

Carnegie Corporation of New York
**Russia Initiative: Reports of the Four
Task Forces**



THE RUSSIA INITIATIVE, A PROJECT OF CARNEGIE CORPORATION OF NEW YORK, IS A MULTI-DISCIPLINARY ASSESSMENT OF RUSSIA'S POLITICAL, ECONOMIC AND SOCIAL CHALLENGES TODAY.

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Introduction

Carnegie Corporation has a 50-year history of association with, first, the Soviet Union, then Russia and other successor states. The Corporation's Russia Initiative was launched in October of 1999 in the realization that, as Russia's economic, political, military and social situation deteriorated, we could not continue to conduct business as usual with respect to our grantmaking activity in that country. Further, the Russia Initiative was born in a climate of increasing "Russia fatigue" in the U.S., a malaise that led to a somewhat disingenuous debate over "who lost Russia." As this debate continues to unfold, there is the danger that the unwarranted optimism of the post-Communist years of the early 1990s will be supplanted by an equally unjustified pessimism about Russia's future. Under the influence of this mood swing, policymakers in both Russia and the West currently appear to be at a loss about how to interact and about what kind of relationship Russia can, or should now have, with the western world.

To play at least a small role in addressing this impasse, our Russia Initiative was aimed at undertaking a comprehensive assessment of Russia's internal developments and offering this assessment to policymakers and the informed public in both countries. Our intent was to base this assessment on "out-of-the-box" thinking: going beyond the situation where bankers talk only to bankers, security experts only to other security experts, and so forth, with the goal of presenting a holistic picture of Russia. The vehicle for this project consisted of four study groups, each of which was charged with analyzing a specific aspect of Russia's national life.

The four groups were organized as follows: The first examined the relationship between Russia's economy and her military, considering the conundrum of how the country's economic decline has undermined its military capacity, while at the same time its security needs drain the economy and thwart economic reform. The second group looked at the interplay between economic reform and political democratization, asking whether these two are mutually necessary (as has been generally assumed) or whether they may, in fact, work against each other. A third group took on the issue of social cohesion in Russia, wherein the period of transition has witnessed extreme social stress, including an upsurge in death rates (and a declining birth rate), suicides, poverty, drug and alcohol abuse, and consequent family breakdown. Finally, a fourth group analyzed the center-region relationship and the future of Russia as a state, considering extreme possibilities from the fragmentation of the Russian Federation to the reimposition of Soviet-like central authoritarian control, with a host of less draconian options in-between.

Each group has now completed its report, and we are pleased to present them in these pages. An overarching report, synthesizing the findings of the four study groups, will be issued by the Corporation in early 2001.

Carnegie Corporation understands that Russia is a moving target and the conclusions in these four reports may be overtaken by ongoing events. We also acknowledge that our ability to influence Russia's future—or even its present—is, of course, limited. This Initiative, however, was undertaken in the Corporation tradition of harnessing the best analytical research and bringing it to the attention of policymakers. We hope we have fulfilled that mission; we know that those who worked on these reports brought their best efforts and most thoughtful deliberations to the task.

Project on Problems of Engagement: Russia's Security, Economic and Banking Crises

Report by

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During the twentieth century, Russia and the United States, both as allies and as antagonists, shaped the destinies of most of the world. Today it might seem that this crucial relationship between the two countries has lost most of its relevance to the world and even to the two countries themselves. After a decade of grueling transformation, Russia finds itself in a position of weakness, while the United States is firmly established as the only remaining superpower in the world, enjoying unprecedented levels of prosperity and military power. Yet to see the relationship as waning in importance to the United States is to make a mistake. Russia's potential is great. It can become either an integral part of the international network of security and economic relationships, or a major source of international instability and criminality. It is in the U.S. national interest to make certain that Russia chooses the path of constructive integration and transparency in its dealings with the surrounding world. This path would lead the United States, Russia and the international community as a whole to a more secure and prosperous future. For the United States to lead the way, it needs to choose engagement and comprehensive dialogue in its relationship with Russia.

This policy of engagement has to be guided by realization of the great positive potential of the two countries, as well as by awareness of their similarities. As far back as 1835, Alexis de Tocqueville, in his seminal work *Democracy in America*, wrote insightful words that still ring true today:

There are now two great nations in the world which, starting from different points, seem to be advancing toward the same goal: the Russians and the Anglo-Americans.

Both have grown in obscurity, and while the world's attention was occupied elsewhere, they have suddenly taken their place among the leading nations, making the world take note of their birth and of their greatness almost at the same instant.

All other peoples seem to have nearly reached their natural limits and to need nothing but to preserve them; but these two are growing. [T]hey alone march easily and quickly forward along a path whose end no eye can yet see.

The American fights against natural obstacles; the Russian is at grips with men. America's conquests are made with the plowshare, Russia's with the sword.

To attain their aims, the former relies on personal interest and gives free scope to the unguided strength and common sense of individuals.

The latter in a sense concentrates the whole power of society in one man.

Their point of departure is different and their paths diverse; nevertheless, each seems called by some secret design of Providence one day to hold in its hand the destinies of half the world.

As the twenty-first century approached, the paths of the United States and Russia seemed to be converging. Russia ceased to fight with its own citizens, and began the transition from a centrally planned, highly militarized command economy, where power was concentrated in the state, to a market economy, such as has developed in the United States, where the power of society is derived from the efforts of individuals pursuing their personal interests. A command economy is generally based on the premise that individual good results from decisions by public authorities, which allocate limited economic resources according to their perception of the public good. A market economy is generally based on the premise that the public good results from individual decisions in the market, which allocates limited economic resources under the constraints of supply and demand. The transition of Russia from the “sword” of a command economy to the “plowshare” of a market economy, which began in the late 1980s, has resulted in an all-encompassing crisis, which has affected every aspect of Russia’s society and politics.

Throughout the 1990s, the collapse of industry, multiple monetary crises, and ever-deepening poverty of the population have been the dominant themes of Russia’s economic life. Although economic performance has recently picked up, with greater than seven percent GDP growth registered during the first half of 2000, there is a lively debate about how long the improvement can last, especially if oil prices decrease and the ruble continues to strengthen. There are still deep structural problems both with the Russian economy as a whole, and with the ability of its legal system to support and foster market activity.

An equally, if not more, alarming situation can be observed in Russia’s security sphere. The end of the Cold War brought about the end of Russia’s claim to being a military superpower. As a consequence of the decreased emphasis on security, the upheaval of massive relocation of front-line troops from former Warsaw Pact allies back to Russia, and growing economic pains, its military entered a period of decline and increasing disorganization. The military budget has decreased dramatically. At less than three percent of the GDP, a budget of U.S.\$20 billion (calculated on the basis of purchasing power parity) is spread thinly across more than one million troops. Most of the needs of the military, even at the most basic level of upkeep, have routinely not been met. Physical equipment, including the highly sensitive support system for strategic weapons and early warning, has been deteriorating. There is widespread demoralization in the military, which is seen in such disparate manifestations as massive draft dodging, high rates of “brain drain” and the lack of public respect for the military. The disaster with the submarine Kursk in the summer of 2000 made many of these problems painfully clear.

In the international arena, the environment confronting Russia has not been entirely favorable. Although Russia’s new statehood was widely cheered in 1992 as a great hope for democracy and international peace, the reality turned out to be much different. Western nations, the United States in particular, had elevated expectations and, as a consequence, suffered much disappointment

when Russia's transformation turned out to be less smooth and less fair than was hoped in 1991 and 1992. The United States' reaction was two-fold. First, a policy of benign neglect was pursued towards Russia, accompanied by hollow rhetoric of engagement, often based on personal rapport between the leaders of the two countries. Second, the United States continued to pursue what it saw as its interests in the world without reference to Russia's position, even when Russia was strenuously opposed to U.S. actions. The most evident examples are the expansion of the North Atlantic Treaty Organization (NATO) to include some of the former Eastern bloc countries, and U.S.-led NATO operations in Kosovo. One could also cite the American approach to the Caspian Sea oil issues and to Russia's engagement with Iran. A decision by the next U.S. Administration to move forward on the U.S. National Missile Defense (NMD) program, designed to create a "nuclear shield" that would protect the United States from low-level nuclear attack, would fall into this category. The net effect has been negative: Russian-American relations, after a brief honeymoon, have been steadily deteriorating since the collapse of the Soviet Union. This perception of a negative international environment has heightened Russian insecurity and has imposed additional high demands on its military.

The military cannot meet these demands. It cannot perform the traditional missions that are essential to the country's security—air surveillance, defense of airspace, territorial defense against external invasion, border control, and maintenance of internal cohesion. Under standard contingency planning, which requires the Russian policy-makers to assess their capabilities against the possibility of NATO or Chinese threat, Russia's military resources appear insufficient. The sole exception is nuclear deterrence. Yet, Russia's deterrent force is disproportionately vulnerable to a preemptive attack from the United States. As a result, Russia is using rapid reaction policies to assure sufficient retaliation to sustain the deterrent effect. This is an inherently unsafe force configuration. Moreover, it is highly susceptible to corrosive effects of inadequate financing. Thus even the mission of nuclear deterrence is becoming more burdensome and problematic to sustain in the face of economic austerity.

The economic crisis expresses itself in various subsets of crises, one of the most significant of which is the ongoing malfunctioning of the banking sector. Without a viable and healthy banking sector, which serves as a highly efficient allocator of financial resources, a strong market economy cannot develop. Yet the banking sector has been one of the most volatile and least transparent parts of the new Russian economy. Originally tied to economic interests that emerged from the collapse of the Soviet state, most large banks were closely linked with an oligarch or a group of oligarchs. Such banks became the cores of large financial-industrial groups. Their visibility, their corruption and lack of accountability, the fact that they did not provide services to the population at large, and the fact that many depositors lost their savings after the August 1998 crisis made banks the symbol of everything that was bad with Russia's nascent capitalism. Public trust in banks has been severely eroded. It will take a long time to restore this trust.

Structurally, the banking system did not conform to the basic requirements for a viable banking system in a market economy. The banking system suffered from structural deficiencies that contributed to the profound crisis of August 1998. The Central Bank of Russia (CBR) was at the core of the problem. Its standards for granting licenses to banks were lax, as was its implementation of its bank supervisory responsibilities. A banking system with too many banks, most of them weakly managed and poorly supervised, operating in an economy with a declining real GDP over several years, cannot be sustained. As a result of that crisis, most of the major, so-called "oligarch," banks went bankrupt, frequently engaging in activities that further undermined public trust

in the banking system, such as the stripping of good assets from the banks and transferring them to new legal entities, thereby leaving regular customers of the defunct banks with no access to their savings. Fundamental problems in the banking system persist. The CBR lacks the administrative resources and political will needed to tackle many of the problems that it confronts. The relative importance of the banking system in the economy remains very low. There is a chronic crisis in the banking system.

The observable crises in economics, security and banking are only three subsets of the overall phenomenon accompanying the massive Russian transformation. Although “crisis” might not be the best term, due to lack of one discrete event that this term usually denotes, the phenomena attendant to the Russian transformation are of crisis proportions. Moreover, it is our belief that the basic negative developments in Russia’s economy, security sphere and banking sector can lead to an actual discrete crisis event—a major upheaval, a social eruption, a disastrous accident—at any point. This makes the term “crisis” justified. There is no reason to believe, however, that the occurring transformation is subject to the acute time pressures connoted by the word “crisis.” As the problems confronted by Russia today are massive, the transformation is of such a scale that it can only occur over a long period of time.

The crises in the three spheres under consideration here—as well as in other spheres outside of the purview of this project—are tightly linked. However, analysts of any one of these fields rarely have an understanding or appreciation of the challenges facing other spheres. Exploring these linkages among the security, economic and banking/financial sectors, and arriving at a better understanding of the joint nature of challenges facing them, are two major steps towards being able to address the challenge of Russia’s transformation itself, and to come up with U.S. responses that are likely to yield most beneficial long-term results for the bilateral relations as well as for both countries individually.

We see the multi-layered structure of linkages as the framework for this study effort. In Russia today, the sense of overall security is crucial to allowing society to focus on economic, banking/financial, legal and other reforms. Easing the military security burden of Russia is imperative for the military to be more capable to deal with security threats and to distribute scarce fiscal resources in the most considered and efficient manner. Easing the burden of military security would also greatly contribute to increasing the sense of overall security in Russia, thus making the focus on the country’s overall transformation psychologically easier for its leaders and population. Economic growth and development are necessary to improve Russia’s overall security environment and to make Russia’s integration into the international system plausible. Finally, banking reform is necessary for economic growth and development.

Political considerations, although of critical significance, are outside of the purview of this project. Democratization, or the process of increasing the basic responsiveness of political institutions to pressures from interest groups and society at large, through regularized “rules of the game” that include elections, is a crucial component of the future development of Russia. Moreover, strong and visionary political will is clearly necessary to use the frameworks of analysis we suggest and to implement the policies we recommend as beneficial to the United States, Russia and the international community.

Russia and the Globalizing World

It is our belief that the most fundamental and pressing concern for Russia is to integrate into the international economic system, which is rapidly undergoing the process of globalization. Globalization is a trend toward increasing interdependence among economies and societies of the world. This process of global economic integration has enormous political and social consequences. As a result of globalization, traditional security considerations, historically bound to relative military strength and hence a state's capacity to successfully repel direct military threat, usually a foreign invasion, and to credibly exert military influence outside its borders, are being superceded by economic considerations, that is, by relative economic strength and hence capacity to compete in and benefit from international markets for goods and services.

Globalization is a set of objective phenomena, which include dramatic efficiency gains in processing information; a surge in human population (on average, by about one billion people added to the total world population every twelve to fourteen years, from 1950 to about 2025); an economic growth pattern where the top twenty percent of the world's population, mostly concentrated in the so-called West, experience rapid wealth growth, leaving the rest of the world behind; and, attendant to the above, the need to increase energy production by three times, and food by two times from current levels, by 2050, while not destroying the fragile environmental balance.

Globalization is fundamentally a process of integration. As Thomas Friedman writes in *The Lexus and the Olive Tree*, "globalization . . . is the inexorable integration of markets, nation-states and technologies to a degree never witnessed before—in a way that is enabling individuals, corporations and nation-states to reach around the world farther, faster, deeper and cheaper than ever before, and in a way that is enabling the world to reach into individuals, corporations and nation-states farther, faster, deeper and cheaper than ever before." Although political and social integration are important, it is economic integration that is at the core of this trend. As a result, priorities of individuals, companies and states change to accommodate—and to benefit from—the economic forces of integration that gradually erode the control the states have over their own actions within the international system as well as over the individual choices of their citizens.

Globalization is an international systemic phenomenon. Russia's policymakers, oriented primarily towards promoting internal political and economic development throughout the period of transformation, probably find it difficult to take account of global trends. Not being leaders of globalization, they have tended to make decisions ignoring the assumptions of interdependence and of preeminence of economics. Yet, regardless of the preferences of Russia's leaders, Russia has operated and will continue to operate within an international system. Developments in this system will affect Russia's policy choices—at least the courses of action open to it in international markets and in the international arena. Russia's policy-making community, as well as the Russian people in general, must take into account new challenges and rewards inherent in the globalized, increasingly

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high-tech world if Russia is to reform and to perform successfully for decades to come. Isolation is not a path to modernity and prosperity in the globalized world.

Russia's integration into the globalizing economy is imperative for several fundamental reasons. First and foremost, it is necessary in order to sustain and assure the internal cohesion of Russia's society and polity. A Russia that is a loser in the globalized world would be a poor country, ravaged by numerous economic ills and without recourse to a cure. In the twenty-first century, development will be ever more predicated on access to international flows of information and capital. The cost of not integrating into the world economy is exclusion from these flows, with grave consequences for the ability of a society to function effectively. By definition, a country on the fringes of the globalized world is not internationally competitive. This would lead to continued poverty for the majority of Russia's population, with the government playing the leading role in economic activity in the country. A pattern of criminality is likely to become more entrenched in Russia if the process of market adaptation is not completed. Even if that development were restricted primarily to economic corruption, already a major problem that needs to be addressed urgently, it would still pose a threat to the legal standards necessary to operate in the global economy successfully.

Second, a failure to reform domestic legal, economic and social systems in line with demands of the international system in order to facilitate their integration into global networks might lead to wide-scale violence on the territory of Russia, with spill-over effects into the neighboring states and, by extension, to wider Eurasia. Internal economic weakness caused by exclusion from the international system could prove to be sufficiently serious to degrade the fundamental elements of civil order. The process of erosion of social cohesion and of depletion of social capital has been well underway for the last decade, with alarming trends in demographics, health, education and general disbursement of social services to wide segments of the population. Collapse of social cohesion and of civil society, understood broadly as systems of social, moral and legal support that sustain collective life of a population, could be expected to generate major outbreaks of communal violence. Russia's southern borders, and its integrity generally, could be threatened. Its nuclear arsenal could be misused as internal managerial control over it weakens and becomes insufficient. Russia's disintegration is not in the interest of the United States and its allies. Neither is broad-scale mismanagement of Russia's immense nuclear potential. The United States, Western Europe and Russia itself should do everything in their power to prevent this negative scenario from unfolding.

