, educational and advanced training courses, special insurance plans, corporate pensions and savings, fitness facilities, and R and R events are now widespread.

More and more often, salaries in the US are determined by individual performance. It was first tested in the American military-industrial complex and was initiated by the government. Its main idea is having a pay band. All positions ranked at the same level have the same pay band. Yet people occupying these positions may have different levels of professionalism and diligence. Thus, in the performance-related pay system, there are situations where a worker occupying a less significant position (in traditional understanding) may have a higher salary than a worker in a more significant position. Also, profession coefficients based on the current situation on the labor market are sometimes used to calculate wages. Workers’ bonuses directly depend on the profit a company makes during a certain time interval (the Rucker plan). One of the most widespread forms of collective stimulation is the use of various ways of “profit sharing.” The government supports this mechanism by making it tax exempt. “Profit sharing” often involves transferring company shares to employees.

The structure of employee income in post-industrial countries is fundamentally different from that in Russia: in those nations which have switched to the stimulated model of administration, various bonuses traditionally pay a much more important role. For instance, in Japan bonuses are paid at least twice a year based on the company’s performance over six months. On the average, such payments constitute a quarter of the annual income. In major Japanese companies, the system of summer and winter bonuses amount to a third and sometimes even half of the annual income (Fig. 6.9).  

![Fig. 6.9. Growth of summer and winter bonuses in Japanese companies](image)

The Japanese system of “floating salaries” for managers seems very promising for the purposes of stimulating government employees. In Japan, managers’ salaries depend on production costs, output quantities, and other indicators of industry or company development.

Another traditional mechanism for differentiating individual wages is the system of professional evaluation. For example, evaluation boards in the United States annually review salaries of almost 90% of employees.

Stimulating invention and rationalization is one of the priorities of the corporate policy. Suffice it to say that in Germany an inventor is

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awarded a tenth part of the profit his innovation yields; in the US, an eighth part; and in Switzerland, a sixth part.

Industrial giants like General Motors keep looking for optimal ways to stimulate labor. For example, West European branches of the concern no longer use the time-rate system. Managers prefer to pay for the work an employee does, not for the hours he spends at work.

Granted, trade unions offer strong resistance to the stimulating policy of individual remuneration in the West. Yet the professionalizing tendency of the post-industrial economy is stronger.\textsuperscript{33}

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Based on Western countries’ experience, we can draw a number of strategic conclusions with regard to the Russian economy.

First, it is possible to administrate economic development while remaining in the format of market economy.

Second, it is possible to stimulate economy indirectly both at the micro- and macro-level.

Third, under current conditions, the mechanism of stimulation is more efficient in prompting development than traditional administrative methods.

Finally, the government has perhaps the widest range of possibilities and methods to stimulate economic success in growth and development.

Russia, obviously, is not the only country with a transition economy. There is a whole group of countries which formerly belonged to the world socialist system and which are now working on a similar strategic goal of reforming their economies. If we consider the results they achieved, we will see if the economic development strategy Russia has chosen is a correct, winning one.

Since different countries have used different approaches to economic reforms, we can consider possible alternatives for the Russian reforms. Primarily, we need to evaluate two models of systemic transition, the East European one and the Chinese one. The first model, implemented according to IMF formulas by “shock therapy” methods, meant a drastic and instant transition to market economy. The economic policy in post-Soviet Russia was based on the same strategic paradigm. The second model, the Chinese one, was implemented through gradual transformations and involved continuity with respect to the pre-reform system. The principle was not to raze everything to the ground before building something new; rather, it was to transform the existing mechanism.

The goal of this study is to compare the results different transition models achieved and thereby to establish whether the vector of transformations in Russia was chosen correctly.

7.1. The phenomenon of a transition economy

In a broad sense, the term “transition economy” may be applied to a wide range of countries in the process of switching from one economic system to another one. Moreover, transitivity is an immanent attribute of a phased economic process. For example, the Soviet political economy considered any economy in the process of developing from capitalism to communism as a transitional one.
Any change may be considered as a transition. In scientific usage, the term “transition economy” implies a certain pace and a qualitative change. A transition economy should not only have a certain level of change (more than it does during regular evolutionary development); there should be changes in its mechanisms, links, core structures, and functions.

The theory of modernization is a methodological foundation for understanding the objective nature of transitions periods. The modernization process in its first historical phase involved a transition from a traditional-society economy (sometimes identified with feudalism) to the stage of industrial development. Presently, researchers distinguish two models of modernization: a liberal one and a conservative one. The distinct attribute of the latter one, economically, was the special role played by the government, social paternalism, ideocratic stimulation of labor. What was implemented in the USSR and other countries traditionally viewed as the socialist bloc was the conservative model of modernization. In the situation where these countries’ starting positions put them behind industrially developed Western countries, this choice enabled them to accumulate resources and accelerate their development. Economic indicators of socialist countries show that the conservative model of modernization does have some competitive potential, to say the least. Yet these countries could not maintain their efforts to achieve accelerated growth for too long. Once the objectives of modernization were achieved, administrative regulation ought have been modified. A transition from the accelerated mobilization system to a system of stable development was the main goal of the expected reforms.

In the meantime, the West has entered the second phase of modernization back in the 1960s–1970s. Essentially, it progressed from the industrial to post-industrial economic system. Thus, socialist coun-

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2 Daniel Bell, The Coming of Post-industrial Society: A Venture in Social Forecasting (Basic Books, 1973); Novaya postindustrialnaya volna na Zapade: Antologiya (Mos-
tries needed to address modernization issues again. According to GDP levels, they were still abreast with the Western world. But the West began mass implementation of new post-industrial technologies, which produced structural changes in economy, which meant sooner or later socialist countries would start lagging behind. Their leader had to choose a modernization model. It was necessary to build a complex administrative system to organize a post-industrial breakthrough. Leaders of the Communist China started building it back in the late 1970s.³

Reformers in the USSR and East European countries picked a seemingly easier road (a trodden path). They completely ignored the experience of conservative modernization which helped make up the lag in transition to industrial society. The very thought of possibly using elements of this scenario was branded as a “totalitarian” economy. As a basic model for post-industrial modernization, they chose the Western economic system, and not in its modern form at that, but rather its prototype at the initial stage of capitalist development. By now, it has become exceedingly clear that not only did the chosen model fail to help achieve modernization objectives; the structural modifications it initiated went in exactly the opposite direction.

Nobel laureate Joseph Stiglitz pointed out that there were two variants of transformations in countries with transition economies. The main difference between the two approaches, according to him, is the pace at which reforms proceed. It was the “shock therapy” school versus the “gradualist” school. “Shock therapists” enjoyed strong support of the US Treasury and the International Monetary Fund, Stiglitz said, which is why their economic program prevailed in most of the countries. The wisdom the gradualist approach was recognized post factum, after the crises that ensued. In fact, even “gradualists,” although they accurately predicted negative consequences of the “shock therapy” program, underestimated the scope of the coming catastrophe. “The tortoises have overtaken the hares,” Stiglitz concluded.⁴

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³ Ye.F. Avdokushin, Teoreticheskiye osnovy ekonomicheskoi reformy v KNR (Moscow, 1990); O.N. Borokh, Sovremennaya kitayskaya ekonomicheskaya mysl (Moscow, 1988).
⁴ Joseph E. Stiglitz, Globalization and Its Discontents (W.W. Norton, 2003), 139.
7.2. The heritage of the socialist economy: destroy or reform?

If we compare economic statistics for socialist countries with those for capitalist ones, the modern stereotype concerning the socialist system being absolutely ineffective economically will be shaken. The rates of their economic growth were significantly higher than those of Western countries with market economies. Of course, their starting positions were much worse. But the lag was decreasing year by year. Socialist countries had higher growth rates both in the industrial and agrarian sectors (Fig. 7.1–7.2). The West somewhat compensated for it stagnation by dynamically developing its service sector.

![Figure 7.1. Average national income growth per year in 1961–1986 in socialist and capitalist countries](image)

The high GDP growth rate in post-war Japan of the 1960s–1970s is usually called “an economic miracle.” Yet Romania, for example, had much better growth statistics under Nicolae Ceaușescu. Of course, nobody speaks of the Romanian “economic miracle,” as it contradicts neoliberal stereotypes. Incidentally, after neoliberal reforms Romania was unable to regain its level of 1980 until the mid–2000s.

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Fig. 7.2 a. Annual average growth rates of industrial output and labor productivity in 1961-1986 in socialist and capitalist countries
The reasons for discrediting the Soviet, conservative model of modernization were mostly ideological, not economic. The system, no doubt, had to be reorganized; primarily, economic stimulation and private initiative had to be developed.

But was there really the need to undermine the pillar of government contribution to the management of economic development? Again, a question arises: isn’t it possible that the real purpose of the global changes imposed on Russia was not to reform its economy but to weaken the military and socio-economic rival of the West and of its leader, the United States? Is it possible that the purpose was to defeat “the evil empire”?

China refused to listen to advice from the West and chose its own way of gradual transformation. The system was not destroyed; it was preserved and gradually reformed, which ensured progressive development without catastrophic downturns like those that took place in
Eastern Europe. In a sense, Belarus is trying to carry out reforms using the same methods, yet it does not have enough political weight to withstand pressure, which by now is coming from both sides. This forces it to accelerate the transformation process.

7.3. The East European model of transition economy: the monetarist prescription of “shock therapy”

The concept of “shock therapy” was first formulated and applied in Poland. Its main theorist is a well-known adherent of monetarism, Jeffrey Sachs. Later he admitted that in many instances of his reformist activities, monetary recommendations did not work as a universal method.

“Shock therapy,” which was theoretically based on the model of a developed market system, did not take into account the social situation in countries with transition economies. For instance, the income level in East European socialist countries was significantly lower than in Western countries. Yet their consumer baskets were about the same. East Europeans’ diet was even richer in calories than that of people in Western countries. Whereas in the West material wealth was based mostly on people’s personal income, in the socialist countries government subsidies were added to it. For example, in Poland, during the Solidarity campaign against Soviet socialism, consumers paid only 20% of the cost for milk, heating, and other utilities. The rest was covered by the government. Food subsidies in East European countries amounted to 5% of GDP. In the USSR, the figure was even 12%. Naturally, price liberalization caused a sharp drop in the living standard for most people. Paradoxically, the goal of the reform was to reach the same living standard as in the West, but the result was exactly the opposite. Today, the quality of life in Eastern Europe is by many parameters worse than in Western Europe. For example, 80% of Bulgarians lived below the poverty level in 1996 due to the “shock therapy” liberalization.

5 Ya.A. Ioffe, My i planeta: Tsifry i fakty (Moscow, 1988), 84–85.
7 Jeffrey Sachs, Rynochnaya ekonomika v Rossii (Moscow, 1995); “Komu grozit korruptirovannaya Rossiya,” Moskovskiy novosti, 1995, No. 87; Jeffrey Sachs and Felipe Larrañaga, Macroeconomics in the Global Economy (Prentice Hall, 1993).
8 N.V. Korovitsyna, S Rossiyei i bez neyo: Vostochnoyevropeiskii put razvitiya (Moscow, 2003).
The doctrine of privatization at any cost also undermined the foundation of socio-economic stability in East European countries. Prior to the reforms, the share of the public sector in industrial output was between 82% in Poland and 97% in Czechoslovakia. Privatization in industry caused particularly serious problems. People simply did not have enough money to buy shares of industrial giants like factories in Poland’s Nowa Huta and Romania’s Galați. Given the shortage of capital, privatization was carried out mostly through vouchers (bonds or certificates) which entitled their holders to a share in state property. As a result of voucher (i.e., free) privatization, the chief objective of transferring public property into private hands, which was to attract investment in respective economies, was not achieved. There was no investment breakthrough for developing economic sections of the budget. On the contrary, the spending part of the budget was cut and East European economies were underfinanced.

The idea of making all people shareholders, promoted by adherents of market socialism, failed as well. The goal was to overcome antagonism between labor and capital, the classical conflict of Marxist political economy, by distributing vouchers to workers and making them shareholders. In reality, though, workers have never become owners. Privatization funds (essentially, holdings) emerged all over Eastern Europe and started buying up vouchers. They were headed by people who belonged to the Communist Party elite. For example, in the Czech Republic 40% of all privatization certificates ended up concentrated in ten funds, which means they divided among themselves 40% of denationalized economy. Everywhere in Eastern Europe, crime and corruption were a major factor in privatization processes. Based on this, we can say that crime and corruption are universal attributes of forced denationalization (denationalization at any cost).

The governments of East European countries came back to their senses earlier than the government in Russia. For example, Romania and Bulgaria suspended further privatization back in 1995–1996. Interestingly, it was at this point that their GDP dynamics changed from negative to positive.

By the time the reforming process was over, the share of public property in East European economies was significantly higher than in Russia. In Poland, which made more progress than other countries in reforming the socialist system, the private sector constituted 56%
by 1996. In more conservative Romania it was only 35%. One should also take into consideration that the degree of statism in East European countries was lower than in the USSR and that private property, albeit on a limited scale, existed even before the reforms.

 Destruction of the cooperative system had a negative effect on the agrarian sector. Reformers regarded cooperation, a universal way to accumulate resources in the agricultural industry, as one of the defects carried over from socialism. Small private farms created during the reforms were extremely ineffective. Most of them regressed from specialization to a subsistence economy. Thus, instead of making a transition to market economy, the agricultural sector moved in the opposite direction, back to the pre-specialization mode of operation. The agrarian sectors of some East European countries to this day (i.e., for more than 15 years) have retained negative dynamics.\(^9\)

 The beginning of *perestroika* and reforms in Eastern Europe is a clear watershed in its dynamics compared with other countries. Whereas in the mid–1980s East European countries on the average had higher GDP growth rates than those in Western Europe, by the early 1990s the situation changed drastically. Western Europe continued developing the same way as before, while Eastern Europe collapsed (Fig. 7.3).\(^{10}\) Maybe this disruption of economic development for one of the rivals in the global competition of two systems was the true reason for reformist radicalism and for imposing the neoliberal model on East European countries and Russia, even though this system has never existed in such a form in the United States and in Western Europe?

 One would think that post-crisis recovery and growth in the 1990s should have compensated the negative dynamics during the “shock therapy” period.

 Yet this did not happen. Post-crisis GDP growth rates were on the average lower than the ones respective countries had during the last year of socialist economy (Fig. 7.4).\(^{11}\) Some may argue that such a lag is insufficient to make an accurate assessment of the reforms’ effectiveness. But then a compensatory pickup should have taken place later. But even as East European economies entered the second post-reform

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decade, there was no rapid growth. The share of Eastern Europe in the world economy is consistently decreasing. Its geo-economic role is decreasing (Fig. 7.5).\textsuperscript{12} In the list of countries by GDP, all East European countries dropped down by several positions compared to the Soviet period (Fig. 7.6).\textsuperscript{13} Thus, we can say that the liberal reforms failed in all East European countries. Their objectives were not achieved. The trajectory of post-reform development was cardinally different from the forecast.

In the former Soviet republics, neoliberal reforms had even more catastrophic consequences. Most republics, including Russia, still have not recovered GDP levels they reached during the Soviet era. Some of them can only dream of regaining at least their 1980 level (Fig. 7.7).

One may recall that after the Second World War, the Soviet Union returned to its pre-war level in five years. Currently, fifteen years have passed since the start of the neoliberal reforms. Interestingly, those former Soviet republics which managed to exceed their 1990 economic levels include Belarus, Uzbekistan, and Turkmenistan, i.e., those nations which chose a less radical model of integration into the market system. The economic standing of former Soviet republics in the world was much better when they were parts of the Soviet Union than after they became independent. Their shares in GWP and their positions in the list of national economies (Table 7.1) significantly dropped compared to the Soviet era. Turkmenistan (the country which is often criticized for being undemocratic) is the only republic which managed to retain the same position it held before (Fig. 7.8).\textsuperscript{14}

\textsuperscript{12} A.A. Dynkin, ed., \textit{Mirovaya ekonomika: Prognoz do 2020 goda} (Moscow, 2007), 384.
\textsuperscript{13} Ibid., 386–394.
Fig. 7.3. GDP dynamics in socialist and capitalist European countries (percent of the previous year)

Fig. 7.4. GDP dynamics in East European countries (percent of the previous year)
Fig. 7.5. The share of Eastern Europe in GDP
Fig. 7.6. East European countries’ positions in the list of countries by GDP

Table 7.1

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Fig. 7.7. GDP in former Soviet republics (PPP)
Fig. 7.8. The share of former Soviet republics in GDP
7.4. The Chinese model of transition economy: tradition-based modernization

In order to justify the reforms in Russia, the idea of it being impossible to carry out reforms without a temporary downturn is being instilled in society. The scale of this downturn allegedly depends on the degree of deficiency in the system being reformed. Since the USSR objectively made more progress in implementing the communist doctrine than any other country, reformers claimed that its crisis should also be deeper than in East European countries, which preserved elements of capitalism in their economic systems.\(^\text{15}\)

However, the experience of China, where a tradition of statist economy was as strong as in the Soviet Union, indicates that it is quite possible to avoid crises in making a transition from the directive to the market model. The opposite is true: skillfully implemented reforms may be a stimulating factor accelerating economic dynamics. The reforming process in China has been going on for several decades now and has not been completed yet. There was not a single economic downturn during this period. China’s transition to a market economy included five stages (1978–1984, 1984–1992, 1992–1997, 1998–2002, and 2002 to date), each of them having mid-term objectives within the framework of the long-term strategy.\(^\text{16}\) Granted, there were some natural slowdowns in growth rates during the 30-year period, but China did not experience anything similar to the collapse East European economies went through (Fig. 7.9).\(^\text{17}\)

Russia had a real opportunity to choose the Chinese model of reform. As is known, the neoliberal monetarist scheme was picked instead. To answer the question of which of the two alternative models for implementing, it would seem, the same strategy of switching to a


\(^{17}\) A.S. Selishchev and N.A. Selishchev, op. cit., 133, 185–186.
Fig. 7.9. China’s GNP growth during the last third of the 20th century (percent of the previous year)

Fig. 7.10. China’s GDP growth during the 9th and 10th five-year periods (percent of the previous year)
market system was more effective, we can compare the dynamics of China’s and Russia’s economies during the reform period. Prior to the reforms, China was lagging behind Russia by 23%. In less than ten years, by 1997, China’s GDP was 6.5 times greater than that of Russia. The default that took place in Russia after that allowed China to overtake it temporarily even with respect to GDP per capita (Fig. 7.11–7.12).

Unlike Russia, China was not affected by the ripple effect of the East Asian crisis that much. Whereas in 1980 China occupied the 10th position by GDP, by 1990 it was already third; and in 2000, second, overtaking Japan. It is expected that the Chinese economy will overtake the American one as well in the next ten years. In fact, this has already taken place. The service sector accounts for 83% of America’s gross product. The service sector is a sector of nominal production, fictitious capital, and phantom figures. Thus, if we subtract the service sector from both GDPs, China will occupy a higher position in the world economic hierarchy than the United States (Fig. 7.13).