Third, Russia is likely to become a key test case for the effects of globalization overall. As a country that finds itself outside large international markets, it needs to integrate itself. Yet, it has a very small economic base (roughly two percent of the U.S. economy) and carries a very high international debt burden. As a country with a poor but well-educated population, it can demonstrate whether catching up with the developed world is viable. Russia also has the largest traditional security burden in the world: it has the largest territory in the world, generally not shielded by mountain ranges or large bodies of water; it borders on many of the world's pivotal regions, including some of the most volatile ones; it has the longest land boundary; and it has a relatively small population, thinly and unevenly spread. As a country facing such major challenges, it would seem to be in an excellent position to demonstrate whether traditional security concerns can be relieved and supplanted by economic cooperation and competition, in a situation where its own military establishment can no longer carry the traditional burden it inherited. Globalization offers a tool to come up with new terms for Russia's transformation.

Globalization raises the stakes of Russia's transformation. A failed Russia, outside of international economic and political regimes, would be a major factor of instability. Characteristics that make Russia carry the largest security burden also make Russia a pivotal part of the international community of nations: instability in Russia, or Russia's aggressive behavior, would have wide-ranging consequences. The international system would be put under tremendous strain if Russia were not able to engage in productive discourse with other countries of the world. Moreover, Russia can be seen as a test case for the power of globalization. A country of such dimensions and potential as Russia cannot be a permanent "exception" to a global phenomenon. Moreover, a failure in Russia—a failure to marketize and to integrate—is likely to spell trouble for some of the other complex multi-ethnic polities, with traumatic and turbulent histories and multiple political and ideological legacies. A failure in Russia of market reform and political democratization, frequently seen as the two chief aspects of globalization, might make globalization appear a less universal and assuredly positive phenomenon than was previously thought.

To summarize, *for Russia, for the United States and for the world as a whole, Russia's successful adaptation to the international market is a central imperative both for economic and for security policy.*

Globalization and the Concept of Security

Globalization requires redefining the concept of security. Within the framework of globalization, the three sectors under consideration in this report—the traditional military security apparatus, the real economic sector, and the financial and banking system—assume different significance. Although the military is crucial to any state's traditional vision of security, it is economic strength that defines a state's relative weight in the new international system. There is no doubt that a high level of economic performance and technological achievement generally means high military potential. The examples of Germany and Japan spring to mind. (Certain countries, such as Singapore, although probably capable of turning their technological superiority to military use, have their military capabilities thwarted by their size and location.) But in the globalized world it is not necessary to maintain high numbers of men under arms, or to have high military procurement budgets, unless a state assumes the overarching global security responsibilities currently shouldered by the United States. Russia currently may aspire to such a role, but it does not have the resources needed to take on and sustain that position. Russia's leaders and people must turn their energies to attaining comprehensive economic recovery and growth. This is both imperative and timely. *Thus, Russia's vision of its security has to be redefined, with economic security being at the core of the new concept.*

Although the military is crucial to any state's traditional vision of security, it is economic strength that defines a state's relative weight in the new international system.

A key problem Russia confronts today is its weak economic base. Deterioration in Russia's military security establishment can be traced to the dramatic plunge in budgetary resources allocated to funding national defense. Lack of money is evident in every sphere of Russia's national defense establishment. From low pay for the officer corps, to deterioration of nuclear facilities, to erosion of some of the traditional communications networks, to collapse of military research, development and procurement, the lack of funds is evident. Social deterioration attendant to economic

collapse leads to the plummeting prestige of military service. High levels of unemployment in the civilian sector make it more difficult for the military personnel to adjust to cuts in the ranks. Military research institutes and design bureaus lose highly qualified scientists and designers to foreign companies or to the pervasive phenomenon of “dropping out” of social and professional life. The military-industrial sector is also attempting to stave off collapse by selling arms abroad to practically any paying customer, often to the detriment both of Russia’s own long-term security interest and of its relationship with the West. In other words, lack of funding undermines every segment of the military security establishment of Russia.

Delay in economic development is preventing military reform, which is necessary to increase Russia’s sense of its military security. The same retardation of economic reform and growth promotes the anemic state of Russia’s nuclear forces. An important element of the general failure of economic development is the lack of transparency in the legal and fiscal foundations of Russia’s state and economy. This profound lack of transparency of foundations cultivates a “culture of corruption,” which hampers Russia’s ability to attract investment and to promote economic and military cooperation, and, hence, development. In military budgeting, pervasive secrecy also has fostered graft and embezzlement, further undermining the morale and impoverishing the troops. One of the Russian policymakers’ chief tasks on the path to successful integration into the world economic and security regimes must be to clarify the legal foundations of economic decision-making and to promote the culture and practice of transparency.

Experience over the last ten or so years—the period since the collapse of the Soviet Union—indicates that the process of market adaptation in Russia will be more difficult and more time-consuming than originally assumed by most policymakers and observers in Russia and in the West. Seventy years of central planning, of which the last fifty years were heavily dedicated to military development, created a rigid and inefficient industrial structure. This structure operates very far from market conditions, and generally persists in ignoring the dictates of the new economic conditions in Russia and globally. Adaptation of this industrial structure, and attendant transformations in the social, political and military spheres, would require a much more wrenching effort than any other major society in the world currently faces or has yet undertaken. Few of the former state enterprises and social networks that depend on them would be able to adapt to market standards. There is an urgent need to attract new foreign capital, without which the necessary restructuring of Russia’s industry will take a much longer time and will be considerably more painful for the society. Russia’s economy as a whole is unlikely to adapt successfully to the international market system without a large-scale, extensive and constructive program of international engagement.

Economic Engagement

This engagement has to be in the spheres of both economics and military security. Both are crucial. Economic engagement must be promoted and deepened for its own sake. At stake is Russia’s place in the process of global economic integration. Some of the most informed Russian observers state that Russia is now choosing a place for itself in one of three primary civilizations of the world, to borrow from Samuel Huntington. These civilizations are broadly and imprecisely termed as Western, Islamic and Asian. According to these observers, although Russia’s current level of economic development is far behind the West’s, politically, socially and culturally it has been, in terms of its history and intellectual antecedents, a part of Western civilization. Keeping and assuring its place in Western cultural and economic life today and for the future is an issue of economic

integration. That is, economic engagement has to be promoted and fostered for its own sake, not as a corollary of traditional security cooperation.

Russia's primary need today is for a healthy—viable, efficient and transparent—market economy. Improvement in the economic sphere is likely to bring about an overall improvement in Russia's fortunes. On the military security side, high levels of economic development and growth will yield higher budget revenues, which, in turn, will allow more money to be allocated to national defense and to the military industrial sector. Combined with prudent manpower reductions and other military reforms, the modernization and strengthening of the military sector are likely to take place more rapidly and somewhat less painfully, while the already existent equipment is likely to be better maintained. Socially, the improved economic situation is likely to have the same positive ripple effects, with both private and public spending on health, education and other social services increasing. Building of a healthy market system is impossible without laying down solid and reasonable legal foundations and defining the rules of the game. The process of marketization will have to go hand-in-hand with defining the legal space for Russian political, economic and social actors. Ultimately, a greater sense of internal security, closely linked to the economic well-being of the population and, by consequence, of the state, will be important in helping Russia find a place for itself in the international system, which is essential if Russia is to be secure when looking at its international situation.

International financial markets, one of the most powerful manifestations of globalization, exert a significant part of their influence in Russia (and in other countries) through banks. The strength and transparency of the Russian banking system are thus pivotal to Russia's security. Through banks, linked into international markets and able to compete successfully, the capital for economic development can in theory be attracted to Russia. The state of Russia's economy, in other words, is directly related to the health of its banking system.

Moreover, sustained economic growth is impossible without an efficient and healthy banking sector. Commercial banks play a pivotal role in any market economy. They serve several crucial purposes. Banks intermediate between savers—those with funds to invest—and creditworthy entities or individuals in need of such funds who endeavor to put them to good economic use. Banks thus provide the necessary currency for economic activity. They also provide safe haven where individuals and businesses can deposit funds they do not currently need, as well as a safe and efficient means to complete payments and funds transfers required to support real economic activity. Through the multiplier effect of the credit-extension process, the banking system creates money that will stimulate economic growth. Finally, a functioning banking system provides a highly effective vehicle through which the Central Bank can implement monetary policy. In short, a market economy needs to have banks at its core, providing a safe repository for savings, allocating financial resources in an efficient and productive manner, and providing a reliable, cost-effective source of funds to finance economic growth.

The Central Bank is to the banking and finance sector what the Ministry of Defense is to the national security sector. It is at the very core of the system, with responsibility for oversight and regulation. The issues of overall reform and strengthening of the banking sector, and of ensuring that a strong, independent and respected Central Bank functions at its core, should be at the center of the Russian reform effort.

The goals of economic engagement of Russia and of economic growth in Russia are the same: to improve the quality of life for Russia's citizens, to insure the safety of its nuclear arsenal, and to make certain that this immense country is a constructive part of international society, not a poten-

tially threatening pariah. To attain these goals, it is necessary for Russia to become an integral part of the global commercial and financial networks. There is no other way. With help from the United States and other Western countries, Russia must take the path of globalization.

Economic engagement has to happen at the same time as traditional security engagement. Due to its economic crisis, Russia's conventional weakness, its over-reliance on nuclear forces, corruption in all spheres of its society including the military and the banking sector, and declining investment in its military upkeep, research, development and procurement are all on the cusp of becoming irreversible. Rapid domestic economic recovery might not lead to military improvement in the short-term, as economic recovery is likely to affect sectors other than the military-industrial sector in the first place, while government priorities in allocating budgetary revenue are not guaranteed to be on the military's side. In order to allow for a sustained military and economic recovery, large-scale security engagement is also necessary.

Security Engagement: Russia's Military Weakness

If the economic transformation is to be successfully undertaken in Russia under the impetus of globalization, it must be accompanied by credible security assurances. This is so for several reasons.

First, with its small economic base, Russia cannot equip and sustain the military establishment it inherited from the Soviet Union. Yet, as noted before, it still carries the largest traditional security burden in the world. That establishment, even if not under-financed, could not under current geo-strategic circumstances reasonably expect to perform the basic missions required under traditional contingency planning. These, most notably, are: air defense against NATO's potential in the West, ground defense against China's potential in Siberia, and the management of communal violence in the North Caucasus.

National survival and preservation of territorial integrity are, traditionally, the two primary and overriding goals of the state. Russia is no different. Its leaders have to think about its security and about threats to its well-being coming from the outside. The world surrounding Russia is not outright hostile, but it is not friendly. Having lost its alliance partners and being surrounded by former constituent republics of the Soviet Union, which were at some point colonial provinces of the Russian Empire and generally harbor little good feeling for their bulky neighbor, Russia finds itself with few friends. To compensate for its loss of great power status, Russia has built its foreign policy on jealously guarding its great power image—on a high level of rhetoric. The clash between its capabilities and its historic vision of itself is at the core of Russia's foreign policy predicament.

To compensate for its loss of great power status, Russia has built its foreign policy on jealously guarding its great power image—on a high level of rhetoric.

In the international arena, Russia faces the world's sole superpower, the United States, and its alliance, NATO, both in a position of unprecedented dominance. In the view of many in Russia, the United States, while claiming to have the interests of the world at large at heart, fails to exhibit "global responsibility." Failing to exhibit "global responsibility" connotes the United States' habit of acting unilaterally when multilateral action is problematic and when opposition is encountered, and its tendency to disregard objections from countries such as Russia when conducting its foreign policy. It is this Russian view of nascent

isolation from the rest of the world and perceived passive hostility from the United States that fuels Russian resentment and increasingly prompts Russian leaders to use ever more stringent rhetoric in their pronouncements.

Russia's economic insecurity, which makes it impossible to afford high levels of traditional security, reinforces Russia's psychological insecurity, increasing its policymakers' concerns over the international environment. In other words, seeing the strenuous limitations that Russia's economic collapse imposed on maintenance and development of Russia's security capability, Russia's leaders are more attuned to perceiving threats, especially from the rich countries of the West. A sense of falling behind the United States and its allies, especially in the economic and military spheres, fuels Russia's resentment and sense of insecurity: Russia's leaders recognize that if there were ill intent from the West, Russia has very few conventional avenues for countering it. Russia's growing reliance on nuclear weapons in the face of its conventional weakness will scarcely alleviate Russia's fundamental insecurity, and if anything will retard the process of security cooperation leading to economic engagement with the West. Alleviating Russia's profound sense of insecurity is imperative before normalization of ties between the United States, its allies and Russia, with subsequent reinvigoration of Russia's efforts at economic reform and integration, could be expected.

Russia also cannot safely and indefinitely sustain its current deterrent force operations. Economic weakness, which already necessitates Russia's over-reliance on nuclear weapons, also complicates the upkeep and management of its nuclear arsenal. Nuclear units are under-paid, under-housed, under-equipped and under-trained. About eighty percent of the personnel of the strategic missile forces live below Russia's official poverty line. Other illustrations of the dire living and working conditions are too numerous to mention. A typical example is the inadequate training of nuclear bomber pilots. A Russian pilot receives an average of only ten to twenty hours of flight time per year, a small fraction of the flight training needed to ensure proficiency and safety. Continued economic hardship in a continuously stressful international environment will lead Russia's all-important nuclear arsenal to be maintained in existence while physical and human resources necessary to assure safety and effectiveness of these weapons decline. The repercussions of taking this path of development could be a tragedy on a global scale.

Challenges of Policy: Security and Russia's Transformation

Russian policymakers face a profound challenge: to attain a transformation of the state, economy and society, with few, and decreasing, resources at their disposal. There are fundamental trade-offs implicit in this situation. Broadly speaking, Russia's leaders strive to reach three goals: marketization of the economy, democratization of politics, and preservation of national security for the state. These three goals, however, are frequently at odds with each other. In a country with limited and declining budgetary and human resources, policymakers need to make hard choices. Judging by rhetoric and allocation of limited budgetary funds, in Russia so far the security sphere has been the relative loser. Pursuing the dual objectives of market economy and democratic politics, the Yeltsin administration continuously downgraded national security, allocating less and less resources to it, as well as generally failing to conduct the military reforms and to address security challenges in a successful manner. The Putin administration appears to place more emphasis on national pride and security, which will probably lead to greater rhetorical, if not actual, importance of the military. The recent decision by President Putin to slash the size of the armed forces to

improve its readiness, management and funding supports this view. We do not believe, however, that paying greater attention to Russia's security needs will necessarily mean a resurgence of authoritarianism.

In Russia today, it is difficult to allocate resources without favoring one of the components of the broader reform effort, and thus relegating one or two others to the secondary position. This is not to say, however, that the three goals—of market reform, of democratic reform and of military/security reform—cannot be pursued simultaneously. We strongly believe that they must be pursued together if Russia's integration into the international system is to succeed. The difficulty of doing so with scarce resources is the traditional difficulty of a government facing multiple demands and possessing few means to address all of them. Yet, the ambition of many in Russia, and the preference of many observers in the United States, is to see Russia not give up on any of the three major components of its reform, and to try to build on linkages among them to move forward.

Developments in security, economic and banking/financial sectors are clearly linked to the broad policy challenge just described. It is our belief that the goals of military reform and reform in the economic and banking/financial spheres must be pursued simultaneously, and supported by a broad popular mandate. Political considerations, and hence the imperative of democratization, are outside of the purview of this project, and are thus not discussed in this report. We believe, however, that democratic development is a necessary and crucial corollary to the developments we advocate. President Putin has a popular mandate to conduct reforms at the current juncture. Security, economic, banking and political reforms can and must go hand in hand.

Fundamentally, attempting to undergo a major social and political transformation means becoming more vulnerable. A society in transition, such as Russia today, is a society that is less able to muster its different resources for attaining any one goal, including the goal of security. Moreover, although today very few of Russia's fiscal resources go to the support of the military, there is a tradition in Russian security thinking advocating vastly increased military expenditure. To allow society to focus on peaceful and constructive transformation of the Russian economy, and to limit the influence of the "hawks" on Russia's policies today and in the future, the traditional security burden on Russia has to be made lighter.

A useful implication of the dilemma of having limited resources while undertaking a comprehensive reform effort is that more resources could be diverted to economic and political reform in Russia if the international environment were different, that is, if Russia's leaders perceived the international environment as being less hostile to Russia and its interests. These resources are primarily psychological. By improving Russia's international traditional security environment, Russia's total security will be improved. As a result, Russia's leaders and people will be able to concentrate on the tasks of economic, political, legal and social reform. This reinforces our position that full-scale military security cooperation is imperative for Russia to successfully attempt the next, more intensive stage of economic and financial reform.