Reducing budget deficit was one of the monetarist objectives during the economic reforms in East European countries. Chinese reformers, fortunately for them, were not bound by monetarist stereotypes. They viewed deficit not only as a normal situation but even as a necessary condition for dynamic economic development. This situation continued in China throughout the reforms, showing a correlation with high economic growth rates. Interestingly, it was after the session of the Central Committee in November 1978, which was the starting point of reforms in China, that spending began to exceed revenues, although until that point the budget had a positive balance. Top government officials in Russia today, who want surplus at any cost, ought to consider the Chinese fiscal policy, as it may cause them to reconsider their position (Fig. 7.14).

“Prudence, gradualness, and persistence” were the main attributes of the Chinese model of reforms. China has declared a combination of planned economy and market as its goal back in the early 1980s. Incidentally, there was a slogan which explained that “planned economy is

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Fig. 7.11. Economic dynamics in Russia and China in 1990—1995
Fig. 7.12. GDP indicators for China and Russia in 1978–1997

Fig. 7.13. GDP by sectors in the US and China
primary, while market economy is secondary.” For each spheres, a certain level of planning was determined: total directive regulation, partial directive regulation, or indicative plans. The private sector, which emerged during the reforms, was not left to spontaneous self-regulation. The mechanism of managing the market economy was described as follows: “The government regulates the market, and the market directs companies.” Thus, the market was not viewed as the opposite of government regulation, as in Eastern Europe; rather, it was defined as one of its most important niches.21

The Chinese economic system is still identified as a socialist one. “Only socialism can develop China,” reforms ideologists emphasized after the Tiananmen Square protests.22 It is necessary to point out that


some often limit the concept of socialism to the Soviet orthodox economic model, which practically does not allow any other type of property than the public one. (We can ignore the cooperative and collective-farm property because de facto it belonged to the government, or rather to the Communist Party, which is the same thing.) Socialism in China, from the orthodox point of view, is not pure socialism, because it is a variety of mixed economy with the government playing a significant role in managing economic development.

The understand the extent of government regulation, it is sufficient to mention that the government not only continues to plan production of crucial industrial goods but also determines their prices. Only the government has the right to purchase essential agricultural products from agrarian producers, and even this is done at the price determined by the government.23

Developing family businesses became the paradigm of the agricultural reform. While being popular in the USSR during perestroika, this method was completely ignored by the neoliberal economic policy of the post-Soviet period. “The policy of family farming,” contemporary Russian researchers write about the Chinese reforms of the agricultural sector, “allowed to feed and dress people. Grain output per year grew from 300 million tons in 1979 to 400 million ton in 1984. Farmers’ income triple over that period. Experts point out that this was the greatest growth of people’s wellbeing in such a short time.”24

Establishing “village companies” was another method reformers used to develop agriculture. This phenomenon has to do with the ancient tradition of artisanship among Chinese farmers. As a result, unprecedented integration of economic sectors took place in China: agriculture now makes a substantial contribution to general industrial output. Village companies specialize in producing consumer goods. Many of the Chinese goods that have flooded the entire world are produced in villages. By the late 1980s, “village companies” produced 20% of industrial goods in China. Their share in gross rural income exceeded 50%. This means that industrial activities of Chinese peasants were even more productive than agrarian ones, which are more natural for their social status.25

24 M.V. Konotopov and S.I. Smetanin, op. cit., 248.
25 Ibid., 247–250.
Unlike monetarist reformers in Eastern Europe, Chinese reformers did not apply any economic theories in a sweeping manner. Communist Party Congresses always emphasized that the situation in socialist China is special. Essentially, an economic system was adapted to a civilizational historical context.\textsuperscript{26}

Economic reforms in China, unlike those in Eastern Europe, did not have a political aspect. It is well-known that a simultaneous reorganization of these two spheres can make the system unbalanced. It is a basic concept of the reform theory. To implement reforms, one needs at least the political resource. Otherwise, reforms will fail and a systemic collapse will ensue. The fact that the Communist Party retained power in China clearly contributed to the success of the economic policy. Captains of private entrepreneurship in China are members of the Communist Party just like government officials. As Communists, they are required to follow government plans as their orders. To a large degree, this is how China manages to use administrative regulation with respect to the private sector.\textsuperscript{27}

Generally speaking, the type of property means little in China. The dividing line between the public sector and the private sector is often nominal. The latter sector serves the interests of the party and the government as much as the former. Thus, when statistics indicates that 18% of employees work in state-run companies, or that the public sector accounts for 40% of GDP, these levels do not reflect the actual situation in the Chinese economy, albeit they are higher than the Russian ones.

Interestingly, the very term “privatization” involves ideas of private ownership which contradicts Chinese mentality. Thus, the term has a negative connotation in China. “It is important to mention that there were no leaps in reducing government control over the industry, the economy’s leading sector,” A.S. Selishchev and N.A. Selishchev, experts on modern economic trends in China, wrote. “The shift towards non-government types of property was taking place rather gradually,


\textsuperscript{27} E.P. Pivovarova, Sotsializm s kitaiskoi spetsifikoi: Itogi teoreticheskogo i prakticheskogo poiska (Moscow, 1999).
through developing them at a faster pace, not through rashly converting state enterprises into private companies. This feature of the Chinese reforms, which distinguished them from those in Russia, made it possible to prevent a large-scale decrease in industrial output and de-industrialization of the national economy.”

The Chinese economy to this day functions according to five-year plans. In Eastern Europe, “market fundamentalism” prevailed. Reformers launched a war against the planning system as an attribute of the totalitarian regime. While claiming that they used the Western economy as a pattern, they forgot that the West does have planning institutions and numerous plans and recommendations. This created an illusion that the Western economy functioned in a self-regulated mode. Idealistic principles were confused with actual organization of the Western economy. This was a mistake.

7.5. The Belarusian experience

Of all former Soviet republics, rash liberalization posed particular danger to Belarus. During the Soviet period, Belarus was the Soviet “assembly line.” After industrial infrastructures were destroyed, the Belarusian economy was doomed to collapse. Neoliberal reforms were suspended in 1994, after Alexander Lukashenko was elected president. Presently, even the West, which traditionally brands Belarus as the last totalitarian regime in Europe, speaks of the Belarusian “economic miracle.” Even the International Monetary Fund had to admit, to its great surprise, that the Belarusian economy had been developing faster than the Chinese one (11% GDP growth versus 9.5% in China in 2005). The Belarusian example is particularly instructive for Russia, as it demonstrates that it is possible for a transition economy to develop intensely without relying merely on exports of minerals. As we know, Belarus is not that rich in natural resources.

To discredit Lukashenko’s economic policy, his opponents instill in people’s minds the myth about the “Belarusian miracle” being based on cheap oil and gas supplied by Russia. Granted, cheap supplies did help in creating a favorable economic situation; yet this factor was not the

28 A.S. Selishchev and N.A. Selishchev, op. cit., 114.
most important one. For example, Ukraine imported Russian minerals on the same favorable terms, yet it failed to use this advantage. In fact, the same can and should be said of Russia itself, which owns cheap sources of energy and raw materials.

Smolensk Region, which is economically and geographically close to Belarus, to this day remains a stagnant subsidized territory. In addition to that, although the Belarusian economy does depend on Russian oil and gas exports, the degree of this dependence is hugely exaggerated. Of all former Soviet republics, Belarus is the least dependent, judging by the structure of final consumption of energy (Fig. 7.15).  

![Fig. 7.15. Former Soviet republics by the share of oil and gas in final energy consumption](image)

When Alexander Lukashenko came to power in 1994, he declared that the priority was not to reform the economy, as other state leaders in the former Soviet republics claimed, but rather to ensure economic development. The goal was to bring idle factories back to life. At the initial stage, the process of privatization was suspended. The president declared the principle of government control as the keynote of his economic policy. Notwithstanding monetarist recommendations, Belarus did not have a radical market liberalization and a large-scale privatiza-

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tion of industrial facilities. The government presently owns 75% of the republic’s industry. There is only one country among the former Soviet republics which has a higher rate—Turkmenistan. While acting contrary to IMF universal recommendations, Belarus achieved better results than those newly independent states which based their economic strategy on neoliberal methods. By 1996, Belarusian GDP dynamics had changed from negative to positive. In the Russian Federation, gross domestic product was still decreasing at the time. Ukraine, for example, was unable to stop the slump until four years later. The ruble default in 1998 did have a delayed negative effect on the Belarusian economy, but this effect was not strong enough to stop the upward thrust. In the 1990s, the economies of Belarus and Russia continued to develop asynchronously, which is another argument against the claims concerning Belarus allegedly being a parasite living off the Russian economy (Fig. 7.16).³¹

It is not altogether correct to refer to Lukashenko’s model of managing the economy as socialist, as his critics do. It combines administrative methods, typical of the Soviet period, with Keynesian mechanisms of indirect market regulation. Some of the methods the Belarusian government uses may be described as Keynesian classics: government investment, subsidies, stimulating demand, active revenues policy, a deficit budget. Some experts view the economic experiment currently underway in Belarus as a successful test of the Neo-Keynesian model for Russia. “We may expect that Russian monetarism will be replaced with mutant Marxist Keynesianism а la Belarus,” wrote Leonid Zaiko, a critic of Lukashenko’s policy.32

The concept that the Belarusian system is an autarky is another popular myth. In this case, autarky is confused with authoritarianism. In reality, 25% of industrial goods produced in Belarus are exported (in the engineering industry, 35.7%; in ferrous metallurgy, 1.4%; in the chemical industry, 53.7%). At the same time, East European countries, with a few exceptions, experience difficulties selling these goods on the international market. Many will be surprised to find out that Belarus is one of the most trade-oriented countries in the world today. Trade amounts to 65.3% of Belarusian GDP (13th highest percentage in the world). Belgium is the only European country that has a higher rate.33

According to the logic of the “open society” theory, there is no way authoritarian Belarus with permanent budget deficit can be attractive for investors. Allegedly, investment will not come to the country without establishing liberal democracy. In reality, the investment climate depends on the government’s stability, not on its format. Stability is exactly what the self-regulated model of the market implemented in the former Soviet republics does not provide. The statist Belarusian economy enjoys a significantly higher level of investment than Russia, which has made much progress in implementing neoliberal reforms (Fig. 7.17).34 Granted, the share of foreign investors in the total amount of investment in Belarus is not that great, but structurally it is comparable to the level in Russia—despite isolationist and boycott sanctions the West has introduced against the Belarusian economy.