The United States should play the leading role in improving the deteriorating relationship between the two countries. Having such a role means both taking the initiative in starting the constructive engagement dialogue, and being the more generally responsible partner. As the far more powerful and influential party, the United States could lead its alliance in engaging Russia more positively with rhetoric of cooperation and engagement, as well as with practical steps, which could include both economic and security cooperation measures. Improving the international environment could leave Russia to its internal, primarily economic preoccupations, focusing on which has been its dominant impulse over the previous ten years.

To reiterate, *if Russia is to protect the core security function that it must perform—responsible management of its weapons arsenals and of their supporting technical capabilities—and if it is to be assured that it can turn its attention to the challenge of integrating its economy into the international system, it will have to be relieved of its other security burdens, which are in any event unmanageable.* The primary security threat perceived by the Russians emanates from the West, and especially from the United States. Although the United States cannot “relieve” the total security burden on Russia (there still will be China and other potentially threatening areas on Russia’s borders), it can significantly ease it, through policies aimed at engaging and reassuring Russia. Importantly, Russia’s reactions to U.S. policies need to be taken seriously, with the goal of not allowing U.S. actions to lead to significant deterioration in the bilateral relationship, and hence to substantial increase in Russia’s sense of vulnerability.

In Russia, the military establishment will have to be reduced to a size that can be adequately financed without threatening the fundamental priority of economic transformation. The underfinancing of the Russian military has to be stopped, which is possible only if the numbers of troops are cut, and the security burdens are significantly reduced. Military security engagement must take place at the same time as, and independently of, economic engagement. If competition needs to be present in Russia-U.S. relationship, the competition should be economic. But engagement must be the chief priority for both parties, and for the world.

Engagement for Transparency

A successful outcome in Russia, or even a tolerable one, will require substantial constructive international engagement. It will also require more systematic and more penetrating transparency in Russia. *The United States and Russia have to strike a great bargain: greater transparency from Russia exchanged for engagement and broad security cooperation from the United States and Western Europe.*

“Transparency” is a concept that is frequently used in the context of discussing business practices and corporate governance. As defined in the April 1998 report of the Organization for Economic Cooperation and Development’s (OECD’s) Business Sector Advisory Group on Corporate Governance, transparency is a timely disclosure of adequate, clear and comparable information concerning corporate financial performance, corporate governance and corporate ownership. Transparency and globalization go hand in hand, as globalization requires information, and transparency assures access to information. Transparency is not only an economic and corporate concept, however. Transparency in political life requires access to information on budgets, funding of parties and politicians, and general decision-making procedures, not limited to those in the economic realm. Transparency is fundamentally about specified, clear and equitable “rules of the game,” with very few restrictions on releasing information into the public domain, with the attendant possibility by citizens and groups to use this information.

Transparency is the cornerstone of Russia’s successful engagement with the world on all levels. Transparency is a necessary condition for an efficient financial system. An efficient financial system is at the core of an efficient and competitive market economy. A competitive market economy is imperative for a country to be secure, successful, and well integrated in the globalized world system.

Similar dynamics apply in the sphere of security cooperation. Transparency on both the American and the Russian side is needed to increase trust. If we posit that engagement between

Russia and the United States is the dominant national security interest for both countries in their bilateral relationship and overall, the need for transparency follows. But as only the United States can provide sufficient security assurances and a sense of engagement and cooperation to Russia, so only Russia can provide sufficient levels of transparency to satisfy the Western security and investment/financial communities. As one cannot be half-efficient, so one cannot be half-transparent. Transparency is key to Russia's success.

Linkages

Linkages between military security and the economy are numerous. The following powerful but conflicting linkages define Russia's situation, and demonstrate the importance of the economic and banking/financial sectors to Russia's vision of a successful future.

- (1) Security is the dominant consideration of the state. Although the concept of security can be defined differently, it is reasonable to expect that a government would put any reform agenda aside if it perceives that the basic survival of the state is threatened. Informed recommendations cannot be offered without this realization. The task is thus to redefine security, not challenge its primacy in policymakers' thinking. We suggest that the economic component must be included in the new understanding of the state's security in the globalizing world. Moreover, economic security—the relative competitiveness of a country's economy in the international markets of goods and services—frequently becomes the dominant consideration of a state's policymakers, overriding more traditional military security considerations.
- (2) Similarly, the absence of external (and internal) security leads to greater societal tension. Attaining a high level of national security is thus imperative for successful reform of Russia's society and economic system. Without increased security, both in terms of the real situation and dominant perceptions, reforms could conceivably lead to a comparatively greater destabilization of the country, and plausibly to grave threats both to the basic organization of Russia, and to its territorial integrity.
- (3) In Russia, the military sector is the source of highest technologies and most promising cutting-edge research. According to one point of view, Russia has three different economies: a free market economy, comprised of new Western-oriented entrepreneurs; an old Soviet-style economy, made up predominantly of the oil and gas sector and governed by a barter system, which is a long-term threat to the economic health of the country; and an economy that is perilously perched somewhere in between—no longer operating according to the command and distribution rules of the Soviet economy, but not yet conforming to the rules and demands of Western-style free markets. This economy contains the remnants of the military industrial sector. At the same time, many, especially in the conservative and centrist segments of the Russian political spectrum, see this last sector as Russia's best hope to break into international markets. This hope seems at least partly justified. Reforming the inefficient high-tech enterprises and spearheading their competitive products' entry into the international markets should be a priority for forward-looking Russian businessmen and economic policy managers.

- (4) Yet, it was the military industrial complex, the mainstay of Russian industry, that was most heavily hit by the economic collapse of the 1990s. The collapse of the inefficient former state military enterprises (some of which are still state-owned) negatively affected both Russia's security capability and its economic situation. These enterprises are the points where economic and security crises merge into one, and spill over into other spheres. The difficulty in reforming these enterprises makes the Russian transition a more torturous and protracted one than was originally expected.
- (5) The security establishment has significant political and social influence. In Russia, the military is still a rather conservative sector. Although the military as an institution is not market-oriented anywhere, it is important for its ranks to share in the objectives of the state. In Russia, substantial numbers of military personnel do not see the objectives of a free market economy, an open society and democratic politics as attractive. For the moment, overall social reform of the military is unrealistic, yet it would be desirable to see the emergence of a non-political, professional, and democratically oriented military corps.
- (6) The social implications of the economic deterioration of the military are grave. The military (as well as non-military heavy industry) has traditionally been the source of livelihood and social infrastructure for millions of individuals. With the deterioration and collapse of funding for the security establishment, several processes started to take place simultaneously. A significant number of military personnel lost their incomes, due to downsizing or non-payment of wages and benefits. As a result, even if some of these individuals are not technically unemployed or underemployed, they are still outside the productive economic main stream of society. Assisting those who leave the military to adjust to their new, civilian lives should be an important part of general social adjustment that Russia has to undergo. The economy generating new jobs, and the former military personnel being re-trained, are necessary to help the military to downsize and reform.

The deterioration in the social prestige of the military is a related issue. Although traditionally the military has been one of the core institutions of Russian society, the military today is seen as lacking in value and prestige. The root of this shift is its economic degradation. A consequence is the increasing demoralization of the military, and an attendant heightening of insecurity for Russia.
- (7) Separate from the deterioration of equipment due to lack of resources for upkeep, economic hardship of the personnel could lead to negative security consequences on an international scale. Temptation to trade in arms, even in weapons of mass destruction, could become irresistible for a guard whose wages are barely enough to sustain his family, and even those wages are not being paid regularly.

Similarly, the economy affects and interacts with security in several major additional ways:

- (1) A small economic pie, that is, an economy of overall small size, means that Russia has relatively little to spend on its military. This means both limited government spending and overall little economic and social support of the military. Military service is not an attrac-

tive option for the young, while former military personnel find it difficult to find employment. In a poor, or at best underdeveloped country such as Russia, the likelihood of misuse of military equipment increases greatly.

- (2) A related problem is that a small economy that yields little budgetary revenue can only sustain a small military budget. In real terms, the military budget has decreased by half in just the period between 1997 and 2000. Since 1990, the decrease has been catastrophic. One of the suggested ways to defuse the crisis in the military is to increase military budgetary allocation. Some observers have concluded that an increase from 141 billion to 186 billion rubles, or 3.5 % of the GDP, would be sufficient. At current exchange rates, forty-five billion rubles is equal to an increase of less than two billion U.S. dollars—a pittance by American standards, yet a pittance that might save, in view of some analysts, the Russian military, especially if coupled with a reduction of troop personnel from the current 1.2 million to 800 thousand, as recently proposed by President Putin.
- (3) The generation of economic liberals who defined Russia's new politics in the early 1990s conceived Russia's economic transformation as an anti-military undertaking. It was broadly believed that the Soviet economy produced too much for the military-industrial complex and too little for the consumer. In important respects, Russia's transformation represents an attempt to reorient the economy from security to the market. Some of the most successful enterprises in Russia are military enterprises that use their technology and experience to manufacture goods for the civilian market. Closer cooperation between the real consumer-based economic sector and parts of the declining military sector would be beneficial to both.
- (4) Most crucially, in today's world, the absence of a strong economy leads to general insecurity. There are two primary ways for a state, such as Russia, that is falling behind the industrialized West to deal with the potential for economic insecurity. The state can isolate and protect the economy, or it can seek to integrate into the international system and to attempt to catch up with and overtake its closest competitors. Although limited protectionism, oriented towards export-oriented growth, might yield good results, it is free competition in the so-called "new," or high-tech information economy that is most likely to lead to rapid development. Still generally economically underdeveloped, Russia nonetheless has substantial potential in the high information and communication technology industries. In our opinion, this potential, one of the positive inheritances from the Soviet Union, should be exploited to the fullest both by the Russian state and by Russia's new class of entrepreneurs.

In important respects, Russia's transformation represents an attempt to reorient the economy from security to the market.

The Russian economy is small and weak by international standards; this heightens Russia's insecurity. Yet economic insecurity cannot be successfully addressed by traditional hard military security measures. Rather, the tools of the new economy should be improved. One of the most important tools in the world of globalized markets is the banking system. Improving and strength-

ening Russia's banking sector would go a long way toward strengthening the Russian economy, and Russia's sense of security in the world.

The International System: United States, Russia and Its Neighbors

In thinking about Russia's security options as well as its economic options, Russia's policy-makers think foremost about Russia's relationship with the United States. Policy- and opinion-makers tend to regard the United States as a suspect "hyper-power" prone to bullying (and thus a potential threat). At the same time, members of the elite realize that the United States is the likely source of much of the capital and expertise needed to propel forward Russia's development, and to help it integrate into the international system. They believe that cooperation with the United States can bring many tangible and intangible benefits (and the United States can therefore be a potential partner and even ally). Both views are strongly present within the Russian policymaking community, and coexist.

This conflicted stance is likely to make Russia's policy- and opinion-makers see much of the future American policy towards Russia as problematic. They might not fully appreciate America's overtures of cooperation and expressions of goodwill because of their suspicion of the United States. Much of the assistance coming from the United States, although appreciated and needed, would at the same time be seen as somewhat humiliating to a "great power" such as Russia. At the same time, negative comments from the United States are likely to be exaggerated and resented, even if not acted upon. Russia's policymakers could easily recognize the need for U.S. assistance and cooperation and yet feel offended by receiving it. Mixed signals coming out of Moscow should not be interpreted as an indication of Russia's ill intent. Rather, they should be taken for what they are: expressions of insecurity and relative weakness.

Mixed signals coming out of Moscow should not be interpreted as an indication of Russia's ill intent. Rather, they should be taken for what they are: expressions of insecurity and relative weakness.

Today, the U.S.-Russia relationship is fundamentally unbalanced as well as based on traditional political and security considerations, rather than on the possibility of economic cooperation. The reflexive posture for both countries is that of confrontation, not engagement. To Russia, the relationship with the United States is still at the core of its foreign policy. To the United States, the importance of its relationship with Russia is ebbing. Yet, this is a wrong approach. U.S. policymakers should be aware of what is happening in Russia and what the options and the implications are for U.S. policy.

The fundamental reason for Russia's importance to the United States is that Russia is at the core of the international system, and is likely to affect in profound ways the evolution of human society. This is so for a variety of historical and geopolitical reasons, ranging from Russia's natural endowment to its experience as a great power over many centuries. Russia's geographic position is crucial. It is the largest country in the world in terms of its territory. It straddles the Eurasian continent, bordering on numerous strategically and economically crucial regions in Europe and Asia. It is a pivot on the largest continent in the world. Its interaction with its neighbors defines an immense political arena. Its natural resource reserves are unrivalled and still untapped to a significant degree. Russia's natural resources alone make it a major player in the international economy.

Its population, although declining, is still substantial and boasts of high levels of education and of great experience in adapting to major upheavals. Its history as a major player in world politics extends back at least three hundred years, while its political history is more than 1,100 years old. Its instincts are those of a great power, its military experience and potential are vast, and its technology, although deteriorating, is still of high caliber. Putting all of these numerous factors—and this is but a partial list—in a dynamic perspective makes it evident that Russia is not going to disappear from the international arena and is not going to decline silently and indefinitely because of enduring ten years of grueling political and economic transformation. Her instincts are likely to make her strive for rejuvenation. Her human and natural resources are likely to make this rejuvenation possible. Her size, area of direct impact and ambition are likely to make the consequences of her rejuvenation felt throughout the world.

Globalization means not only that Russia needs to engage for its own benefit and that the consequences of not doing so are very negative and long-term. It also means that if Russia is excluded from the international system, the costs to this system are likely to be great. This is not because of Russia's economic prowess. It is because of Russia's great, and still generally untapped, promise. Not engaging Russia in itself creates a substantial cost to pay: it means forfeiting the great economic potential that Russia represents to the world.

Moreover, an isolated Russia will be more prone to aggressive or subversive behavior. A country of such vast resources, size and location has a great potential to upset international balance and to threaten international peace, even without recourse to its ample supply of weapons of mass destruction. Continued economic and social degradation will likely increase even greater the spread of organized criminality, both inside Russia and outside of its borders. Already today, criminal groups that have origins in Russia and other former Soviet republics operate throughout the world, engaging in wide-scale drugs and arms trafficking, sex trade, money-laundering and a vast variety of other illicit schemes. The so-called Russian "mafia" is becoming a major problem in the United States as well as in Western Europe. The further Russia slides into economic decay and social upheaval, the wider will be the ripple effects of Russia's criminal upsurge. The United States, and the world, can hardly afford this. A strengthening market economy in Russia will be the greatest deterrent to crime and corruption in Russia.

Policy based on fear of dire possible consequences, although realistic and pragmatic, is not the best course of action. It is more constructive to think in terms of long-term benefits from cooperation, and to weigh them against the short-term benefits and the high cost of estrangement. (Short-term benefits are primarily the greater ability to divert resources and time to dealing with other, seemingly more pressing demands presented to policymakers daily.) A Russia incorporated into the international financial and economic system, or, less ambitiously, engaged in productive regimes of trade and arms control, is likely to be a country with significant and growing weight in the international arena. If helped along and encouraged by the United States at crucial junctures, it could become a strong partner of the United States as well. The two countries share many characteristics, including great, continental size; multi-cultural legacies; a sense of great untapped potential that has to be developed; and a willingness to engage in dialogue based on common objectives. If these commonalities, rather than disagreements, are stressed, the two countries could find many avenues for cooperation and friendship.

The United States has an interest in having a strong Russia, although this might appear counterintuitive to some. Under current circumstances, it is difficult to imagine a strong Russia that is authoritarian and aggressive. The demands of the globalized international economic system

and the power of the United States make such an outcome unlikely. And there is no doubt that a strong Russia, even one that disagrees with the United States on some issues but still conforms to basic rules of democratic governance and free market economy, is preferable to a weak, unstable, insecure state with nuclear weapons and only limited government control over large parts of its territory. Although there is a remote chance that an authoritarian and nationalistic Russia could experience resurgence, this is unlikely, and the best way to prevent this scenario from unfolding is constructive and comprehensive engagement with Russia today.

A related consideration is Russia's neighbors. One of the fundamental points of this report is that Russia does not operate in a vacuum. It operates within an international system, which provides incentives and, at least partially, defines outcomes of behavior. Although Russia's interaction with its Western partners, primarily with the United States, is crucial, its interaction with its immediate neighbors, especially the other former republics of the Soviet Union, is one of Russia's primary admitted national security concerns. Moreover, development within its neighboring states could affect Russia's own fortunes. Is it possible to attain prosperity, integration and security in Russia if Kazakstan and Ukraine persist in poverty and do not pursue market and democratic reforms?

Relatively speaking, Russia exerts more influence on its neighbors than its neighbors exert on Russia's internal developments. It is assumed that Russia should work on integrating itself into the international economic system. This means being focused on its internal economic development (which should largely prevent Russia from being too engaged in domestic politics of its neighbors) and developing markets for its goods and services. An evident direction for market expansion for Russian companies would be the neighboring states, where Russian goods and services would be more competitive than in the more developed markets. Russia's orientation towards economic competition, and the sense of cooperative security that has to be fostered concurrently, will also serve to alleviate fears of, for example, the Baltic States. This is admittedly a positive scenario, but we believe that it is a realistic one if the imperative of comprehensive engagement is met.