33 Mir v tsifrakh: Statistichesky sbornik. 2007 (Moscow, 2007), 22.
34 Strany Evraziiskogo ekonomicheskogo soobshchestva (Moscow, 2006), 25.
The fundamental difference between Belarus and Russia is in the way their economies are organized structurally. The Belarusian model is closer to the ideal of “physical economy” described by Lyndon LaRouche. Real sectors account for a larger share of the national economy in Belarus than in Russia. Similar systemic principles of GDP production are implemented in China. The Russian economic model, on the contrary, is ahead of the Belarusian one in virtual sectors, such as trade, financial activities, and services (Fig. 7.18–7.19). Isn’t it possible that the secret of the Belarusian “economic miracle” is in emphasizing its real production?\(^{35}\)

Among all former Soviet republics, the Belarusian economic policy meets the standards of social humanism the most. It has the highest rate of wages growth in Europe (Fig. 7.20). The poverty level in Belarus is the lowest among all former Soviet republics (Fig. 7.21). The Gini index in Belarus is one of the lowest in the world (third place in Europe, the first two being Denmark and Sweden) (Fig. 7.22). The unemployment level is minimal compared with the world’s average level. Belarusians have a much better diet than Russians (Fig. 7.23). While 100 Russian families own 35 cars, 100 Belarusian families own 53 cars (also the best level among former USSR republics).\(^{36}\)

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\(^{35}\) Rossiya i strany mira. 2006: Statisticheskii sbornik. (Moscow, 2006), 60, 82.

\(^{36}\) Ibid., 104, 105, 107, 116–123.
Fig. 7.18. Sectoral structure of GDP in Belarus and Russia

- Agriculture, forestry, fishing, and hunting
  - Russia: 5.4%
  - Belarus: 9.4%

- Trade, hotels, and restaurants
  - Russia: 11.3%
  - Belarus: 21.5%

- Financial activities, real estate business, rent and services
  - Russia: 5.2%
  - Belarus: 12.8%

- Transport and communications
  - Russia: 10.3%
  - Belarus: 10.5%

- Other services
  - Russia: 7.2%
  - Belarus: 9.5%

- Education, health care, social services
  - Russia: 5.7%
  - Belarus: 10.8%

- Construction
  - Russia: 5.7%
  - Belarus: 8.2%

- Industry
  - Russia: 31.4%
  - Belarus: 32.5%

Fig. 7.19. Percentage of workers by sectors in Belarus and Russia

- Agriculture, forestry, fishing, and hunting
  - Russia: 5.4%
  - Belarus: 9.4%

- Trade, hotels, and restaurants
  - Russia: 26.7%
  - Belarus: 17.4%

- Education, health care, social services
  - Russia: 16.3%
  - Belarus: 18%

- Other services
  - Russia: 13.6%
  - Belarus: 13.6%

- Agriculture, forestry, fishing, and hunting
  - Russia: 10.7%
  - Belarus: 10.7%

- Transport and communications
  - Russia: 7.5%
  - Belarus: 9.1%

- Financial activities, real estate business, rent and services
  - Russia: 2.1%
  - Belarus: 7.7%

- Construction
  - Russia: 6.8%
  - Belarus: 7.8%
Fig. 7.20. Real wages in some former USSR republics (Eastern Europe) (1995 = 100%)

Fig. 7.21. The poverty level in former USSR republics (percent of the total population)
Fig. 7.22. The degree of social and economic differentiation in former USSR republics (Gini index)

Fig. 7.23. Food consumption per capita in Russia and Belarus (kg)
Despite this obvious success, Western organizations, which rely on monetarist stereotypes, grade the Belarusian economy extremely low. For instance, the Index of Economic Freedom puts Belarus on the 151st place among 161 countries. According to this rating, Russia has the 122nd place, whereas Ukraine is 99th. Apparently, Western experts view the Ukrainian variant of economic development as more desirable. Britain’s Economist Intelligence Unit, which rates countries according to the “quality of life,” describes Belarus as one of the least developed countries, socially and economically. Among 112 countries, it is listed on the 100th line, between Uganda and Botswana. Incidentally, Russia occupies an even lower position—the 105th place.

Obviously, the methodology for calculating such indices, which contradict elementary statistics and even common sense, should be declared erroneous and perhaps even manipulative.37

Reforms in Russia are a failure not only because economic parameters in almost every area became worse, but also because the main objectives announced by reformers themselves were not attained.

* * *

Reforms cannot be a goal in itself. They are an instrument for achieving certain goals. China keeps this in mind, conforming the logic of the transformations they have been implementing for 30 years now with the general goal of economic development. Reforms which are not result-oriented always become destructive. Neoliberal reformers throughout post-socialist Eastern Europe and former USSR have replaced the goal with the means. They deformed the hierarchy of values and goals, and reforms became a goal in itself. Eventually, not only did they fail to foster economic development; they even became a hindrance.

We can conclude that between two models of transition to a new social system Russia chose the worse one. Not a single strategic goal of the transition was achieved. The failure of transitional development caused a systemic geo-economic reshuffle. The position of the world’s second largest economy, formerly occupied by the USSR, went to China. As for Russia, to this day it cannot overcome the consequences of the 1990s reforms. Its failure during the transition period cost it decades lost in the world economic race.


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To produce a realistic strategy of Russia’s economic development, one must be familiar with its starting position. Traditionally, this identification is achieved by comparing the Russian economy with other national economies. For this purpose, various international ratings are usually used. According to most of them, Russia is at a very low level in the world’s economic hierarchy. Frankly speaking, the role it is assigned may be described as that of an underdog.

The impression one gets is that Russia is doomed to remain on the outskirts of the world economy. Of course, Russia is in an extremely difficult situation, but it is far from hopeless, as international ratings of economic development suggest. Clearly, the government’s policy should be based on realistic assessment of the country’s resources. Yet at the same time, underestimation of the starting position is as dangerous as utopianism. The inferiority complex is not the best helper in economic development.

Another danger of popularizing Western development indices has to do with imposing false benchmarks. When some tell Russian people to consider how Luxembourgers live (having the largest GDP per capita), they, in a way, encourage Russians to align their policies with Luxembourg standards. Such advice hardly can be helpful for Russia.

8.1. Using GDP as a reference: the problem of accuracy

It may seem that in order to answer the question concerning the place the Russian economy occupies in the world, it would be sufficient to look up statistics for various countries’ gross domestic product (Fig. 8.1). In absolute figures, Russia’s GDP was the 10th in 2005. This is the worst result for Russia in modern history.

The Russian Empire has never fallen below the fifth place in the GDP rating list. The Soviet Union, after accomplishing the industrialization leap, occupied the second place, the first being occupied by the United States. Russia proper, if considered as a separate country, would occupy the third place, Japan being the second. Thus, in the last
25 year Russia has dropped seven places lower in the world’s economic hierarchy. Among the first 20 countries, Russia is the only one where GDP has decreased in the last 20 years.

If we consider the list of countries with largest GDPs, we will see that it does not match the G8 list. China, India, Brazil, and Spain are not among the G8 countries, although their GDPs are larger than those of some G8 countries. This indicates that the G8 list is based on politics and ideology more than on economy.¹

Russia’s starting position according to its GDP per capita, as compared to its own history, is much worse (Fig. 8.2). But the drop it experienced on this scale was also more drastic. By 2000, it dropped 26 places lower. Granted, later it somewhat improved its position, securing by 2005 the 53rd place between Congo and Botswana.²

However, it is questionable whether one can accurately assess economies by their gross domestic product. If we consider how GDP is distributed among sectors, Russia’s position in the world economic hierarchy will stop looking so pessimistic. Western countries (including Japan) have impressive GDPs to a large degree due to their service sectors. It is in this sector that Russia mainly lags behind the “post-industrial” world (Fig. 8.3).³ At the same time, Russia occupies the fifth place in the engineering industry. There are some other rapidly developing countries in Asia and Latin America whose economic potential is underrated because of the service sector.

Many of the world’s leading economists have repeatedly pointed out that the service sector deforms GDP data. For instance, Lyndon LaRouche pointed out that fictitious, virtual capital is hiding under the mask of the service sector. He contrasted the “phantom economy” of service with the “physical economy” of industry and agriculture.⁴

There is some indirect evidence that Russia’s economic potential is underrated. The most popular method of identifying underrated

¹ Mirovaya ekonomika. Prognoz do 2020 goda, 386–387.
² Ibid., 414–415.
³ Ibid.
⁴ Lyndon H. LaRouche, Jr., “The Science of Physical Economy as the Platonic Epistemological Basis for All Branches of Human Knowledge,” Executive Intelligence Review Vol. 21 (No. 9–11, 1994); “On the Subject of Strategic Method,” Executive Intelligence Review (No. 22, 2000); Denis Tukmakov, “Upodobleniye Bogu (Fizicheskaya ekonomika kak preodoleniye entropii),” http://www. zavtra.ru/cgi//veil//data/zavtra/01/396/52.html
Fig. 8.1. List of countries by GDP (billion USD, in 2005 prices and PPP)
Fig. 8.2. List of countries by GDP per capita
(billion USD, in 2005 prices and PPP)
Fig. 8.3. Leading countries’ GDP distributed among sectors (billion USD, in 2005 prices and PPP)
<table>
<thead>
<tr>
<th>Country</th>
<th>USD</th>
</tr>
</thead>
<tbody>
<tr>
<td>China</td>
<td>-56</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>52</td>
</tr>
<tr>
<td>Venezuela</td>
<td>-51</td>
</tr>
<tr>
<td>Malaysia</td>
<td>-50</td>
</tr>
<tr>
<td>Egypt</td>
<td>-47</td>
</tr>
<tr>
<td>Ukraine</td>
<td>-46</td>
</tr>
<tr>
<td>Sri Lanka</td>
<td>-46</td>
</tr>
<tr>
<td>Philippines</td>
<td>-46</td>
</tr>
<tr>
<td>Indonesia</td>
<td>-46</td>
</tr>
<tr>
<td>Thailand</td>
<td>45</td>
</tr>
<tr>
<td>Russia</td>
<td>43</td>
</tr>
<tr>
<td>Paraguay</td>
<td>-41</td>
</tr>
<tr>
<td>South Africa</td>
<td>-34</td>
</tr>
<tr>
<td>Slovakia</td>
<td>-34</td>
</tr>
<tr>
<td>Uruguay</td>
<td>-33</td>
</tr>
<tr>
<td>Costa Rica</td>
<td>-32</td>
</tr>
<tr>
<td>Taiwan</td>
<td>-29</td>
</tr>
<tr>
<td>Poland</td>
<td>-29</td>
</tr>
<tr>
<td>Japan</td>
<td>28</td>
</tr>
<tr>
<td>Pakistan</td>
<td>-28</td>
</tr>
<tr>
<td>Singapore</td>
<td>-26</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>-25</td>
</tr>
<tr>
<td>Saudi Arabia</td>
<td>-25</td>
</tr>
<tr>
<td>Lithuania</td>
<td>-24</td>
</tr>
<tr>
<td>Estonia</td>
<td>-23</td>
</tr>
<tr>
<td>Latvia</td>
<td>-22</td>
</tr>
<tr>
<td>Argentina</td>
<td>18</td>
</tr>
<tr>
<td>Mexico</td>
<td>-17</td>
</tr>
<tr>
<td>Australia</td>
<td>-17</td>
</tr>
<tr>
<td>Peru</td>
<td>8</td>
</tr>
<tr>
<td>Hungary</td>
<td>-7</td>
</tr>
<tr>
<td>Brazil</td>
<td>6</td>
</tr>
<tr>
<td>Chile</td>
<td>5</td>
</tr>
<tr>
<td>Colombia</td>
<td>5</td>
</tr>
<tr>
<td>Canada</td>
<td>-4</td>
</tr>
<tr>
<td>South Korea</td>
<td>-4</td>
</tr>
<tr>
<td>New Zealand</td>
<td>-2</td>
</tr>
<tr>
<td>Turkey</td>
<td>0</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>6</td>
</tr>
<tr>
<td>Euro Zone</td>
<td>19</td>
</tr>
<tr>
<td>Sweden</td>
<td>43</td>
</tr>
<tr>
<td>Denmark</td>
<td>50</td>
</tr>
<tr>
<td>Switzerland</td>
<td>57</td>
</tr>
<tr>
<td>Norway</td>
<td>106</td>
</tr>
<tr>
<td>Iceland</td>
<td>131</td>
</tr>
</tbody>
</table>

**Fig. 8.4. The Big Mac index**
economies is the Big Mac index (Fig. 8.4). It is based on the differences in prices for Macdonald’s international goods in the US and in other countries. If the price is higher than the American standard ($3.22.), this means the national currency is overvalued; if the price is lower, this means the currency is undervalued. The ruble, according to the Big Mac index, is significantly undervalued. At the same time, the economic and financial condition of the West is overrated. The Chinese yuan is expectedly the world’s most undervalued currency.

Thus, taking into account the fact that the ruble’s purchasing power is undervalued, we should adjust the GDP rating, since GDP is measured in its monetary equivalent, and other economic indices. After such an adjustment, Russia will occupy the fifth line in the world hierarchy of national economies instead of the tenth, while China will occupy the first place.5

Various indices for measuring the scope of shadow sectors also indicate indirectly that Russia’s GDP-based assessment is underrated. The shadow part of economic activities, naturally, is not included in GDP. Yet, according to the Russian Internal Affairs Ministry, shadow economy currently exceeds 40% of Russia’s GDP. If we make this adjustment and add this hidden economic sector to the overall figure, Russia’s rating in the world economic hierarchy will also improve, putting Russia on the 5th or the 6th line.

8.2. International indices as a propaganda tool: investment-mongering ratings

Many of the popular economic ratings are nothing else than ideological propaganda. This is true, for instance, of the index of economic freedom determined by the Heritage Foundation and the Wall Street Journal (Fig. 8.5). The purpose of this index is to consider how much national economies comply with the principles of liberalism. It is based on the idea that a country’s wealth is determined by the degree of its economic liberalization. The authors of this rating even claim that it has a forecasting potential, since the more liberal an economy is today, the higher the results of its growth will be tomorrow. Experts divide all countries into four categories: free economies, mostly free economies, mostly unfree economies, and repressed economies. Russia was

5 Mir v tsifrakh. 2007 (Moscow, 2007), 27.
put in the third category, together with China. Economies of Baltic states, Moldova, Georgia, and Azerbaijan are listed as more liberalized than that of Russia. At the same time, the economic system of Belarus is described as “repressed.”

Experts interpret economic freedom indicators quite freely. For instance, although Russia has significantly reduced custom duties (on the average, from 11.3% to 8.4%), experts still graded its trade protectionism rather poorly—as “three.” Amazingly, even though Russia has adopted a uniform low income tax at 13%, experts still characterized it as a country with a substantial tax burden. Such “misunderstandings” can be found for any of the indicators.  

As an alternative to the traditional GDP-based rating, there is the competitiveness index. According to this index, Russia was only 64th in 2007. Moreover, despite the growth of Russia’s GDP over the last few years, its competitiveness grade decreased as the country deve-

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oped economically (54th place in 2005, and 63rd in 2006). Factors that caused this drop included the widespread practice of money laundering through banks (78th place among 80 countries), poor property rights protection (75th place), poor auditing standards (74th place), poor banking system (73rd place), and poor business ethics (73rd place).  

Why then, despite the drop in Russia’s competitiveness, does it have better economic growth than countries rated above it? Even a superficial examination of various countries’ GDP makes it clear that Russia is not the only country where these two indices contradict each other.  

Let us limit ourselves to comparing ratings for the world’s 20 leading economies. (If we add more countries, the disparity will be even worse.)

As we compare GDP ratings with the global competitiveness index, we see that the two do not match. The higher a nation is in the competitiveness list, the worse its GDP growth is. Thus, to resolve this contradiction, one of the two systems of economic development assessment should be recognized inaccurate. The competitiveness index looks more vulnerable, since it is based on experts’ opinions on arbitrarily chosen criteria.

Indices’ vulnerability is in their subjectivity. When dealing with qualitative, not quantitative, parameters (unlike growth, development is qualitative concept), the element of relativity increases significantly. Unlike pure statistics, modern ratings are based more and more on experts’ grades and polls. How else can one assess, say, such a parameter as effectiveness of government spending or favoritism in the government’s decisions? It is noteworthy that most indicators are polled, not statistical, in the competitiveness rating (Table 8.1).

It seems that the main methodological error of this index is its universal approach to different countries. In reality, there is no such thing as one universal road for economic development (Table 8.2). Each country’s national economic context determines its individual hierarchy of factors. Civil rights and liberties often are related to economic growth. However, there are many cases when growth was achieved

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9 Ibid.
10 Ibid.
through completely different mechanisms. Thus, the methodological goal is to switch from the universal approach to a range of approaches based on the civilization context.