A country of Russia's size, geographical location, history and potential will be a major player in world politics, whether it is poor or rich, and whether it is a constructive and influential presence, or a weak and obstreperous one. Its path will affect the path that other parts of the world will take, and the way even Americans will live their lives in the future decades of the twenty-first century. It is in the American long-term interest to engage Russia and to help assure its recovery and development. It might seem that among the pressing foreign policy concerns of the day Russia should be relatively low on the list: there is brewing conflict in the Middle East, rapid changes in China as it tries to transform its economy, turmoil in Indonesia, shifting political realities in Serbia, major changes in South America, violence and instability in Africa. Yet American policymakers would do well to keep in mind that Russia as an unstable foe is likely to replace any one of these considerations as the overriding problem of American foreign policy over the longer term. The Soviet Union had been the primary consideration of U.S. foreign policy, and a major theme in U.S. domestic politics, for more than forty years. American policymakers need to remember the lessons of the Cold War and the promise of new Russia, and to act accordingly.

Recommendations

The next U.S. Administration, as well as the incoming Congress, should keep in mind that responsibility for engaging Russia lies with the United States. The relationship is of para-

mount importance to Russia; and the United States is in a position to offer help and cooperation that Russia itself would probably find impossible to solicit. Moreover, Russia can guarantee only particular modes of conduct, most notably standards of transparency. It cannot offer guarantees at the same technical and economic level as the United States. It is less rich, less secure, and has less to offer. The United States, however, can reassure Russia in terms of both nuclear security and economic non-discrimination.

Russia is weak, and its policies are mostly ad hoc; it reacts, rather than formulates its own independent policy. The United States frequently sets its policy without consultation with other countries of the world, or without taking these countries' views into account. In its conduct with Russia, the United States should thus pay more attention to Russian policymakers' concerns and take the lead in offering guarantees and in steering the relationship toward comprehensive engagement, cooperation and productive dialogue.

The dominant need in the U.S.-Russian relationship is for comprehensive engagement. The engagement should proceed out of an understanding of Russia's relative weakness in every sphere of bilateral dialogue. The United States should realize that the short-term costs of such engagement are more than covered by the benefits to the United States itself and to the world from Russia's successful transformation. Economic engagement should proceed for its own sake, with a clear view of Russia's great economic potential.

The overall recommendation is for the United States to abandon its traditional confrontational pattern of behavior, which is a heritage from the Cold War. "Confrontational pattern of behavior" does not mean ill intent on behalf of the United State—or Russia. It rather means a particular mode of reactive conduct, based on assumptions of strategic competition. The posture is that of containing or mitigating actual and perceived threats, not of exploring avenues for cooperation and exploiting openings for engagement.

Yet, competing with Russia serves no purpose, as Russia is no longer able to compete with the United States in any given area, let alone comprehensively. Russia does need assistance in understanding the international rules of the game and in learning the technical side of running an efficient political economy. The United States is uniquely placed to help Russia along. Russia's policy is reactive, and has been such even in the times of the Soviet Union. *The United States must avoid behavior that would play on Russian insecurity and provoke Russia's defensive responses, diverting Russia's attentions from internal, primarily economic, restructuring, and exacerbating fears for its military security.*

In the economic sphere, Russia needs U.S. help and expertise on a wide array of issues. Most importantly, in its dealings with Russia, the United States should sacrifice its natural inclination to approach it as a typical negotiation partner, and thus to get the best possible result for the United States in every negotiation. U.S. posture should ideally be that of a counselor, not of an adversary.

Economic engagement has to be comprehensive. It will have to include the following:

- Technical assistance and investment to strengthen infrastructure;
- Debt relief;

- Facilitated market access;
- Access to new credit.

Extensive international cooperation on the governmental, supra-national and NGO levels will be necessary to create a viable market-oriented banking system and to develop strong legal foundations for Russia's new market economy.

Other recommendations include:

- Continuing and completing negotiations on regulation of intellectual property rights, started under the aegis of the Gore-Chernomyrdin Commission;
- Facilitating Russia's entrance into international financial and trade organizations, such as the World Trade Organization;
- Increasing the effectiveness of the G-8 Group;
- Devising and implementing a program for training Russian managers. The lack of qualified personnel, versed in practices of economic and corporate management in a market economy, is one of the major obstacles to Russia's successful development.

Joint projects on a variety of technical issues in the economic and banking/ financial spheres have to be encouraged. There is no doubt that upon successful implementation of the first stages of reform in Russia, market forces will accomplish much of the necessary work to foster cooperation in the economic sphere without government involvement.

In the security sphere it is even more important to remember that the purpose of U.S. policy should be to facilitate Russia's integration into the international economic system. To do so, the United States should take the lead in easing the security burden on Russia. *Thus, the process of engagement with Russia should take precedence over most other considerations on the policymaker's table.* The purpose of this engagement, on the security side, is to allow Russia to:

- Reduce its military forces to the level where they can be adequately supported by the necessary funding and equipment;
- Lift the burden of standard contingency planning, which Russia's military forces cannot sustain, from Russian policymakers' shoulders;
- Improve deterrence planning;
- Improve maintenance of and control over Russia's nuclear arsenal.

The most direct implication of this set of propositions is the necessity to redefine the mission of NATO and to halt any plans for NATO's further expansion to the East. The Russians uniformly view NATO's current mission as being aimed at Russia. NATO's capabilities are overwhelmingly superior to anything Russia would be able to muster for years to come. NATO is the dominant foreign policy irritant for Russia's policymakers. The alliance's military forces, arranged ever closer to Russia's borders, greatly heighten Russia's sense of insecurity. Russia's security establishment could be reduced if it did not have to see itself as involved in a confrontation with the NATO alliance, but NATO has to be willing to change some of its policies and attitudes.

A step on the path to normalization of NATO-Russian relations could be the re-defining of the Partnership for Peace (PfP) framework, which, according to most analysts, has outlived its usefulness and is regarded today as largely ineffectual. Created as a framework for cooperation

between NATO and, primarily, the former Warsaw Pact countries, Partnership for Peace fell victim to the political turmoil surrounding the first wave of NATO expansion. Although some training exercises and consultations are still held under the aegis of PFP, Russia has been generally disdainful of it.

The second direct implication of the urgent need for comprehensive engagement is shelving plans for a National Missile Defense (NMD) by the United States. Unless fully offsetting constraints are imposed on U.S. offensive forces and other dimensions of U.S. military force projection, NMD would serve only to undermine gravely most of the security and arms control regimes put in place over last several decades. The Russians would view NMD as being directly aimed at them. A crisis in the bilateral relationship would be likely to ensue, with an attendant breakdown of all initiatives and efforts in the economic, security and other spheres. NMD, the possible effectiveness of which is widely questioned, would lead to substantial deterioration not only in the U.S.-Russian interaction, but in the global security climate overall.

Nuclear weapons cooperation—regarding both the regime of nuclear deterrence and the numerous disarmament and non-proliferation regimes—is another aspect of the bilateral relationship between Russia and the United States that is crucial. The major example of a positive cooperative agreement is the Cooperative Threat Reduction program, popularly known as the Nunn-Lugar program, that aims at and finances decreasing the size and increasing the safety-security of Russia’s inventory of nuclear weapons and materials. Military experts and politicians in both the United States and Russia hail the process as well as the results of the initiative. During the original stage of the program, all the necessary equipment for the dismantlement, storage and transportation of weapons was imported into Russia from the United States; at a later stage, the equipment was made in Russia. The program promotes transparency and is a prime example of the mutual benefits accruing from an exchange of American engagement for Russian transparency. Not only was mutual security enhanced, but economic benefits, in the form of job creation and attendant tax revenue, accrued as well. Both countries recognize this as an ideal arrangement for dealing with similar concerns. Targeted programs such as the Nunn-Lugar should be encouraged and financed.

The most direct implication of this set of propositions is the necessity to redefine the mission of NATO and to halt any plans for NATO’s further expansion to the East.

Other recommendations, on which numerous U.S. and Russian experts agree, include:

- Developing the systems for joint early warning;
- Mutual nuclear de-alerting;
- Re-starting nuclear stability talks;
- Increasing the effectiveness of alternative to NATO regional and global collective security organizations. These could include, should their mandate be redefined, the Council of Europe, the Organization for Security and Cooperation in Europe and the G-8 Group;
- Stressing the areas of common interest and concern, such as threats of nuclear proliferation, terrorism, and nuclear arsenal mismanagement;

- Cooperating in developing regional nuclear safeguards;
- Cooperating in developing joint theater defense.

The role of Europe and its bodies, most notably the European Union and its military security arm, the Western European Union, could be crucial. The approach of Western Europeans has frequently differed from that of the United States on a number of important issues. Brussels could be a useful starting point for some of the more far-reaching initiatives aimed at improving the relationship between the United States and Russia.

The precondition for many of these initiatives is increasing transparency, both by Russia and by the United States. With the concept of “information security” gaining credence not only in Moscow but also in Washington, DC, and other Western capitals, the threats of breakdown of information exchanges, or of increased mutual suspicion due to only selective release of information, are very real. Russia is more prone than the United States to conceal or selectively release information. The most recent trends are worrying. The new Doctrine of Informational Security of Russia, recently unveiled by the Putin Administration, is vague but could easily accommodate substantial restrictions on the freedom of the media as well as on releasing government data into the public domain. Even specialists associated with different branches of the Russian government bemoan the trend to make more and more of government policy, for example the military budget, closed. Increasing the transparency of the Russian legal, political, economic and military systems is a necessary condition for Russia’s greater engagement with the world. The sooner Russian policymakers realize that secrecy carries great costs, to themselves as representatives of particular institutions as well as to Russia as a whole, the better.

To summarize, there are two approaches that the United States should follow. We believe that these approaches apply equally well to the security and to the economic/ financial sectors.

First, targeted expert and financial assistance should be directed to Russia. Russia will continue to lack knowledge and resources to effect its transformation for many years to come. Although a highly educated society, Russia lags behind, for evident reasons, in most social and technical knowledge that is taken as a given in the United States. Sensitively offering help, when and where requested, would be both appreciated and useful. Equally important is not to impose advice that is seen as insensitive or unnecessary. Arrogance is likely to jeopardize positive progress in the bilateral relationship, as Russia and Russians are extremely sensitive to perceived slights.

Second, and most important, comprehensive rhetorical and practical engagement is essential. Engagement on the broadest level should be the dominant theme of U.S. policy toward Russia. It should be predicated on approaching Russia as a partner and as a potential ally, both in the economic and the military security spheres. The temptation for neo-isolation, or for cool detachment from day-to-day perturbations in Moscow, is an understandable impulse, yet a counter-productive one. It is by greatly reducing the security burden on Russian policymakers’ shoulders, by demonstrating on a practical day-to-day level the U.S. interest in seeing Russia succeed and integrate into the world economic and security system, by being receptive to Russia’s concerns and fears, by fostering dialogue with the Russians, and by facilitating dialogue among Russians (as the Carnegie Corporation Russia Initiative strives to do) that the best results and most progress are likely to be attained. The world, as a result, is likely to be made a better and safer place for all.

“Problems of Engagement: Russia’s Security, Economic and Banking Crises”

Kempinski Hotel Corvinus, Budapest, Hungary
May 19–20, 2000

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The Challenge of Russian Reform at a Time of Uncertainty

Report by

Thomas Graham, Alexander J. Motyl and Blair Ruble¹

Executive Summary

Despite the disappointments of the past and the current doubts about Russia's direction, the transformation of the country into a liberal democracy based on a prosperous market economy and integration into the West remains in the strategic interests of both the United States and Europe. Such a Russia could make an invaluable contribution to building and maintaining peace and security in Europe, the Persian Gulf region and East Asia, while becoming a leading player in the global economy. At the same time, despite concerns about certain Western policies, especially on security matters, Russia should remain focused on integration into the West, which offers the country its best hope of building a successful society and raising its status in the world.

Our efforts to assist Russia's transformation during the last decade and Russia's own policies, while achieving some successes, have on the whole left Russia far short of the desired goal. In important ways, the efforts were misguided and counterproductive.

Today's Russia is quasi-democratic with a quasi-market economy. The state is weak, incapable of guaranteeing basic rights, enforcing laws, protecting property or maintaining social welfare. Civil society is weak, the media is increasingly intimidated by power holders and oligarchs, political parties are fragile and elections are growing less competitive and free and fair. The economy lacks an integrated system of complex market institutions that would foster investment and sustainable growth. The economy has collapsed by some 40 percent in the past decade, despite the recent upturn in production.

Despite deep socioeconomic depression and widespread discontent, the new system that has emerged in Russia is remarkably stable and resistant to rapid transformation. The very fragmentation and dispersal of power tends to localize unrest and minimize the consequences of governmental crises in Moscow. The elites—including nominally opposition elites—have benefited greatly from the system and have little incentive to change it and the bulk of the population is neither rich nor poor enough and neither hopeful nor desperate enough to take risks to change the system. The West, through its financial

Despite deep socioeconomic depression and widespread discontent, the new system that has emerged in Russia is remarkably stable and resistant to rapid transformation.

and political support to Russia's ruling elites, failure to protest vigorously enough blatant departures from democratic practices, and blindness to the widespread misery, has sanctioned this system.

There are, however, elements of change, both positive and negative, in Russia. A new entrepreneurial class is slowly emerging that could press for significant economic and political reform. The younger generation is more supportive of such reform than their parents and grandparents. At the same time, there are forces supportive of more authoritarian forms of government and greater state interference in the economy. President Vladimir Putin's first months in office suggest he is drawing on those forces in setting his course. As a result, as we look out over the next decade and beyond, three broad scenarios for Russia present themselves: Democratization and marketization; authoritarianism and state capitalism; and stagnation.

Guidelines for Policymakers

Our analysis leads to several general principles for policymakers wishing to promote democratization and marketization in Russia.

- Policy must be grounded in the realities of Russia's current political and economic system.
- Russian and Western policymakers need to move toward more compromise-oriented and inclusive political mechanisms than has been the case in the past decade.
- Russians should take the lead in devising economic and political strategies for rebuilding their country, while the West should be prepared to offer advice and assistance when needed and requested for goals consistent with our interests and values.
- The West must act in ways consistent with the expectations it has raised. That is, the West cannot promote democracy and markets in Russia by pursuing self-interested policies that undercut popular participation, promote immiseration, and isolate Russia.
- Because Russia does not exist in a vacuum, the West should always calculate the impact of its policies toward the non-Russian CIS on Russia itself.
- Patience is required because there are no quick fixes to the multiple ills afflicting Russia.
- The United States and Europe must maintain a common approach toward Russia, while Russia must resist the temptation to play on differences between the two.

Russian policymakers do not now appear committed to moving forward on democratic reform, although they have shown greater interest in rebuilding the economy. We believe they should focus their efforts in the following areas, while continuing measures that promote macroeconomic stabilization: tax reform, judicial reform, protection of private property, and corporate governance.

The West should focus its efforts on ensuring the construction of effective state institutions in Russia and preserving the democratic gains Russia has already made. To that end, concrete steps the West should take with regards to Russia are:

- Supporting independent democratic media and engaging journalists in exchanges and dialogue.
- Promoting entrepreneurial forces within and enhancing the effectiveness of organiza-

- tions pressing for the interests of small businesses and entrepreneurs.
- Focusing on forces pressing for the rule-of-law and on forces responsible for maintaining the rule of law.
 - Creating exchanges and dialogues to reach opponents of reform.
 - Supporting successor generations and unemployed workers and pensioners.
 - Helping Russia resolve the Chechen crisis as soon as possible.
 - Promoting programs that reinforce the view of Russia as a civilization rooted in many of the values and traditions of Europe.
 - Resisting policy measures that enhance Russia's isolation from the world, the West, and its neighbors.
 - Creating an international environment conducive to democratic state-building and marketization.
 - Maintaining a common Western approach toward Russia.

A Time of Uncertainty

Nearly a decade after the breakup of the Soviet Union, Russia belies easy characterization. It is certainly not the vibrant democracy or prosperous market economy that many leaders and experts in the West and in Russia had hoped for, but neither is it the remake of the Soviet Union that many had feared. It has acquired some of the attributes of a democratic society and a market economy, but still falls far short of having built institutions that would characterize it as a functioning democracy and market economy. It retains features of its authoritarian past, but remains far from a consolidated authoritarian regime. It has many characteristics of a failed or failing state, but it retains the potential to regain its position as one of the world's leading powers.

In the next decade, the muddle of the recent past is quite likely to continue, with Russia retaining the potential to develop in different directions, toward greater democracy or toward greater authoritarianism, toward a free market or toward a regulated market, toward a failed state or toward a world power. For this reason, just as it was a mistake for Western officials to prematurely proclaim Russia a democracy and market economy in the nineties, it would now be a mistake to reject Russia as a hopelessly authoritarian government with a corrupted economy.