Table 8.1

Polled/qualitative data ratio in the growth competitiveness index (%)

<table>
<thead>
<tr>
<th>No.</th>
<th>Index</th>
<th>Weight, %</th>
<th>Polled/qualitative data ratio in the indicator, %</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td>Polled</td>
</tr>
<tr>
<td>1</td>
<td>Innovation</td>
<td>4.17</td>
<td>25</td>
</tr>
<tr>
<td>2</td>
<td>Technology transfer</td>
<td>12.5</td>
<td>100</td>
</tr>
<tr>
<td>3</td>
<td>ICT</td>
<td>16.67</td>
<td>33</td>
</tr>
<tr>
<td>4</td>
<td>Contracts and law</td>
<td>16.67</td>
<td>100</td>
</tr>
<tr>
<td>5</td>
<td>Corruption</td>
<td>16.67</td>
<td>100</td>
</tr>
<tr>
<td>6</td>
<td>Macroeconomic stability</td>
<td>16.67</td>
<td>29</td>
</tr>
<tr>
<td>7</td>
<td>Country credit rating</td>
<td>8.33</td>
<td>0</td>
</tr>
<tr>
<td>8</td>
<td>Government waste</td>
<td>8.33</td>
<td>100</td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>100</td>
<td>65.6</td>
</tr>
</tbody>
</table>

Table 8.2

GDP and global competitiveness ratings

<table>
<thead>
<tr>
<th>No.</th>
<th>Country</th>
<th>Position according to the prospective competitiveness index</th>
<th>Position according to the microeconomic competitiveness index</th>
<th>GDP growth in 2006, %</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>United States</td>
<td>1</td>
<td>1</td>
<td>3.2</td>
<td>Among the first ten, average growth is 3.17%</td>
</tr>
<tr>
<td>2</td>
<td>Taiwan</td>
<td>3</td>
<td>16</td>
<td>4.6</td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>Australia</td>
<td>7</td>
<td>14</td>
<td>2.7</td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>Canada</td>
<td>8</td>
<td>10</td>
<td>2.7</td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>United Kingdom</td>
<td>11</td>
<td>3</td>
<td>2.8</td>
<td></td>
</tr>
<tr>
<td>6</td>
<td>Japan</td>
<td>13</td>
<td>11</td>
<td>2.2</td>
<td></td>
</tr>
<tr>
<td>7</td>
<td>Germany</td>
<td>14</td>
<td>4</td>
<td>2.7</td>
<td></td>
</tr>
<tr>
<td>8</td>
<td>South Korea</td>
<td>21</td>
<td>23</td>
<td>4.8</td>
<td></td>
</tr>
<tr>
<td>9</td>
<td>Spain</td>
<td>22</td>
<td>25</td>
<td>3.9</td>
<td></td>
</tr>
<tr>
<td>10</td>
<td>France</td>
<td>30</td>
<td>15</td>
<td>2.1</td>
<td></td>
</tr>
<tr>
<td>No.</td>
<td>Country</td>
<td>Position according to the prospective competitiveness index</td>
<td>Position according to the microeconomic competitiveness index</td>
<td>GDP growth in 2006, %</td>
<td></td>
</tr>
<tr>
<td>-----</td>
<td>---------</td>
<td>---------------------------------------------------------------</td>
<td>---------------------------------------------------------------</td>
<td>-----------------------</td>
<td></td>
</tr>
<tr>
<td>11</td>
<td>China</td>
<td>33</td>
<td>38</td>
<td>10.7</td>
<td></td>
</tr>
<tr>
<td>12</td>
<td>Italy</td>
<td>39</td>
<td>24</td>
<td>1.9</td>
<td></td>
</tr>
<tr>
<td>13</td>
<td>Mexico</td>
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<td>55</td>
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</tr>
<tr>
<td>14</td>
<td>Brazil</td>
<td>46</td>
<td>33</td>
<td>3.7</td>
<td></td>
</tr>
<tr>
<td>15</td>
<td>India</td>
<td>48</td>
<td>37</td>
<td>9.2</td>
<td></td>
</tr>
<tr>
<td>16</td>
<td>Argentina</td>
<td>63</td>
<td>65</td>
<td>8.5</td>
<td></td>
</tr>
<tr>
<td>17</td>
<td>Russia</td>
<td>64</td>
<td>58</td>
<td>6.7</td>
<td></td>
</tr>
<tr>
<td>18</td>
<td>Indonesia</td>
<td>67</td>
<td>64</td>
<td>5.5</td>
<td></td>
</tr>
<tr>
<td>19</td>
<td>Turkey</td>
<td>69</td>
<td>54</td>
<td>5.3</td>
<td></td>
</tr>
<tr>
<td>20</td>
<td>Iran</td>
<td>-</td>
<td>-</td>
<td>4.3</td>
<td></td>
</tr>
</tbody>
</table>

Among the second ten, average growth is 6.06%.

Many indicators used in traditional rating systems are based on the stereotypes of the neoliberal economic theory. Yet, when a different approach is used, some of these parameters have the opposite influence. For instance, this is the case with the budget deficit indicator, which is used to determine the competitiveness index. According to the monetarist theory, high deficit has a negative effect on economic development. Thus, deficit-oriented national economies get poor rates. But the Keynesian approach is not opposed to the budget deficit. Moreover, judging by most rapidly developing economies, a deficit is quite desirable. Thus, China, which has a permanent budget deficit, gets fewer points for its competitiveness index.

Indicators are not neutral not only in the conceptual sense (since they are linked with a specific economic theory), but also with respect to values (since they are linked with a specific axiological scale). Practically all of them are based on Smith’s model of the “economic man.” In connection with this, it is interesting to consider the human development index, which the UN introduced in 1980. It is based on three elements: GDP per capita (a material indicator), life expectancy (a biological indicator) and the knowledge level based on educational attainment and literacy (a social indicator). The spiritual aspect of human development was excluded from this index. Wealthy

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societies are given as examples to follow. Man's moral improvement was left without consideration. As a result, an amazing coincidence happened. Leading countries according to the human development index were also the ones most affected by vices. One just has to compare the list of countries by this index with crime statistics per 100,000 people (Table 8.3). Top-twenty groups in the two lists amazingly coincide (55% match). So, what kind of potential does the UN index refer to?

Table 8.3

<table>
<thead>
<tr>
<th>Human development index</th>
<th>Number of crimes per 100,000 people</th>
</tr>
</thead>
<tbody>
<tr>
<td>Place</td>
<td>Country</td>
</tr>
<tr>
<td>1</td>
<td>Norway</td>
</tr>
<tr>
<td>2</td>
<td>Iceland</td>
</tr>
<tr>
<td>3</td>
<td>Australia</td>
</tr>
<tr>
<td>4</td>
<td>Canada</td>
</tr>
<tr>
<td>5</td>
<td>Luxembourg</td>
</tr>
<tr>
<td>6</td>
<td>Sweden</td>
</tr>
<tr>
<td>7</td>
<td>Switzerland</td>
</tr>
<tr>
<td>8</td>
<td>Ireland</td>
</tr>
<tr>
<td>9</td>
<td>Belgium</td>
</tr>
<tr>
<td>10</td>
<td>United States</td>
</tr>
<tr>
<td>11</td>
<td>Japan</td>
</tr>
<tr>
<td>12</td>
<td>Netherlands</td>
</tr>
<tr>
<td>13</td>
<td>Denmark</td>
</tr>
<tr>
<td>14</td>
<td>Finland</td>
</tr>
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<td>15</td>
<td>United Kingdom</td>
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<td>16</td>
<td>France</td>
</tr>
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<td>Austria</td>
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<td>Italy</td>
</tr>
<tr>
<td>19</td>
<td>New Zealand</td>
</tr>
<tr>
<td>20</td>
<td>Germany</td>
</tr>
</tbody>
</table>

8.3. The civilizational relativity of economic success

The category of a country’s successfulness is civilationally relative, for each civilization has its own criteria of success. There is no universal principle in the ethology of economic existence as well. The value of material increase is questionable to the axiology of many civilizational systems, including that of the Russian Orthodox tradition. Moreover, based on the fundamental conclusions drawn by Max Weber in his comparative study of history, we can say that the phenomenon of economic success is limited to the spiritual habitat of the Protestant civilization (and, accordingly, the habitat of the modern Western economy, which is based on the former).13 “To achieve success is to knock down others and to stand on their bodies,” Jawaharlal Nehru said in keeping with the Indian traditional ethics.14

Many outstanding thinkers of the past have pointed out that Russia does not have the ethics of success in the Western sense and that this category is not applicable to the Russian national mentality. In this sense, success-oriented Americans are the opposite of Russians. The Orthodox Christianity has historically reproduced in Russia the ability to limit one’s material demands to a vital minimum and economic activity aimed at self-sufficiency, not at consumerist expansionism (permanently increasing the amount and scope of goods and services). In this ethical paradigm, gross economic growth is necessary to ensure national security, not to increase individual consumption. Hence, Russia’s criterion of economic success has always been defined as its defense potential, the resources it can mobilize in case of an external threat. Thus, it is not quite correct to use plain, formal statistics to measure success of civilizations which have different economic goals.15

So, how can we find an appropriate foundation for comparative analysis? The main thing is to acknowledge that there are various understandings of success in the world. This means that economic de-

13 A.S. Panarin, Pravoslavnaya tsivilizatsiya v globalnom mire (Moscow, 2002).
14 E. Borokhov, Entsiklopediya aforizmov (Mysl v slove) (Moscow, 1999), 606.
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Development should match the strategic objectives of the national value-oriented goal-setting. In keeping with this approach, those countries which achieve their goals and objectives better should be recognized as economically successful.

From this angle, economic success is essentially one of the manifestations of national identity. This is particularly important as a warning against hasty extrapolation of other countries’ economic models (especially those Western post-industrial countries which constitute “the golden billion”) to Russia. At the same time, we should pay much more attention to the experience of those national economic systems which are similar to Russia in their goal-setting and which face similar problems (i.e., rapidly developing economies of the East).

When performing comparative economic analysis, one should make sure comparisons are valid. Not all countries in the modern world can be compared according to universal criteria of economic development. To evaluate, for example, Russia or China by comparing its statistics with that of a European country which is about the same size as any of its administrative parts, means practically to discredit large countries from the viewpoint of small ones. The principle of territorial comparability, which has been established since the time of Montesquieu, was ignored by admirers of small European democracies. Also, comparative analysis should not ignore the difference in starting positions. It is obvious that it makes no sense to apply statistical characteristics of “golden billion” countries to catch-up economies like Russia.

So, what countries one can compare Russia with? If we emphasize demographic resources, this would be a group of countries which is sometimes called “the great semi-periphery seven”: Brazil, India, Indonesia, China, Mexico, Pakistan, and Russia. On the other hand, if we emphasize territory, we can limit ourselves to BRIC countries: Brazil, Russia, India, and China.16

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The habit of depreciating one’s own country, instilled by the liberal media with the help of various international indices is by itself a hindrance for economic development. A national economy which

does not believe in its own potential has no future. Sergei Kara-Murza was right when he said about the phenomenon of Russian self-concept, “Most nations do nor know about the world around them and think that they are the best and that they live better than anybody else; but Russians are different. Having no information, they tend to imagine the worst: that other nations are more smart and kind and that everybody else lives better than they.”

Even in its present condition, Russia remains potentially a great economic power. In the long run of global development, its chances are still good.

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As the authors were traveling on the long journey of the present study, they were often bewildered as their results seemed uncommon and contradicted familiar stereotypes. One would expect that a scientific study should be free from bias and stereotypes. Yet the subject under discussion is heavily influenced by ideology and propaganda. Dozens of magazines, newspapers, and TV suggest that Russia should be the same as all civilized countries. Does this mean that Russia is not a civilized country? Generation after generation, people are taught that abundance of goods on the shelves of department stores is the best thing in life, the ultimate dream. Now, here it is: stores are full of goods; but for some reason people are dying at an unprecedented rate. For fifteen years we have been told that we should not print money lest we have inflation. Inflation does not cease, and Russian businessmen have to go to Western banks for loans; they have already loaned up to 400 billion rubles, and this with $2,000 billion “sterilized” in Russia. What is the problem? Why are these absurd and destructive stereotypes imposed on us?

The reason is, each nation, each state has its national interests. When a state, a country, a society forgets about its own interests, it starts following and serving somebody else’s interests.

So, what should be Russia’s strategic choice as to a nationally-minded economic policy? What are the fundamental reference points for Russia’s national ideology in economy?

Integrative value-oriented goals of Russia’s economic policy include:

1. Economic growth and development.
2. Social humanism.
4. Ensuring Russia’s national security as a prerequisite for all three items above is another top-level value-oriented goal.

Economic growth is the process of increasing output of produced material goods and thus raising the living standard. Yet not any kind of growth is due to improvements of the economic mechanism and coordination of quantitative and qualitative results, which is necessary for economic development. This is called “economic modernization.”
Reforms as such are not among the value-oriented goals of the new economic policy. The principle of economic development sets the goal of qualitative improvement and optimization of both the economic system in general and its individual components. The priority of economic development is to ensure proportionate development. To optimize Russia's economy, it is necessary to level out existing disparities. The general view among experts today is that the Russian economy has come to be one of the grossest examples of disproportions in world economic practice.

Economic growth and development are meaningless unless they are matched with the policy of social humanism. The category of social humanism should be introduced in the administrative sphere as a definition of a man-oriented economy. Man is both the means (the resource of labor) and the goal of the economic policy. Social humanism means rights and freedoms of an individual (the humanistic aspect) should be harmonized with the interests of society in general (the social aspect). The administrative dimension of the social humanism policy involves raising the government's social responsibility and optimizing its social functions. The policy of social humanism manifests itself in establishing ethical criteria by organizing harmonious relations between various groups within society, between the state and an individual, between the state and groups, between employers and employees, and in fiscal procedures.

The principle of long-term development stability means the government's economic policy should be assessed on a geo-economic and civilizational scale. The word “long-term” means economic forecasts and plans should be made for extensive time periods. Stability means the government should devise mechanisms which will allow to respond promptly to emerging threats and challenges of global economic development. In this respect, it is our priority to create a long-term system of supplying economy with resources, which means the Russian economy should switch from non-renewable resources to renewable ones.

The criterion of national security means the Russian state and society should be recognized as top values. Presently, Russia has exceeded many conventional limits of economic security. The first prerequisite for implementing this criterion is to produce a corps of nationally-minded government officials and to create mechanisms which will prevent them from becoming corrupt.
Strategic benchmarks of economic development may be described as building an “intelligent and ethical economy.” Methodologically, both elements match the definition of a value-oriented goal. The first element emphasizes the rational logic of goal-setting whereas the second one emphasizes its value content.

On the one hand, intelligent economy means the government’s administrative activities in the economic sphere should be rationalized. To achieve this goal, the authorities should regularly communicate with scientists.

On the other hand, it is necessary to develop a strategy for making a transition from the model based on exports of raw materials to the innovative model of economic development. It is of utmost importance that the Russian economy is abreast with scientific progress; for this purpose, a system of multi-stage (from scientific research to marketing) innovative process should be designed. The Russian system of education should be modernized according to economy’s real demands so as to increase the role of knowledge as a factor of economic development.

The principles of “ethical economy” (a term first introduced in scientific usage by Jean Sismondi) match mankind’s highest spiritual ideals. It is necessary to overcome the tradition of viewing economics purely in terms of material sustenance. We should restore the missing link between economic theory and ethics. This means the government should take steps to recover the view of economy, especially labor, which was formed in Russia based on the spiritual inheritance of its traditional religions. Practical results of the government policy should be measured not only by economic indicators but also by the ethical criterion. In addition to being used as a criterion, the ethical potential (the ideological and spiritual factor) may be used as a special resource for economic growth and development.

The ideological and spiritual condition of Russian people directly depends on the government’s policies with regard to ideology and national (civilizational) identity. Creating the ideological and spiritual resource may be and should be viewed as the government’s administrative task.

In order to identify one’s own ideological positions accurately, one needs to identify the ideological positions of his antagonists. For a nationally-minded ideology at the present stage, these would be liberal
and neoliberal theories in economics. In order to overcome the consequences of liberal and monetarist reforms, it is necessary to rebut these teachings. False benchmarks of the neoliberal trend during Russia’s recent period include the following ideological and fundamental elements:

- minimizing budget deficit;
- liberalizing financial markets;
- a floating exchange rate;
- liberalizing import (mostly through low tariffs);
- removing restrictions on foreign investment;
- total privatization;
- deregulation;
- the policy of shock therapy;
- artificial de-monopolization;
- self-regulation of market activities, replacing market economy with market self-regulation;
- demonetization;
- rash and unrestrained integration into the world market.

To follow monetarist theories today is to lag behind the world economic thought. The Western economic system typical of the early, initial stage of capitalist development was chosen as a basic model for neoliberal reforms in Russia. Not only did the chosen model fail to help solve the problem of modernizing the economy; the structural modification it effected produced exactly the opposite results.

Existing variants of reforms in transition economies, the East European and Chinese models, indicate there are other ways to perform economic modernization than liberal reforms. The main goal of the Russian economic transformation, which was to switch from the directive mobilization system to the system of stimulated development, has not been achieved during the reforms and remains to be accomplished.

It is necessary to defeat extremism of the neoliberal ideology and the contents of the current economic policy. The level of government intervention in the national economy (re-monetization of the economy, the share of government spending in GDP, the government’s involvement in innovation and scientific and intellectual progress, the government’s social responsibility) and the degree of the Russian economy’s openness (the problem of overemphasizing exports and raw materials) should be fundamentally reconsidered.
The ideology of self-regulated market has manifested its utopian nature. There is a number of socially important functions which market infrastructures cannot be trusted with. A modern government should perform the following functions with respect to economy:

- provide a legal foundation;
- organize monetary circulation;
- produce social goods;
- minimize transactional costs of the economic system in general;
- regulate the level of monopolization and promote fair competition;
- optimize the influence of external factors—reduce the negative effect and increase the positive effect in keeping with national political and economic interests;
- redistribute income;
- maintain the optimal level of employment;
- pursue a regional policy to level out living conditions in various territories;
- promote national interests on the international arena;
- perform macroeconomic regulation;
- offer social support to people;
- coordinate the development of the private sector.

Transition to the post-industrial phase of development means administrative mechanisms become more complex. The essence of the proposed transformation is to switch from the directive method to the stimulating method. The new government policy should include not only direct regulation in the form of decrees but also creating conditions which prompt man to make the desired decision. Instead of being coerced, economic subject are stimulated.

A realistic economic strategy should match the resources available to the country. Unless existing limitations are properly considered, the proposed strategy would become an economic utopia. The main types of resources used in the economic policy are minerals, nature, climate, finance, stock, labor, administrative resources, and passionarity.

The government’s policy with respect to resource-saving should be to overcome the discrepancy between the country’s resource potential and its actual economic effect. The disregard for Russia’s special civilizational context, which developed during the liberal and monetarist reforms, should be overcome.
The current structure of the Russian economy’s resource base dominated by non-renewable resources is obsolete compared to international development trends. The new economic strategy of the Russian government should initiate a transition from raw materials to human resources.

Russian economic resources have a dual nature. Unless managed properly, they will:

a) remain an unrealized potential; and

b) hinder Russia from moving on to qualitatively new stages of economic development. To convert this potential into a working factor of economic growth and development, the government should pursue an intelligent policy with respect to resources.

On the one hand, our country’s resource base defines a “corridor” for administrative decisions; on the other hand, resources themselves are the object of administrative activities. Thus, the government policy should include a special section, which will work to expand and enhance economic resources, to accumulate resource potentials intelligently, and to promote resource-saving.