That Russia's future remains open means that the coming decade holds promise for Americans, Europeans, and Russians who would like Russia to join the ranks of Western liberal democracies based on prosperous market economies. But to succeed, they will have to appreciate the trade-offs between democratization, marketization, and global stability and security, at least in the short run, and they will have to appreciate that progress is likely to be slow with inevitable reverses in all areas. Even then success will be far from certain in the long run.

Immediately after the break-up of the Soviet Union, policymakers in the West and Russia began to talk about a partnership that would transform Russia into "a normal, modern state—democratic in its governance, abiding by its own constitution and by its own laws, market-oriented and prosperous in its economic development, at peace with itself and with the rest of the world."² Policymakers in many countries spoke and acted as if the processes of democratization, marketization, and integration with the West moved along parallel, mutually reinforcing tracks. Moreover, until the financial collapse in Russia in August 1998, Western leaders argued in public that steady progress was being made in all three areas.

The Russian financial crisis of August 1998 put an end to this chapter. It punctured illusions in the United States and Europe, nurtured by official rhetoric, that Russia could, with international assistance, rapidly transform itself into a vibrant democratic society based on a robust market economy. It confirmed increasing numbers of Russians in their belief that eroding Russia's power and turning it into a third-rate country had been the West's goal all along. Channels of communication broke down as the West's favored interlocutors in the Russian government, the so-called "radical reformers," were dismissed from positions of power. Russia's relations with the West deteriorated sharply in acrimonious exchanges over the Kosovo conflict, NATO expansion, the Bank of New York corruption scandals, and the war in Chechnya that followed the financial crisis.

Under these circumstances, expectations and attitudes have changed drastically. There is a palpable fatigue with Russia throughout the United States and Europe as well as pervasive disillusionment with the West across Russia. Worse, few Americans and Europeans expect Russia to move forward smartly on democratization and marketization. Even those in the West who believe that the presidency of Vladimir Putin has a chance to advance economic reform remain wary of an authoritarian turn in politics. Unwilling to provide credits on promises of reform, Western policymakers are now demanding concrete actions. In turn, Russians no longer expect or want significant assistance from the West in rebuilding their country. They have come to believe that they have to rely first of all on themselves and their own resources.

Most important perhaps, the way the West and Russia speak of the basic challenge facing Russia reveals a fundamental difference of perspective. Policymakers in the West continue to talk of reform; Russians stress the need to rebuild their country. How much those two processes overlap is an open question, but rebuilding Russia clearly need not entail reforming it along Western lines, at least not in the short run.

Despite the disappointments of the past, the acrimony of the present, and the formidable challenges of the future, the United States and Europe continue to have a profound interest in the domestic transformation of Russia. For much of the second half of the twentieth century, irreconcilable differences in fundamental values together with an unrelenting arms race put the very existence of Western societies at risk. The West rightly feared Soviet strength wedded to hostile intentions. Now, after the breakup of the Soviet Union, the thorough discrediting of Soviet ideology, the demise of the international communist movement, and Russia's socioeconomic collapse, Russia no longer presents a strategic threat to the West. But Russia's very weakness poses a new set of challenges. It has sharply raised the risks to the safety and control of nuclear assets in Russia, the threat of ecological catastrophes a la Chernobyl, and the danger of massive instability and a power vacuum in a country at the heart of Eurasia.

Moreover, continued decline bears considerable opportunity costs, since a healthy Russia could, with its tremendous potential in natural and human resources, make an invaluable contribution to building and maintaining peace and security in Europe, the Persian Gulf region, and East Asia as well as become a leading player in the global economy. Finally, Russia's embrace of democracy and a market economy—of basic Western values—would ease concerns about Russia's resurrection and

In sum, Russia matters because a democratic and market-oriented Russia would greatly enhance the West's own security and well-being, whereas the reemergence of an authoritarian, anti-Western Russia or a final collapse and disintegration would raise formidable dangers.

multiply the opportunities for a constructive partnership with the West. In sum, Russia matters because a democratic and market-oriented Russia would greatly enhance the West's own security and well-being, whereas the reemergence of an authoritarian, anti-Western Russia or a final collapse and disintegration would raise formidable dangers.

With its long-standing illusions about the inevitability and speed of Russia's transformation into a developed democracy and market-based society now dashed, the West faces difficult prospects in the years ahead. If Russia will not be transformed overnight, then assistance to Russia must be placed on a long-term basis. If a stable quasi-democratic, quasi-market system has emerged in Russia, then the task before Western policymakers is not how to consolidate the transition, but, possibly, how to help restart it. If Russia moves further in an authoritarian direction, then Western policymakers and publics will have to ask themselves whether their commitment to human rights and democracy should affect their relations with a country of Russia's size and continued strategic importance.

Lastly, were Russian state power to continue to atrophy, the West may have to confront the possibility of a trade-off between continued state survival and democratization and marketization. Do the United States and Europe have an interest in the revival of Russian state power, even if that is not accompanied by democratic and neoliberal economic reform? Would an assertive, revived Russia, even one whose government often opposed Western policies in the global arena, be less troublesome to Western governments than a more accommodating but decaying and disunited Russia? Would such a Russia be less troublesome to the West even if a revival of authoritarianism and nationalism began to threaten Russia's neighbors, such as the Baltic states, Ukraine, Georgia, and Azerbaijan? Is there a point at which American and European interests with respect to Russia might even begin to diverge? There are no easy answers to these questions. Although a strong, democratic, peaceful, and market-oriented Russia is obviously everyone's optimal variant, there is no guarantee that Russia will acquire these characteristics at the same rate and to the same degree.

Over the long run, the United States and Western Europe continue to have a deep interest in achieving the goal the Clinton Administration set forth seven years ago—the transformation of Russia into a strong, responsible, and peaceful democratic state with a market economy integrated into the West. The question facing the incoming American administration is whether Russia or the West can do anything now to increase the chances of a good outcome. Answering that question requires taking a hard look at what Russia has become over the past decade and what role the West has played in shaping its evolution. Only then will it be possible to see what Russia and the West, both separately and jointly, can do to move Russia along the path of democratic and market-oriented development.

The New Russia

The Emergence of the System

Today's Russia was not the one Boris Yeltsin and his allies expected to build when they assumed power. The rhetoric in late 1991 was of rapidly transforming Russia—with considerable Western assistance—into a liberal Western democracy with a prosperous market economy. Much of the initial effort had two main thrusts. First, it was—understandably—deemed imperative to achieve supremacy over those elites opposed to rapid political and economic change. Second, it was believed that top-down reforms would suffice not only to dismantle the institutions of the totalitar-

ian Soviet state (including the Communist Party of the Soviet Union, the system of soviets, and the structures of the planned economy), but also to lay the foundation for a democratic market-oriented society.

The showdown between Yeltsin and the Supreme Soviet in fall 1993 and the presidential election in spring 1996 revealed the prominence that both approaches had assumed in the Yeltsin elite's thinking. Both were intended to reassert Yeltsin's prerogatives as the country's top leader and to create an opening for the "reformers" around him to press ahead on their agenda even in the face of widespread public discontent. An even more glaring example was the so-called "loans-for-shares" deals in fall 1995, when the assets of some of Russia's leading strategic enterprises were transferred to a small group of Russian businessmen at cut-rate prices. While the main reason for this deal was ostensibly to raise money for the budget in a non-inflationary way, two other goals also figured high in the minds of the Yeltsin team: (1) hedging against a communist victory by handing key state enterprises over to private individuals and (2) creating a base of wealthy supporters to finance Yeltsin's reelection campaign in spring 1996. But the scheme grievously tainted the integrity of the privatization process, consolidated the positions of a class of oligarchs, and thereby compromised the broader goal of building a democracy and a competitive market economy.

With the exception of the voucher privatization program, the radical reformers led by Yegor Gaidar and Anatoly Chubais did little to build political support for their reform efforts. Disdainful of the rest of society—which they saw as either reactionary or ignorant—they sought to push through policies with the backing of Yeltsin and the West against elite and popular resistance. In the process, some reformers themselves grew corrupt. Their policies also retarded democratization by impoverishing the urban intelligentsia, which had formed the backbone of the democratic movement in the Soviet period, without creating the middle class of property owners who were supposed to provide the political base for democracy.

The West played a significant role in the situation that resulted in the current state of affairs in Russia. Like Yeltsin and the so-called radical reformers, the West believed that keeping the communists at bay and promoting top-down economic reform would usher in both democracy and the market. As a result, it was happy to overlook many blunt violations of democratic norms—particularly in the conduct of elections. The West also applauded Yeltsin's disbanding of the parliament in October 1993 and hailed the adoption of a new constitution, which provided for a strong presidency, even though both these acts arguably undermined respect for representative democracy in Russia. Finally, the West did not move energetically to build public support in Russia for its policies or those it was encouraging the Russian government to pursue, nor did it press its Russian partners to build a solid domestic base.

The system that emerged was thus not the result of a grand design, but of the mutually reinforcing relationship between tactical decisions made in the battle against the past and for a naïve vision of the future on the one hand and, on the other, the institutional legacies of six decades of central planning and totalitarian Party rule. Although these legacies did not preclude democratic and market-oriented change, they greatly enhanced the difficulty of attaining it by bequeathing to Russia a plethora of nondemocratic and antimarket institutions, a nondemocratic and antimarket political culture, as well as nondemocratic and antimarket elites. The unavoidable struggle with antireform elites fostered a neglect of democratic institution-building, while state-directed reform distorted the emerging economic institutions by, in essence, replicating some of the worst features of "top-down," overly centralized, and socially insensitive communist economic management.

By the end of the 1990s Russia had acquired a stable and more or less durable system of

political and economic relations that fell far short of being an efficient market economy and a viable democracy.

The Russian economy today lacks the deep structural characteristics of a modern market economy. Financial markets exist, but they have failed to develop into an integrated, self-correcting system of savings and investment which rational monetary policy can influence to promote economic growth. Instead, economic activity has devolved to quasi-autarchic networks using quasi-monies, barter and artificial exchange controls to isolate and protect themselves from illiquidity and other risks associated with the national currency. In these networks, the exercise of power and authority, in both business and government, is personalized, non-transparent, and arbitrary. Operating in what has been termed the “virtual economy,” these networks exploit their ability to operate outside the cash economy, and, in the process, destabilize the national monetary system.

Russia’s status as a democracy is also in doubt. Political parties and civil society are weak, and the media, although boisterous, have increasingly become intimidated by power holders and oligarchs. Moreover, the potentially democratizing effect of elections has been undermined by several factors reflective of systemic disarray: Limitations on press freedoms, falsification of electoral results, disqualification of potentially strong challengers on flimsy legal grounds, and harassment and intimidation of opposing candidates and their staff.

Russia ranks somewhere in the middle of post-communist countries in terms of both democratization and marketization. Its ratings in various cross-national surveys measuring political openness and the extent of economic reform place it in a large middle group of countries—such as Ukraine, Armenia, Kyrgyzstan, Moldova, and Georgia—that have partially open, semi-democratic political regimes and economies that have undergone substantial but highly uneven transformation. Russia may even belong near the bottom of this group. The World Economic Forum’s Global Competitiveness Report for 1999, which ranked 59 countries on economic competitiveness and growth potential through the year 2008, put Russia 55th place (just above Zimbabwe, Ukraine, Bulgaria, and Ecuador, and just below Bolivia, Columbia, Vietnam, and Venezuela). Like many of its neighbors, Russia is, institutionally, a predominantly authoritarian state. The weakness of that state, a point pursued below, has thus far enabled Russians to enjoy unprecedented freedom—and that is certainly an advance on the oppressive nature of the Soviet state—but it is by and large a freedom that is not yet rooted in fully functioning and widely accepted democratic and market-based patterns of behavior—nor institutions.

Weak State

One of the major consequences of these developments has been the erosion, fragmentation, and privatization of state power. The bitter inter- and intraelite struggles for the spoils of the victory over communism—in particular, for the vast economic and financial resources up for privatization—undermined governmental discipline and robbed Moscow (or the Center) of its unity of purpose, as individuals seized bits and pieces of the state for their own parochial interests. Bold regional leaders exploited the disarray to seize assets, enhance their political and economic autonomy, and establish regional satrapies. Aggressive businessmen used it to appropriate enterprises, often at cut-rate prices, and build empires across the country. Even the more timid regional leaders were compelled to assume more power simply in order to survive, as the Center grew increasingly unable or unwilling to provide the necessary resources. Moreover, the elites found it advantageous for the Center to be weak and incapable of mobilizing resources, for they enriched themselves by preying on—or stealing from—the weak Center.

The Russian state is currently unable to fulfill its central role—providing a stable political, institutional, and social environment that would allow the determination and implementation of economic decisions, including those regarding investment and economic development. It is not that the state should be capable of investing sufficient resources; after all, state-led investment is as often wasteful and damaging as it is helpful. Rather, the issue is that the state be capable of providing a transparent, stable framework with adequate protections for both private and public investment—in other words, of fostering and supporting a market system. Such a state would pave the way for increasing domestic investment, bringing back the more than \$150 billion of flight capital, and would encourage massive foreign direct investment (FDI).

The rule of law is poorly institutionalized. Legal institutions are weak and politicized, and largely depend on the executive branch. Law enforcement is poor, with private, including criminal, organizations routinely arrogating to themselves many of the police functions of the state. Property rights and investments are at best haphazardly protected. Such an environment undermines people's faith in the rule of law. It dramatically reduces the incentives to invest and increases those to strip assets and extract cash flow from firms, regardless of the impact on future capabilities. It also breeds corruption and extortion, generating barriers to imports, to entrepreneurship, and to the free movement of resources across regions and activities, as officials, administrators, and managers collect rents through the rationing of permissions, allocations and protections. The problem is particularly clear in the arbitrary and capricious system of taxes and tax collection at all levels, and in the extortionate licensing and inspections policies of local governments. In many respects Russia resembles a third-world state burdened with a corrupt and parasitical bureaucratic apparatus with a deep interest in distorted economic development that sacrifices popular needs to its own enrichment.

Moscow notwithstanding, the declining power of the center did not create strong regions. Regions suffer from the same range of disabilities as the country as a whole, and the overall economic decline has deprived them of the resources they need to address those ills. "Weak center—weak regions" provides an apt description of the current situation. That is, the striking feature of the Russian political and economic system is the near total absence of concentrations of power capable of governing effectively.

In this respect, Russia bears some resemblance to the image of the international system as anarchic—i.e. as orderly, but lacking in an effective authority structure—proposed by international relations experts. Russia, to pursue this image, is not chaotic: rather, it consists of a multiplicity of more or less autonomously functioning power centers.

A more appropriate comparison therefore comes to mind. In many ways, today's Russia offers an imperfect parallel with, to pursue an analogy made by sociologist Vladimir Shlapentokh, feudal Europe. In Russia today, as in feudal Europe, there is no clear distinction between the concepts of sovereignty and ownership, between the public sphere and the private sphere, between government and business, between power and property (or wealth). Rather, these elements exist in a symbiotic relationship, capable of being transformed into one another without great difficulty. At the same time, power is fragmented or "parcelized:" that is, the state is a decentralized, but strongly hierarchical political and social structure, which gives rise to a multiplicity of competing power centers, or "localized states." Political power is exercised arbitrarily, in large part because of the lack of third-party restraints on government agents.

As in feudal Europe, the structure of political power in Russia distorts economic processes. Instead of a national economy, there are numerous local economies, with a tendency toward autarchy and with their own idiosyncratic valuation systems. Immediate consumption takes prece-

dence over investment in economic decision, while little heed is paid for the bottom line. Thus, necessary activities must take place regardless of costs or ability to pay. Finally, payments are made on the basis of power relationships rather than for economic services or benefits received.

Although such a weak state does not preclude the seeds of a market economy and a democratic society from taking root—indeed, feudal Europe did lay the basis for both more authoritarian, mercantilist states and more democratic, modern market societies—it does create formidable obstacles to their development and growth. Europe required several hundred years to shed its feudal baggage. Even if, as is likely, Russia succeeds much sooner, overcoming the legacy of feudal conditions will obviously take time—perhaps decades, perhaps generations.

Complicating the matter is that the crumbling state, socioeconomic decline, and nondemocratic development now form a vicious circle. The first accelerates economic decline by leaving the country without effective institutions to support market activity, eroding the quality of public goods (such as health, education, and economic infrastructure), and creating an opening for organized crime. A crumbling state also weakens the institutional underpinnings—rule of law and a civil society—of any stable democracy. Socioeconomic decline, in turn, deprives the state of the resources it needs to rebuild its capacity to govern effectively and delegitimizes democracy in the eyes of the population. Finally, authoritarian attitudes and rule undermine the pursuit of a market economy by raising the costs and risks to any initiative or entrepreneurial undertaking, as those implicitly threaten existing economic and power relations. Sadly, the one area in which the vicious circle may be broken is in the relationship between authoritarianism and state building: the popularity of President Vladimir Putin and his own decidedly nondemocratic proclivities suggest that, increasingly, Russian elites believe that a dose of authoritarianism may be the cure-all for the weak state and thus the shortest route to Russia's recovery. However, merely strengthening the forces of coercion is no recipe for establishing an effective 21st century state.