Obviously, Russia’s opponents and rivals do not want to see it strengthening its geo-economic positions. Competition in the world economy is fierce, and when one player achieves success, this is an automatic setback for other players. Therefore, Russia should be prepared for external challenges. Veiled methods of competitive struggle include not only all sorts of international economic indices but also obsolete and unproved economic models imposed on Russia. They demonstrate a tendency for underrating Russia’s development and competitiveness. The country that occupies a seventh part of the world’s dry land is being, in a sneaky way, convinced to follow the example of Switzerland or Luxembourg in its development. The new approach recognizes that criteria of success are varied and that they depend on the individual context of national goal-setting. According to this approach, economic success is defined as a country’s ability to reach its own value-oriented goals and objectives.

These conclusions were echoed in the speeches of some authoritative participants of the 12th Economic Forum in St. Petersburg on June 6–8, 2008. Russian President Dmitry Medvedev addressed the issue of “economic selfishness.” “The way that major financial companies underestimated risk … led to losses not only in corporations. Unfor-
fortunately, the majority of the world’s population lost.” “I note that the crises taking place before our eyes—the financial crisis, rising prices for natural resources and food, as well as a number of global catastrophes—have clearly demonstrated that the current system of global governance is not equipped to meet the challenges it faces. There is a kind of institutional vacuum....”

US Secretary of Commerce Carlos Gutierrez urged countries to invest in creating global international institutions to regulate the economy. German Minister of Finance Peer Steinbrück said that Germany could not just trust in private investors’ intelligence and interest and that political measures were necessary. All these remarks match the conclusions reached in this study and rebut those neoliberals who claim that the government cannot take part in economic development.

Notwithstanding the complexity of Russia’s current geo-economic situation, it is too early for sackcloth and ashes. In its present condition, it remains potentially one of the largest economic powers in the world. Given its resources, Russia may play a leading role in the global prospect of the world’s economic development, as long as it makes a transition to a national ideological platform of economic development. Only one thing is needed: to start working.
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Invitation to Cooperation

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S.S. Sulakshin


The monograph analyses official state policy on fighting inflation in Russia. Its contradiction to the causes of inflation and inadequacy to the goals of state administration have been revealed. The methods of factorial analysis have been examined. With its help the origin and the causes of inflation of multiple-factor relaxation type have been set. Nonmonetary character of inflation has been proved. The governance measures combining inflation targeting with multivariate governance, particularly in economic growth sphere, the problems of low labour remuneration and other important spheres of the state’s responsibility have been proposed.

Sulakshin S.S., Vilisov M.V., Sazonova E.S. and others.


The work deals with the present-day condition of the state investment policy in Russia, its peculiarities and main miscalculations and the scheme of their elimination by the creation of the State off-budget investment and credit fund of RF.

The special feature of the monograph are the concrete proposals on improving the Russian legislation in form of federal laws projects, governmental regulations.
S.S. Sulakshin

Russian economy: from raw materials to knowledge (technology of transition).


In this monograph the quantitative scientific instruments for the description of the type of national economy on the scale «raw materials economy — intellectual economy» is implemented. Russian economy is diagnosed as being in process of steady degradation towards raw materials economy.

An active state governance technology able to bring Russian economy on the way of diversification and innovatisation is proposed.

V.I. Yakunin, S.S. Sulakshin, M.V. Vilisov, V.I. Kushlin


In the monograph the normative and virtual state system of the governance of economic development in Russia is analyzed. Significant disadvantages and problems are revealed, concrete recommendations able to create an effective mechanism of economic development governance are proposed (for the early 2008).

I.B. Orlov, S.S. Sulakshin, I.Y. Kolesnik, M.V. Vilisov

State of social humanism — from theory to practice.


Basing on a large body of historical, legislative and statistical material the authors unfold the main stages of formation and realization of the concept of a social state in Russia and abroad. A comparative analysis of constitutions, as well as economic, social and demographic policies of a number of countries demonstrates how great is the influence of historical, religious and cultural traditions on understanding the essence and mechanisms of social relations and social policy. A new concept — that of social humanism — is introduced that develops the approaches based on social justice.
S.S. Sulakshin, V.N. Leksin, A.N. Shvetsov and others.


In the book the results of research of actual problems of social-economic development of Russian regions are presented, as well as the researches of the effectiveness of the main approaches to solve these problems in the network of state regional policy. The well-grounded proposals on improvement the system of governance measures in this sphere are given.

V.I. Yakunin, V.E. Bagdasarian, S.S. Sulakshin


The monograph poses the question about connection of Russian state economic policy and civilization-value historic accumulations of Russia. In comparison to the traditional economic theory, new methodological approaches are proposed and the theory of civilization diversity is formulated.

The possibility of creation in Russia of the spiritual economy of new type is substantiated. The question of specific Russian work ethic is worked out, its mental and religious grounds.

With the use of historic-statistical series an optimal model of Russian public economy administration is determined.

A.V. Kashepov, S.S. Sulakshin, A.S. Malchinov


The monograph presents results of a research on actual problems of labour market in Russian Federation. The effectiveness of the used instruments of the state employment policy is estimated, administrative solutions for lowering unemployment and improving public administration efficiency in the employment sphere are proposed.
S.S. Sulakshin, B.B. Rubtsov, M.A. Abramova and others.


The work reveals the role and condition of financial markets, peculiarities of the actual state policy of Russia in this sphere, its achievements and main miscalculations, the sharpest problems, affecting the development of financial markets are marked out and the ways of solution are put forward. The specific features of the monograph are concrete proposals on improving the existing Russian legislation.

V.I. Yakunin, S.S. Sulakshin, V.E. Bagdasarian, M.S. Netyosova

Education as a factor of economic development.


The monograph studies the problem of correlating the policy in the sphere of education with tasks of economic development.

On the vast statistic material the deprofessionalisation of educational process out of touch with the requests of market economy is shown. The knot problems of the Russian educational system are revealed.

The comparative materials about the development of foreign educational systems are presented.

The authors propose a principally new approach to considering education as a part of an integrated economic process, as a factor and resource for economic development. The practical result of the research is a package of proposed public administration solutions, including normative acts.

V.V. Simonov, S.S. Sulakshin, I.V. Podporina, M.Y. Pogorelko

Budget and taxes in the economic policy of Russia.


In the monograph the theoretical and methodological grounds of state budget and taxes policy and its virtual state in modern Russia are examined.

The main trends are identified for 2007 and prognosed till 2010. A conclusion is made that Russian taxes and budget systems and policy need significant modification. Concrete proposals for perfection of Russian legislation considering revealed problems are grounded in form of so called governance-problems matrix — original methodological product of Governance and Problem Analysis Center.
Economic doctrine of Russian Federation.  
The collective work of the Center proposes an unprecedented for Russian practice project of a normative legal act of doctrinal level, defining economic development policy of Russia. Economic doctrine of RF is a document of new type, determining the administrative content of the state policy — including the strategic perspective — and is formed for 2007 as a qualifying date. Doctrines in other areas of public administration can be constructed basing on its model. Initiatory normative packet meets the case of the regulations of legislative procedure and is ready for official adoption.

The monograph published by the Center — is a dedicated expert scientific research, unifying methods and knowledge of abstract sciences (philosophy, history, law, physics and mathematics), applied sciences (economy, political science, sociology, psychology, demography, ecology, management), sectoral sciences (according the forms of economic activity and other segments of economy) and special methods of state governance practices planning. The applied methods of analysis, results verifications, prognostication of the results of proposed governance decisions heighten the practical meaning of the work.  
In common, more than 30 separate directions of social-economic development of the country and corresponding segments of state governance policy were examined, in which some 550 specific values, aims, problems and tasks were identified, the solutions were found and doctrinal positions for each of named directions were proposed.

Economic competition is one of the most important institutions of modern market economy. For development of this mechanism it is necessary to work out and implement some sensible public policy. A clear and systematic legislation on stimulation and protection of competition is needed as well. The monograph studies these and other problems of state regulations of competitive economic relations.

In the second volume a program of public administrative actions for protection and stimulation of competition in RF will be expounded.


The collective two volume monograph is a result of complex investigation of problems of corruption and shadow economy in modern Russia. Authors’ collective proposed a new approach how to oppose the named occurrences. In this research the corruption and shadow economy are presented as interrelated and engendering each other phenomena. The problems of corruption and shadow economy are considered in the framework of six types distinguished as self-sufficient identifiable corruption and shadow phenomena: personnel corruption, economic corruption, merger of business and authorities, ideological corruption, customary corruption, shadow economy.

In the second volume a program of public administrative actions against corruption will be expounded.
V.I. Yakunin, S.S. Sulakshin, V.E. Bagdasarian and others.

**Governmental demographic policy to meet the crisis.**

The collective monograph is a fundamental research work on the Russian demographic crisis. The authors of the book propose a four-factor model of demographic development which allows adequate understanding the nature and explaining the peculiarities of the Russian demographic crisis. The conclusion made by the authors on the basis of mathematicaly verified analysis is the following: demographic behaviour in Russia is manageable and the crisis might be overcome. On the basis of research, the book proposes efficient administrative decisions with accompanying documents which, if applied, can make the anti-depopulation policy more viable.

V. Makarov, A. Bakhtizin, S. Sulakshin


The book gives an exposition of the theory of CGE models and full description of four models of this class concerned with different aspects of Russia economy. It also contains a detailed analysis of the advantages of CGE models over other methods of modeling economy and describes some basic details of their building. The questions of gauging CGE models, mechanisms of their functioning and most known methods for their numeric resolution are considered separately. In the last chapter, the results of calculation of consequences of realization of various administrative decisions are given.

**Scientific seminars of the Center (Proceedings).**

Governance and Problem Analysis Center has been conducting regular scientific seminars, that have interinstitutional, interdisciplinary character for already 10 years. Their participants — well-known lawyers, mathematicians, physicians, political scientists, economists, philosophers, historians, experts.