Stability and Change

Although Russia has endured an unprecedented socioeconomic depression and discontent has been widespread throughout the past decade, Russia appears remarkably stable. Freedom House's Nations in Transit studies capture this stability by consistently assigning to Russia scores in the 3.5 - 4.5 range³ for the degree of its progress toward effective governance, democracy, civil society, rule of law, independent media, and a market economy. To say that the Russian system is stable is to argue that it has logic, coherence, and staying power. It is decidedly not to say that Russia is incapable of change, that the Russian system benefits all Russians equally, that serious problems do not beset the system, or that it will, or must, survive indefinitely. The dysfunctional institutions that comprise this system do form an interlocking and mutually reinforcing network of behaviors that can successfully reproduce themselves for many years. Feudal Europe survived—despite wars, plagues, and other crises—for centuries; the countries of the third world are still with us, despite four-to-five decades of postcolonial distress. The longevity of Russia's current system is anybody's guess. It would, however, be foolhardy to assume that its manifold problems are incompatible with longer-term survival. There are four primary reasons for this stability.

First, as was the case with feudal Europe, the fragmentation and dispersal of power means that there is no concentration of power and dynamism sufficiently large to upset it. Feudal Europe existed for centuries as a system despite innumerable jacqueries and wars between feudal lords. Similarly, in Russia, the dispersal and fragmentation of power do not preclude local unrest or gov-

ernmental crises; indeed, both have occurred frequently over the past decade. The dispersal, however, minimizes the consequences of crises at the center for the system as a whole, while fragmentation tends to localize unrest. Indeed, it is surprising how infrequently instability in one region spills over into another, even in such an unstable area as Chechnya.

Second, as a whole, the elites, including even so-called opposition forces, benefit greatly from the system and have little incentive to change it. Their power and welfare are firmly rooted in the personalized, non-transparent, relation-based structure of economic and political activity and interaction. Moreover, over the past decade, the elites have enriched themselves by preying on the weak state. With a stranglehold on political and economic power, Russia's elites have formed something in the nature of a more or less coherent "parasitic" stratum that, while divided by differences of personality, competition for scarce resources, and even policy, has an interest in maintaining the system as is. The introduction of genuine democracy and market relations would undermine these elites and their power bases in the feudal system. A strong state, on the other hand, may not necessarily be incompatible with their interests, as it should be possible for the elites to acquire sinecures in the state and thereby retain most of their privileges.

Third, despite widespread discontent, there is little political or social activism. Russians have a profound fear of instability, political conflict, and the possibility, however remote, of civil war. Because, by some estimates, seventy percent of Russians live below or just above the official poverty level, under conditions of immiseration and lumpenization, they have to spend most of their waking hours making ends meet. In such circumstances, in Russia as in other poverty-stricken parts of the world, political activity becomes an unnecessary and risky endeavor. Moreover, there are few if any organizational vehicles for channeling mass misery into political activism. Despite the large number of parties and non-governmental organizations that exist in Russia, the vast majority of Russians are completely outside their structures. This situation will change only under one of two conditions: (1) the situation deteriorates so badly that large numbers of Russians can no longer make ends meet and therefore have nothing to lose by expressing their discontent in political action, including violence; or, (2) the situation improves sharply, dramatically raising expectations and leading to demands for greater participation in decision-making, while facilitating the emergence of a civil society that could provide the structures for organized protest.

Fourth, the West has for all intents and purposes sanctioned this system and the elites that run it. For much of the last decade policymakers looked the other way when violations of democratic norms occurred, disregarded the misery that economic change has brought to millions of Russians, ignored crass violations of human rights in Chechnya, dismissed the hyper-nationalist statements of individual policymakers as mere grandstanding, remained unconcerned about crime and corruption until it began to penetrate Western institutions, and provided enormous dollops of financial aid and political support in both appropriate and dubious circumstances. Indeed, many Russians blame the West for having helped bring about the current state of affairs in Russia. Their anger is not wholly misdirected.

As stable and coherent a system as this will resist rapid transformation, while as decentralized and anarchic a system as this will remain resistant to guidance from any emergent power center, however strong and however inclined to strong-arm tactics. A reforming president cannot simply flip switches in the Kremlin and expect the rest of the country to respond to his directives. Changing policies, replacing cadres, and building chains of command are important and indispensable first steps on the road to transformation, but they are far from sufficient to guarantee such a transformation, and certainly not a rapid transformation. It is worth remembering that even under

far less stable circumstances, it took Stalin a decade and the massive application of country-wide terror to impose his system on the Soviet Union. It will take at least that long to move Russia toward a stable democracy and prosperous market economy, to return it to an authoritarian, centralized state, or to move it in other directions.

Not unlike medieval kings, a Russian state builder will have to maneuver among the competing centers of power and slowly expand his own power and authority. Most important, a Russian state builder genuinely committed to democracy and the market will have to engage in the arduous task both of building democratic and market-oriented institutions and, what is arguably far more difficult, of transforming existing nondemocratic and antimarket institutions into stable, durable, and taken-for-granted patterns of democratic and market-based behavior. And since the end goal is democracy and the market, it follows that institution building cannot involve violence, coercion, and excessive manipulation.

Stability, however, does not preclude change. Even highly stable systems can and do change, sometimes quickly. The Soviet Union, for instance, was most susceptible to change during succession struggles, when competing elites jockeyed for power under somewhat fluid conditions and used disparate policy initiatives for their own ends. Vladimir Putin's first two years in office may provide him with similar openings. All types of systems—authoritarian, totalitarian, and democratic—can respond to the targeted interventions of charismatic leaders, such as Napoleon, Hitler, Lenin, Washington, and Mandela. Whereas there is some evidence to suggest that Yeltsin played such a role in the early 1990s, there seems to be little of the visionary revolutionary in President Putin's past or present. All systems are also susceptible to internally and externally generated crises or shocks—an economic failure, a lost war, a natural catastrophe—that can unbalance them and generate change. Another Chernobyl could easily delegitimize the Russian political elite; growing instability to the south of Russia could tip the system in direction of stronger rule or greater anarchy. Future Balkan crises or thoughtlessly provocative Western approaches to, for example, NATO enlargement and national missile defense could also be just as debilitating.

Amid the war in Chechnya, organized crime, and pervasive disorder, the role of the secret police and army is likely to grow. This eventuality bespeaks a possible turn toward militarism and an intensification of nationalism, but it could also portend the emergence of a significant source of change. Militaries have assumed reformist agendas in underdeveloped states and, although the Russian and Soviet military has historically eschewed political engagement, there is no reason to think that such a stance can never change. Unfortunately, military involvement in politics has often resulted in economic decay, increased corruption, and democratic retardation. What it almost invariably has led to is some form of systemic crisis, in which militaries and their opponents develop radical schemes for overcoming the crisis or forestalling systemic collapse.

Russia's ongoing struggle to establish its own national identity—whether uniquely Russian, Eurasian, Western, or some combination thereof—will also serve to promote change. At present, Russians are still reeling under the impact of imperial collapse and are intensely debating the question of who they are and where, civilizationally, they belong. There is an emerging consensus that Russia must remain a great power, but the nature of that Russia—its defining national and cultural characteristics—is still a matter of dispute. Reflecting debates that first emerged in the eighteenth and nineteenth centuries and that have been with Russians ever since, some Russians see their country as being an intrinsic part of Western European civilization; others prefer to locate their country in the history and culture of Eurasia; still others assert that Russia is, on its own, a unique civilization. While the Russian elite sees itself as European, not as Asiatic or even Eurasian, it is at

present still unclear how these debates will be resolved in the years to come.

It is fortunate that some of Russia's own historical traditions bolster the case of the Westernizers. In contrast, a turn toward Eurasia or Russia itself could easily retard Russia's integration into the West by emphasizing just those features within Russian culture—such as a distaste for individualism and an overwhelming respect for authority—that do not sit well with modern conceptions of democracy and the market. Whatever its ultimate outcome, however, the very process of growing self-identification is likely to produce dissatisfaction with Russia's currently fluid, anarchic, and semifeudal political-economic system and thus to stimulate change—albeit not necessarily in a direction that will move the system in a distinctly democratic and market-oriented direction.

Finally, the outside world, and particularly the West, has historically provided a strong impulse for change in Russia, either as a pole of attraction or a looming threat. The resentment against the West's actions in such places as the former Yugoslavia is at least in part sparked by fears of being left out of Europe and more generally out of the corridors of world power. Success in the West, in the form of rising living standards and economic expansion, will only increase the numbers of those in Russia demanding that their country emulate the West. Hiding the West's achievements—a tactic used with some success by the Soviet leadership—is no longer an option in the age of the Internet.

In addition, a substantial share of the elite still harbors great-power aspirations and realizes that Russia's current political and economic system is incapable of generating the resources needed for Russia to regain its position as a major actor on the world stage. Such attitudes could quickly become a major force for change in Russia; indeed, that appears to be the driving force behind President Putin's current efforts to rebuild the state by recentralizing power in Moscow. That change could, of course, be either positive or negative for the prospects of democratization and marketization in Russia.

Prospects for Economic Growth

Although the current system is stable, it is not stagnant. Through mid-2000, the Russian economy experienced a strong recovery from the collapse in the last half of 1998. In particular, industrial output has recovered, exceeding that of 1997 by almost 13 percent. The recovery has been especially strong in those manufacturing sectors hit hardest over the last decade: machinery and equipment, textiles, food processing, and chemicals. The question is whether it is sustainable.

Three factors have caused the economic upturn: (1) devaluation, which has priced competing foreign products out of the market; (2) dramatic rises in basic commodity and energy (in particular oil) prices, which have greatly enhanced the relative value of Russia's primary exports; and (3) Russia's continuing regulation of internal energy prices, which have kept production costs for Russian producers low. These factors have led to substantial import substitution in both the consumer and producer goods markets and a strong improvement in the current account. These developments, in turn, have substantially improved the government's liquidity and begun to remonetize economic activity and improve enterprise cash flows, as witnessed by a drop in wage and tax arrears and a decrease in barter. Improved enterprise cash flows have further aided the recovery of state finances to the point where Russia is in substantial compliance with the budgetary and macroeconomic performance conditionality imposed by the International Monetary Fund (IMF), despite limited progress on the required structural agenda.

While these events provide hope for positive economic developments in the next decade, there are also reasons to believe that the underlying basis of this recovery could be fragile.

First, there is little prospect of a sufficient increase in effective demand to sustain expansion after the impact of these factors passes. Nor is there evidence of an increase in mobilizable household savings, which will be needed to raise investment in the maintenance and enhancement of production. Real incomes contracted sharply in 1998, and only now are slowly recovering. The real wage is now just 80 percent of its 1997 level, with wage arrears (both government and private together) holding at some three-quarters of their 1997 level, albeit only half of the late 1998 peak. Pensions and other household transfers are only beginning to be adjusted to the change in purchasing power of the ruble, with the real average pension payment still some 35 percent below the 1998 level. At the same time, capital flight continues and is undiminished, and perhaps even increasing, rate. Although federal tax collection and finances have improved substantially, the improvement is still far less than the rents that have accrued to the energy and export centers from devaluation.

Second, while there has been a substantial increase in domestic investment in the last year, it remains far short of what most observers believe necessary for sustained economic recovery. For the first eight months of 1999, investment was down 0.8 percent year-on-year (YOY) from 1998, when it was only about a third that of 1992. Since then it has recovered to exceed the 1997 level by some 10 percent, but still remains about 60 percent below the 1992 level. Similarly, foreign direct investment (FDI) recovered smartly in 1999, reaching some \$4.6 billion, or about 85 percent of its 1997 level. But it too remains small relative to the needs for retooling. Indeed, cumulative FDI per capita in Russia is less than one-twentieth the level in Hungary. In addition, the new foreign investment has been largely focused on the food, beverage, and—in mid-2000—retailing sectors, which are generating immediate cash flow from import substitution, but which contribute little to the fundamental restructuring needed by industry.

New investment—on the order of 3,200 billion 1998 rubles (\$540 billion, at the then prevalent exchange rate) or about eight times gross investment in 1998—will by some estimates be needed to fully modernize existing production facilities and processes, and to improve the quality of products to international standards. Most capacities inherited from the Soviet Union were obsolete, and extremely inefficient in their use of energy and material inputs. They have been neither replaced nor maintained due to the lack of investment. Despite the fact that current capacity usage is (officially) at a level of 40 percent, over two-thirds of the equipment in use has been in place for over 15 years, and almost one-third is over 20 years old. Most, by some estimates over two-thirds, of the currently idle capacity has deteriorated to the point where it can no longer be brought back into service. Thus the investment needs for restructuring and rebuilding industry vastly exceed current and prospective levels, unless there is a dramatic change in the internal economic environment to make investment for the long term in Russia substantially more attractive.

New investments will not be enough, however. Nothing less than a substantial strengthening of the legal system is essential to improving the operation of markets in Russia. The legislation already on the books governing market activity is generally regarded as up to the standards of an advanced reforming country. For example, the Arbitrazh court system, which adjudicates disputes between businesses and between businesses and the government, has proved to be a relatively successful market institution. Where the court system is lacking is in the weakness of the mechanisms for enforcing court decisions and independent funding of court budgets. Building up the independence and effectiveness of the court system would address another important element of lawlessness in Russia—the willingness of governments at all levels to ignore their own laws and those of superior levels of government. If businesses were given more effective legal rights to challenge the actions of government, in particular, it would provide a check on the power of government to stop businesses from operating.

Scenarios for Russia

Over the next decade, Russia can follow, broadly speaking, three possible paths of development: (1) democratization and marketization, (2) authoritarianism and state capitalism, and (3) stagnation.

Democratization and Marketization

There are some grounds for hope for the first scenario. The record in East Asia and elsewhere suggests that economic growth and increasing prosperity gradually creates pressure for an opening of the political system. A similar process may unfold in Russia over the next generation, especially if elections remain in place and become truly competitive and free and fair. After all, despite a quasi-authoritarian system, Russia possesses a considerable degree of pluralism and competing interests represented by regional elites, oligarchs, civic forces, and media. The last thirteen years of glasnost and post-Communist rhetoric about democracy and human rights have, together with economic freedom, created a citizenry that regards these phenomena as the characteristics of a normal society. Public opinion polls indicate that 35 percent still support continued market reform, while only 24 percent do not. Support for reform is more prevalent among 20- and 30-year olds. Demographics and generational politics could thus be on the side of economic and political freedom. Even if Russia's economy retains the characteristics of a patrimonial system, it should be possible for a new entrepreneurial class to emerge and consolidate its position in society. Over time, this new enterprising sector of society can help create a middle class capable of pressing for significant economic and political reform.

The key question is whether the political leaders will seek to nurture these positive developments or whether they will see them as a threat to their own power and authority. While the elites may be satisfied with the system in the short run, it is clear that this system will not support the type of role the elites want Russia to play in the world over the long run. Putin rose to power with promises of rebuilding Russia and regaining its standing in world affairs, and he will be under pressure to make good on both those promises. But Putin, like the rest of the elite, understands that Russia cannot rebuild successfully without access to Western credits, investment, and technology.

Moreover, Putin himself has called for integrating Russia into the global economy. All of this will require steps that open up the system and provide a further impulse for entrepreneurial activity, even if the current elites do not feel uncomfortable with it. In short, the

The trust between the West and Russia has deteriorated significantly over the past few years. A turn-around is possible, of course, but it will take time and patience.

drive to rebuild Russia may therefore compel the leadership to take steps in the direction of further democratization and marketization. For Russia to become a European power once again may well require Russia to become a European society. And because the economy is currently near a feasible bottom, even small steps allowing clear legal sanction of economic initiative without prior political authorization and improving the transparency of contracting and the effectiveness of legal enforcement would go a long way toward reviving economic activity.

A benign international environment would facilitate the move toward democracy and the market. The current turn toward authoritarianism in Russia is at least in part a response to

Western actions—NATO enlargement, Washington’s pursuit of a missile defense system, and particularly NATO’s air campaign against Serbia in 1999—which Russian elites saw as serious encroachments on their own national security and spheres of influence. The perception of the West as a possible threat has also driven decisions to allocate greater resources to the Russian military and security services and to step up Russia’s diplomatic activity throughout the region. In an environment perceived as less threatening, Russia could devote more energy to building economic and political structures that would enable it to compete successfully in the global economy.

The problem for the West is two-fold in this regard. First, the West must in fact pursue policies that any objective observer would not see as threatening to Russia. This has not been the case over the past few years. It is not difficult to see how some Russians might perceive as threats NATO military exercises off the Crimea or in Central Asia and the Baltics under the auspices of Partnership for Peace. From their perspective, who other than Russia could the conceivable enemy in these exercises be? Second, even if the West pursues less provocative policies, it is not certain that it will be able to convince the Russian leadership that its policies are not threats. The trust between the West and Russia has deteriorated significantly over the past few years. A turn-around is possible, of course, but it will take time and patience.

Authoritarianism and State Capitalism

Authoritarianism and state capitalism might be another scenario for transforming the system. State-building could go hand in hand with a dirigiste economic and industrial policy built around control of the “commanding heights” of the economy (e.g. large-scale industry; the resource, energy, and infrastructure sectors), investment aimed at restoring industrial capacities and rebuilding deteriorated Soviet infrastructure, remilitarization as an engine of development, campaigns against corruption and unauthorized entrepreneurship, strict regulation of small-scale enterprise operating on the fringes of the economy, and Keynesian aggregate demand pumping. This would allow the resuscitation of moribund Soviet industry, reemployment of the bulk of the population, and the further development of a few high priority, high-tech sectors under the guidance and with the support of the government.

Such economic policies are likely to go hand in hand with growing authoritarianism, even if strictly controlled elections are employed to create a veneer of democratic legitimation. Current attitudes and Russian political culture might support such a move. Popular support of “strong” rule appears to be on the rise, the desire for “law and order” is also growing, democratic traditions are weak, and the last ten years have not been kind to elite and popular views of democracy. Putin’s pledge to impose a “dictatorship of law” has resonance.

Such developments may have also enhanced the attractiveness of the authoritarian option. Over the past few years, the Russian political elite has grown increasingly anti-Western, partly as a result of disillusionment with the reform process, partly in response to NATO enlargement, the war against Serbia, and the U.S. pursuit of a national missile defense. Anti-Westernism promotes, and is promoted by, pervasive feelings of resentment, fear, and national humiliation. Not surprisingly perhaps, the Kremlin is seeking to exploit these emotions and to promote patriotism and nationalism as a way of enhancing its ability to mobilize popular support for rebuilding the state and its capacity to extract resources for national purposes. The war in Chechnya is especially important in this respect, both because it has become a symbol of national rebirth and because it has increased the role of the military and secret police in political life.

Sadly, just as Russia may be withdrawing from the West, the West may, unwittingly, be

withdrawing from Russia. The countries of the European Union (which may soon include some of Russia's western neighbors) are undergoing rapid institutional development. As the *acquis communautaire* (the EU's massive body of laws) expands, as economic integration proceeds apace, as joint European institutions multiply, and as the EU's barriers to the movement of people grow, Russia may find itself increasingly isolated from European political and economic processes. A vicious circle could develop as growing isolation promotes greater nationalism and a "fortress Russia" mentality, political authoritarianism and the growing prominence of the security forces; state intervention in the economy, all of which will only further inhibit dynamic economic growth and further isolate Russia.

Some Russian leaders and analysts frequently point to the "Pinochet model" as a possible path for Russia. Whether or not their analysis is correct, the fact is that there are examples of both authoritarian modernization and state capitalism. Russia's own history—in the late nineteenth and early twentieth centuries—suggests as much. The East Asian "tigers" successfully combined authoritarian rule with dynamic capitalist development using interventionist policies that were supportive of private market incentives and enrichment. Social scientists may be absolutely justified in believing that their example may not be applicable to Russia, but policymakers often are, for better or for worse, either ignorant or dismissive of such assessments and proceed to do otherwise.

There is a clear relationship between economic and political reform in all the post-communist states, suggesting that there may be something to their political cultures or institutional legacies that inclines democratization and marketization to proceed hand in hand.

Obstacles to a successful authoritarian course are no less impressive than its blandishments. Dirigiste economic policies would mean the entrenchment of a wasteful economy postponing still further the development of a market economic system. A closed, parasitic, authoritarian, and hyper-bureaucratic system will not fare well in an increasingly globalized economic environment. Indeed, over the long run, authoritarianism appears to be a dead-end. What successes there have been in more interventionist economies (e.g., in East Asia) have occurred because interventionist policies were supported by effective, growth-oriented state institutions. Such institutions do not exist in Russia and it would be optimistic to assume that a reform of the state could produce them in the foreseeable future.

Finally, there is a clear relationship between economic and political reform in all the post-communist states, suggesting that there may be something to their political cultures or institutional legacies that inclines democratization and marketization to proceed hand in hand. In cross-national perspective within Eurasia and Eastern Europe, political reform and economic reform have been positively and intimately related. The concentration of power in the chief executive and the insulation of executive power from exposure to public pressure have had none of the auspicious effects on economic reform that many economists and other social scientists anticipated. On the contrary, many of the region's most reformed economies, from Poland to Mongolia, are found in polities in which power on the national level is separated and dispersed; many of the least reformed economies, from Belarus to Uzbekistan, are found in presidential dictatorships. Democratization and marketization may or may not remain related as conditions change and these countries shed their institutional legacies and transform their cultures, but for the time being the evidence cautions, or should caution, leaders against believing that authoritarianism can produce a market.

Stagnation

The third scenario for Russia is more of the same—a continuation of the system that has developed and consolidated over the past ten years. Under this scenario Putin's reforms could produce some changes in the system—undermining the power of some oligarchs, moving some power from the periphery back to the center, reenergizing parts of the economy—but, at the end of the day, the system would “absorb” the reforms and subordinate the changes to its own logic. There is, alas, no reason to believe that such an outcome is impossible—a variety of dreadfully inefficient and retrograde systems have managed to survive for decades, their key institutional features more or less unchanged, in various parts of the third world.

Even in the quasi-market, quasi-authoritarian environment of a stagnant Russia, however, there would be pockets of democracy and market economics, particularly in large urban centers. Such enclaves could encompass up to twenty percent of the Russian population. Economic expansion would presumably strengthen and deepen these pockets, as well as provide opportunities for them to spread further across the country. Younger generations of business leaders, unencumbered by Soviet indoctrination but frozen out of opportunities for quick enrichment available to the Komsomol alumni of the early 1990s, will begin to clamor for changes in the economic order.

In addition, Russia has already generated over 60,000 non-governmental organizations during the past decade and has sustained vibrant niches within which a nascent civil society endures. Environmental movements are especially robust and are tied to genuine popular concern. Since such agents for change are tied to local concerns, they do not at this moment threaten the overall stability of present economic and social arrangements. They do, however, provide opportunity for positive change in the future.

The continued stabilization of the present quasi-feudalized and highly politicized system in Russia would yield a seriously under-performing economy with a miserable population suffering continued depredations by rapacious elites. Such a dynamic could well produce a truculent, blustering, possibly overly militarized Russia that would be a destabilizing political force. It could also be accompanied by the further parcelization of sovereignty among the regions, each pursuing its own strategy of political and economic development.

This scenario could lead to four highly destabilizing outcomes for Russia, its neighbors in the so-called “near abroad,” and the outside world. The first two are possible in the medium term, while the second two are only plausible in the long term.

First, economic decline and political decay in Russia would, almost unavoidably, diminish the prospects for democratization and marketization in the non-Russian states of the near abroad. Most of them are still highly dependent on the Russian economy; all of them still take their political, social, economic, and cultural cues from developments in Moscow; all of them still have more or less “transparent” borders with Russia through which goods, ideas, people—and refugees—easily pass. A stagnant and unstable Russia will not as a rule make for dynamic and stable non-Russian states. It could of course spur some to strike out on their own and embrace radical change, but such a course will be difficult if membership in NATO or the European Union is excluded and Russia remains these states' major pole of orientation.

Second, stagnation could make Russia especially susceptible to the destabilizing impact of extra-systemic shocks—in particular, those produced by simultaneous crises. It is impossible to say whether and when such multiple shocks might strike, but continued, or even accelerated, systemic weakness would certainly raise the probability that even relatively minor problems—of the sort that

most healthy systems could easily address—could acquire critical proportions. History is full of examples of “triggers” and “sparks” that initiate full-scale systemic disintegration. These may, for instance, be earthquakes, such as that which struck Managua in 1972 and exposed the rapacious nature of the Somoza regime, or fires, such as that in Abadan in 1977 that mobilized Islamic opposition to the Shah of Iran. It may be especially important for President Putin and other supporters of radical change to recall that triggers may also be provided by failed reform efforts—such as the program of *perestroika* pursued by Gorbachev.

Third is the possible disintegration of Russia. This would not necessarily result from the actions of consciously separatist movements, such as we see in Chechnya today. Rather, the continuing erosion of central power that is implicit in the inertia scenario could eventually compel the regions of Russia to look elsewhere to guarantee their security and welfare. Creeping disintegration would also have the potential of destabilizing such states as Ukraine, Kazakhstan, Belarus, Estonia, and Latvia, where large Russian minorities could easily become the targets of irredentist claims and nationalist accusations. Such developments would dramatically raise concerns about the control and safety of the considerable nuclear assets located on Russian territory.

Fourth is that a weak Russia would eventually become an arena of competition, economically, politically, and militarily, among neighboring states and the world’s leading powers. So far, memories of Russia’s former strength, appreciation of its residual military might, and widespread convictions that Russia is preordained to reemerge as a great power have operated as potent disincentives for other states that might consider meddling in Russian affairs. In the absence of a sustained economic recovery, however, the outside world will eventually conclude that Russia’s weakness is not a temporary but permanent condition and that conclusion will inevitably lower the threshold for interference in Russia affairs. Some states might even conclude that it is in their advantage to support separatist forces in specific regions.

Which of these scenarios (democratization and marketization, authoritarianism and state capitalism, or continued stagnation) is most likely? Which is least likely? And what are the likely time-frames in which they are most or least likely to occur? If, as has been argued above, the current Russian political-economic system is coherent, stable, and, as a anarchically organized feudal-type system of authority relations, particularly resistant to directed change, then the first option—while optimal for Russia and the rest of the world—is most likely to occur only in the long run, several decades or generations from now. The second authoritarian-capitalist option may be in the process of asserting itself in the person of Vladimir Putin, but it too is unlikely to produce a breakthrough, both because of the nature of the system and because of the intrinsic limitations on authoritarianism in both the specifically Russian and more general world contexts. The third option of stagnation, albeit punctuated with bouts of authoritarianism and periods of economic growth, thus seems to be the most likely in the short to medium term.

President Vladimir Putin’s Choices

President Vladimir Putin’s background as a KGB officer—indeed, his pride in having served in one of the twentieth century’s most repressive security apparatuses—his distressingly quasi-authoritarian political statements, and his initial measures to centralize power in the Kremlin suggest that he will pursue a tougher line than Yeltsin and make a consistent effort to strengthen the Russian state according to Russian traditions. Putin has surrounded himself with advisors who, like himself, have evidenced tactical rather than strategic thinking. The present leadership of Russia favors administrative solutions over pursuing innovations. Yet all these seemingly decisive steps do

not amount to a strategy capable of leading Russia out of stagnation.

He has shown in Chechnya that he is prepared to go to war and permit his military's crimes against humanity in order to maintain the territorial integrity of the state. He has already taken important steps toward centralizing power and promoting state building. He appears to be committed to reining in the oligarchs and reducing their influence. He has spoken vigorously about the necessity to root out crime and corruption, to establish the "dictatorship of the law," and to promote Russian nationalism and patriotism.

As Putin strives to reassert and expand the authority of the central government, his popularity remains high. According to one poll, he enjoyed an approval rating of 60 percent at the beginning of September 2000. Putin's popularity would seem to reaffirm the traditional idea that the Russian people yearn to be governed by a strong figure, which is partly true. At the same time, Putin must take care not to tread on the individual freedoms, including speech and property, that the Russian people, especially the young, have grown accustomed to over the last decade. Public opinion polls indicate that 35 percent of the Russian population believe that there is a danger of a military dictatorship emerging in Russia.

Whether or not Putin's centralizing measures succeed on a practical level is of course a different question. The above analysis suggested that Russia's feudalistic anarchic system would not lend itself to quick or easy change. But even if one assumes that the system is substantially less entrenched and stable, it is not at all clear that Putin possesses the power, resources, legitimacy, and authority to tackle all recalcitrant power-holders simultaneously. Can he crack down on both the oligarchs and governors without either undermining his own position or becoming too dependent on the "power structures," the secret police and army? In turn, can he retain the loyalty of the police and army—not to speak of the population in general—if the war in Chechnya remains unresolved and thus a constant source of vast resource diversion? Can his appeal to national solidarity and patriotism work if the nation's elites are engaged in a vicious free for all? Can his call for a dictatorship of the law sound persuasive if it increasingly implies a dictatorship of the police? Can crime and corruption both be rooted out, if crime prevention requires the loyalty of possibly corrupt state officials charged with the task? Although there are no obvious, or easy, answers to these questions, their very multitude suggests that, whatever the ultimate course and outcome of Putin's reform efforts, they are unlikely to result in a radical transformation of the system. Unless Putin resorts to massive applications of violence and coercion—and it is hardly certain that he has the resources and authority to embark on such a move—the system is likely to reassert itself. Worse, an unsuccessful attempt at radical change could, in the manner of *perestroika*, even push the Russian system over the edge.

While Putin's centralizing policies may, at least in principle, be reconciled with the pursuit of democracy and the market, it would be naïve of Western policymakers and analysts to ignore the fact that such a mix of attitudes and behaviors has, historically, generally gone hand in hand with political authoritarianism and dirigiste economic development. Russia could of course prove to be a significant exception to this general rule, but it should also be noted that Russia's own pre-Soviet history, traditions, and political culture on the one hand and the seven decades of Communism on the other offer little succor to this hope. Indeed, President Putin's popularity seems to be to a large degree a function of the popular perception that democracy and the market have created chaos and diminished Russia's greatness, that law and order must therefore be reestablished and a strong and powerful Russia must be built. While a strong Russia may be perfectly compatible with democracy and the market—indeed, it may be the case that only a truly democratic and market-oriented

Russia can be strong in today's circumstances—it is not clear that Putin's way of building a strong Russia will be as democratic and market-oriented as policymakers in the West would like.

Indeed, even if Putin's reforms are only marginally successful and the system's logic asserts itself, Russia will almost certainly become even less democratic, and possibly less free. For the time being, therefore, it is probably prudent to proceed on the assumption that democratic development and free-market, non-state-directed, capitalism will not be priorities on the Putin administration's agenda. Policy recommendations should therefore reflect this fact and, as we suggest below, attempt to sustain those democratic developments that have occurred, prepare the ground for future reassertions of democracy, and promote the kinds of economic change that will benefit the population without provoking so much elite resistance as to be non-starters. For better or for worse, both Russian and Western democrats and supporters of the market are entering a period in which they will have to make tough choices possibly involving trade-offs between cherished values, such as democracy, the market, prosperity, human rights, and stability.

Policy Recommendations

The Lessons of the Past

From the breakup of the Soviet Union until Russia's financial collapse of August 1998, the West, with the United States in the lead, was rhetorically and practically focused on the domestic transformation of Russia. The United States in particular was heavily involved in Russian domestic politics, calibrating, to the extent possible given its other goals, the timing of its public statements and announcements of significant initiatives to the domestic political needs of President Yeltsin and a group of "radical reformers." The United States played a leading role in forging the "Washington consensus"—the focus on monetary and fiscal measures for the purpose of macro-economic stabilization—that became the West's guide in pressing economic reform in Russia (as elsewhere in the world). It devised—and sold to its Western partners—an extensive package of assistance programs designed to further democratization and marketization.

Russia's financial collapse marked the failure of the West's approach. This is not to say that it was a failure across the board. There were some successes. In the economic sphere, for example, the West imparted a considerable amount of information on market structures and institutions to Russian officials and businessmen, even if much of it was not immediately applicable to Russian conditions. Exchange programs brought thousands of Russians to the West and gave them at least some sense of how democracies and market economies could function effectively in the real world. But overall, the results in Russia fell well short of expectations in the West and Russia.

What went wrong? In the West, policy-makers failed to pay sufficient heed to how conditions in Russia stood in the way of textbook approaches to the rapid pursuit of marketization and democratization. On economic assistance, for example, the West failed to articulate a coherent, complex, and long-term strategy. Moreover, the programs, at least in their initial phases, relied too heavily on Western consultants without deep knowledge of Russia. Most important, the West failed to appreciate how little popular support there was for reformist policies and therefore tended to brand opponents of government policies as reactionaries who wanted to return Russia to the Soviet past. Worse, the West willfully turned a blind eye to election tampering, vote buying, and sundry other antidemocratic practices, on the rationale that the means pursued by the self-styled "democrats" justified the end of defeating the "reactionaries." As a result, the West found itself allied with a small group of unpopular "radical reformers," pressing ahead with a program against

the wishes of the majority of the Duma and without much public support. Personalities, not policies and certainly not institutions, became the focus of Western reform assistance. Worse, not only was the economic program not fully implemented, but the West's behavior also cast doubt on the depth of its support for democratization.

Russian policy-makers repeated many of the mistakes of their Western colleagues. They too failed to give sufficient heed to the realities of Russia's political and economic situation as it emerged from decades of Soviet misgovernment. Programs were devised by people with some understanding of modern economic theory, but with little practical experience in managing Russia's economy. They saw little reason to explain their policies to the broader public; they did not seem particularly concerned about the real hardships that their policies inflicted on the vast majority of Russians; they railed against corruption while lining their own pockets; and, they were happy to break and bend democratic rules when the situation so required and their power so permitted. Whatever the assessment of the strengths of their economic policies, it was clear to most Russians that the reformers in government cared little about democracy, at least in the short run.

Guidelines for the Future

This analysis leads to several general guidelines for policy-makers wishing to promote democratization and marketization in Russia. Some of them are obvious, but they bear repeating, if only because policy-makers have been prone to ignore them in the past.

First, any policy must be grounded in Russia's current political and economic system. That means that policy should not be left to the theoreticians alone, be they economists or political scientists, as it was to a great extent in the 1990s. Practitioners must be brought into the process, if only because they have invaluable knowledge about how policies might be subverted.

Second, both in Russia and in the West, policy-makers need to move away from the hardball politics of Soviet-type "*kto-kogo*," or a "good guys vs. bad guys" approach, toward more compromise-oriented and inclusive political mechanisms. Russian economic policy-making and reforms require patient consideration in formulating and adopting significant new measures and close attention to the character of the existing institutional fabric so that pragmatic, productive institutional reforms can be designed. Such reforms presuppose an ability to focus on the prosaic elements of policy and institutional reform, an ability that has not been seen in abundance in the actions of Russian policy-makers and multilateral financial organizations in the last ten years. Relatedly, it is important that all elements of systemic change—democratization, marketization, and state building—be pursued simultaneously, lest any one feature gain the upper hand and profound systemic distortions result. Democracy and the market can only function in the presence of a state that establishes rule of law, but a state that is unfettered by democratic and market controls could easily come to resemble a fascist dictatorship with little sustainable legitimacy and thus capacity to promote real change.

Third, Western-styled democracy and market economics cannot be imposed. They can only be nurtured—above all, by Russians themselves. As a result, Russians should take the lead in devising economic and political strategies for rebuilding their country. At the same time, the West should be prepared to offer advice when asked, to assist in carrying out those policies that make sense from its standpoint, and not to support those policies that it abjures. Moreover, the West should be hesitant to offer more than general advice on how specific problems might be tackled. Detailed programs should be lent up to the Russians, both in the government and private sectors, and Western assistance should go to a wide spectrum of recipients.

Fourth, Western policymakers and advisors must appreciate that, if they genuinely expect Russians to view their political and economic system as an appropriate model for Russia, Western countries must act consistently with the expectations to which they themselves have given rise. The West cannot speak of promoting democracy and markets in Russia and of integrating it into the world while simultaneously pursuing myopic or self-interested policies that undercut popular participation, promote immiseration, and isolate Russia.

Fifth, Russia does not exist in a vacuum. The non-Russian states of the near abroad affect it as much as it affects them. It is imperative to remember that policy choices inevitably resonate beyond the borders of any one country. Western policymakers must therefore always calculate the impact on Russia of policies—such as continued NATO enlargement—pursued with respect to the non-Russian states. Policymakers must likewise consider the impact on the non-Russians of policies—such as turning a blind eye to crimes against humanity in Chechnya or supporting economic integration within the CIS—pursued by or with respect to Russia. In turn, Russian policymakers must avoid questioning the validity of internationally recognized borders, engaging in irredentist posturings, and promoting hyper-nationalist rhetoric—even if their sole intent is to mobilize internal political support. Tensions between Russia and its neighbors will always obstruct, and never promote, healthy domestic change.

Sixth, reform must enjoy the support of larger segments of the Russian population. On the one hand, a much greater effort must be made to explain policies to the broader public, including segments traditionally resistant to reform, to build the type of support necessary for successful implementation. This is all the more important now because the types of structural reforms required to rebuild Russia will depend on millions of Russians changing their expectations and behavior. On the other hand, it is imperative that policies bring immediate tangible benefit to the population. The time is long past when any government can assume that the Russian public is prepared to make considerable short-term sacrifices for vague long-term benefits. The sustainability of any program will depend on incremental success in improving the economic situation of the population, whatever the program's long-term consequences.

Seventh, there are no quick fixes to the multiple ills afflicting Russia. Building a vibrant democracy and a prosperous economy will take at least a generation, because at base it will take more than just institutional changes or improved performance on a range of concrete issues. Changing institutions and improving performance are hard enough, especially in current circumstances. Things appear even more complex in light of the fact that genuine democratization and marketization will also require changing ingrained habits, many acquired in the Soviet period, many traditionally Russian.

For Russia

What, then, may realistically be expected of Russia in general and Russian policymakers in particular at this point in time? Ideally, constitutional reform involving the transformation of the “super presidency” adopted by Yeltsin and exploited by Putin into a more balanced system of government should be at the top of Russia's hypothetical list of priorities. It is unrealistic, however, to expect President Putin to countenance abandoning the very powers that have, thus far, permitted him to pursue a variety of centralizing measures. Because the prospects for continued democratic development appear to be weak, the following recommendations, for Russia, focus on economic reform, especially of the kind that would move the economy in a market-oriented direction and improve the lives of ordinary Russians—without necessarily under-

mining elite power and quasi-authoritarian rulers. It goes without saying that the measures noted below should be pursued along with a program that continues to foster macro-economic stabilization.

- **Tax Reform**

First on nearly everyone's potentially "doable" list is tax reform. Indeed, Putin has already taken significant steps on this issue. Nevertheless, the tax system remains in dire need of dramatic simplification, and "uniformization"—establishing clear, simple rates that are uniform across all agents, independent of branch, activity, position or history. The categories taxed should be relatively few and clearly observable in current accounting systems; they can be adjusted as a second important change is introduced, i.e. modern accounting categories and standards. Second, tax enforcement must be made fully transparent and legally accountable, and fully separated from the banking and local governmental administrative systems. A reform should also involve clear assignment of different specific categories of tax to different governmental units/levels, with joint collection and sharing eliminated in order to improve accountability and transparency. Tax reform, however, can never be truly successful unless there is a corresponding effort to reform government's propensity to spend money "off-budget" to evade parliamentary control and IMF loan conditions. While some elites will suffer from a comprehensive tax reform, it should also be possible to improve the system without alienating the most powerful elites.

- **Judicial Reform**

The effective operation of a reformed tax system, as well as any improvement in the operation of markets in Russia, will require a substantial reform of the judicial system. Federal laws, ignoring ad hoc Presidential decrees and the innumerable administrative "instructions," are generally adequate, if still incomplete, for further marketizing development, but are woefully enforced, and often roundly ignored by powerful political and economic agents, in particular regional and city governments. While a greater degree of rule of law will alienate some elites, it may find support with some proponents of more authoritarian solutions.

A politically independent judicial and enforcement system could then begin, case by case, enforcing and protecting the establishment and trading of effective property and contractual rights, an elementary prerequisite for proper market development. It is particularly important, as an initial step, to enforce the contractual rights of employed workers to their full, negotiated wages; this will provide a necessary spur to essential market-oriented restructuring of industry as well as have the side-benefit of enhancing the regime's popularity and legitimacy. And it will cut into the rent extraction by managerial "owners" who have uses other than covering costs for the income their enterprise receives, releasing resources for entrepreneurial market development. Bankruptcy could then also become an economically meaningful procedure, mobilizing improperly used economic resources for effective employment, rather than an instrument of property seizure or political revenge, as is sometimes the case.

- **Protection of Private Property**

The security of private property should be at the center of economic policy. The government itself is the greatest danger to private property rights. The arbitrary tax regime, the unmonitored activities of tax collectors, and the multitude of officials that inspect business facilities and issue licenses all impose huge burdens on business. These burdens are probably the reason why small enterprise growth has been so much slower in Russia than in other transition countries.

Unless government restrains itself and is constrained by the legal system, the small enterprise sector will not become the engine of growth that it has been elsewhere. Where there are strong calls for reversals of those privatizations that had the character of theft due to the flouting of procedural rules, then the appropriate institution to handle these is the court system. There is some basis for hoping that the courts will handle the issues as effectively as any other Russian institution could. The average Russian citizen will not be helped by any punishment of past theft that is perceived by investors to be motivated by political motives rather than by legal processes.

- **Corporate Governance**

From the viewpoint of improvement in the economy, rather than economic justice, a more important task for government is to foster improvement in the ownership structure and the corporate governance regimes of the enterprises that have been privatized, especially those privatized in the voucher program. Governmental efforts to consolidate shares and to sell block-holdings to strategic investors and to encourage initiatives that persuade the manager-worker owners of poorly performing enterprises to sell out to such investors should be based on small programs limited by their initial infusion of capital, constrained by a charge that these programs should make a profit, and that they have only the power of the purse to take ownership stakes. Linkage can be made with attempts to handle the settling of tax arrears and the processing of bankruptcies. Organizing such schemes on a regional basis will help provide the relevant competition and decentralization that is appropriate. Here, too, existing elites are unlikely to protest against policies that legalize their own ill-gotten gains.

For the West

What can the West—including government, business, foundations, and non-governmental organizations—do? Most of all the United States and Europe have to accept that they can do little and that they have a minor role in determining developments in the Russian economy. The West can give financial assistance and it can offer those skills that it has in abundance. Overall, the West should seek to work at the lowest levels of the institutional structure, eschewing the glamour of trying to move the levers of power concentrated around the Kremlin and instead working in the “Siberia,” both literally and figuratively, of real institutional processes. It will be necessary to move from a shock strategy to a strategy of patience and prepare for a long process in which setbacks and regressions will occur and in which the West will be blamed for many of the evils now going on in Russia. The strategy of patience has to be complemented with a strategy of confidence, this time not towards “big” reformers but toward those “small” reformers with a sense of measure and reality.

Despite these limitations, the West’s primary goals at this point in time should be 1) to ensure that the construction of effective and powerful state institutions in Russia do not outrun the construction of democracy and the market and, in this spirit, 2) to preserve the democratic gains that Russia has already made, especially if, as seems likely, Russia embarks upon a spell of authoritarian rule. The West can do this by pursuing policies that encourage the development of bottom-up initiatives rather than top-down decree, by focusing its efforts on the preservation of formal democracy—the rules, regulations, and procedures involving party competition, periodic elections, and media independence, and by creating an international environment that is supportive of Russia’s continued integration into global processes and Western institutions.

The temptation for the West to rationalize a turning back of democratic gains as necessary to make Russia safe for foreign direct investment may, if some of Putin’s putative reforms take off,

become enormous. This temptation must, if Russia's long-term welfare matters more to the West than short-term profit, be resisted.

It is particularly important to promote change among elements within Russian society that are less than fully committed to democracy and the market. In the early years of reform, it might have been necessary to aid only proponents of change so as to ensure their survival as a force to resist reversal of reforms. But large-scale and long-term reversal in the form of the restoration of Soviet-style Communist administrative economy and authoritarian political regime is no longer in the cards, though a number of unpleasant alternatives may be in the offering. So the question is no longer one of reserving a place in Russian politics for supporters of reform, but of determining which efforts will promote continued reform most effectively and efficiently. That may entail promoting programs that persuade opponents of reform that reform is imperative to their own well-being and that train them to adapt successfully.

A strategy based on patience, small steps, democratic consolidation, and societal consensus implies the following policies:

1. *Supporting independent democratic media and engaging journalists in exchanges and dialogue.* Business development funds should be encouraged to devote resources to the financing of what can become fiscally viable independent publishing and broadcast media efforts. In the absence of economic conditions that can sustain financially viable media, Western donors should help finance the deficits incurred by independent media and provide support for indigenous organizations supporting press freedoms. At the same time, it is imperative that anti-reform journalists be exposed to the workings of the free media. Involving them in training, internships, and exchanges in the West is imperative.

2. *Promoting entrepreneurial forces within and enhancing the effectiveness of organizations pressing for the interests of small businesses and entrepreneurs.* Policies and initiatives that improve the environment for small business development would include resources for small business investment loans based on the model of Central European Enterprise Funds. Efforts aimed at the self-organization of small business organizations could include efforts to establish more vibrant "chamber of commerce" structures, grass-roots movements pressing for deregulation, and stronger enforcement of contracts.

3. *Focusing on forces pressing for the rule-of-law and on forces responsible for maintaining rule of law.* This would include grants and technical assistance to organizations (legal aid groups, civil liberties associations, and human rights groups) that use the legal system to press for property rights, due process, contract enforcement, the protection of minorities, civil rights protections, press freedom issues as well as training and exchange possibilities for judges, police officers, border guards, and others involved in actual law enforcement activities. Similarly, it is imperative that Western agencies abjure the kind of methods that reinforce cronyism and corruption. Developing a Code of Conduct for Western agencies and actors would go a long way to showing Russians that aid programs do not rest on double standards and a sense of superiority.

4. *Creating exchanges and dialogues to reach opponents of reform.* Grants and programs of technical assistance—possibly involving collaborative programs with U.S. and East Central European counterpart organizations—should expose anti-reform groups and individuals to successful reform efforts in Poland, Hungary, the Czech Republic, and Slovakia, engage them in discussions with former opponents of reform in these countries, and offer examples of successful adaptation to democratic and market-oriented conditions.

5. *Supporting successor generations and unemployed workers and pensioners.* Exchange programs and scholarships for college and graduate students should target Russia's future generations of leaders. Year-long residencies for Russian students in Western countries can, as the success of current exchange programs have demonstrated in other settings, have a profound effect on changing values, building institutions, and promoting understanding. Programs should also focus on the unemployed, pensioners, and others who possess skills but lack the opportunity and know-how to participate in a marketizing economy. Further, technical assistance with respect to educational programs involving retraining and pension reform should also be provided.

6. *Helping Russia resolve the Chechen crisis as soon as possible.* If, as has been argued, continuation of the war in Chechnya can torpedo democratization, marketization, and state building, then it is imperative that the international community, led by the West, devote at least as much effort to helping find a solution there as in the Middle East and former Yugoslavia. The Balkan Stability Plan may be an appropriate model for thinking about Chechnya.

7. *Promoting programs that reinforce the view of Russia as a civilization rooted in many of the values and traditions of Europe.* These initiatives can include cultural exchanges, support for joint European-Russian research and cultural efforts, support for educational institutions which promote curricula that expand awareness of Western and European ideas and traditions, and historical projects that focus on Russia's European links. By the same token, it is imperative that European policymakers also work hard to overcome popular attitudes of mistrust, suspicion, and fear of Russia at home. Europeans must accept Russia just as much as Russians must accept Europe.

8. *Resisting policy measures that enhance Russia's isolation from the world, the West, and its neighbors.* It would be a mistake to close the eastern borders of the enlarging European Union to Russia. Care must be taken that the adoption of the Schengen Convention rules for travel security controls by East European nations does not create a new iron curtain that separates Russia from the West. Borders should be kept as open as possible to Russian tourists, scholars, and business people. Punitive visa regimes that succeed in keeping honest Russians out of the West are no way to promote democracy and markets in Russia. In addition, it is imperative that the United States and the European Union both open their own markets to Russian products and abandon the knee-jerk protectionist tendency to accuse Russia of dumping. It is also important that Western governments resist the temptation of providing Russia with credits specifically earmarked for the purchase of Western products (such as grain), thereby obviating Russian agricultural reform and undercutting Russia's economic relations with its own neighbors.

9. *Creating an international environment conducive to democratic state-building and marketization.* The West has to remember that the policies it pursues outside of Russia can and do affect developments within Russia. A benign, constructive, and open international environment will be

most conducive to Russia's democratic revival and democratic state building. This will require the West to reassess, if not the substance of its policies, at least the way they are presented to Russians and the way Russia is engaged as these policies are formulated. At a minimum, greater attention has to be paid to the consequences on Russian politics of further NATO enlargement, U.S. anti-missile defense policy, and NATO out-of-area activities.

10. *Maintaining a common Western approach toward Russia.* It is imperative that the United States and Europe maintain a common approach toward Russia if the full benefits of success in Russia are to be realized. U.S.-European cooperation will be tested in coming years when the difficulties surrounding the trade-offs mentioned above are likely to become most acute. Russia's pursuit of more authoritarian practices at

The hope is that the lessons of the past will help both Russia and the West to pursue this common interest in a democratic and market-oriented transformation in Russia with greater intelligence and mutual respect.

home or a more assertive defense of its interests abroad, for example, could provoke different responses in the United States and Europe. Geographic proximity and greater vulnerability could compel Western Europe to seek ways to accommodate such developments, while the United States could seek more forceful ways of reversing what it would see as challenges to its core values. The cohesiveness of the West and its key institutions could very well be weakened in such circumstances. Western policymakers will have to be especially sensitive to this possibility and work hard to resist letting it emerge. In addition, the United States and Europe must impress upon Russian leaders that any effort to play the United States off against Europe will retard their own country's integration into global and European institutions and thus jeopardize Russia's transition to a functioning democracy and market economy.

Despite the disappointments of the past decade, the concerns of the present, and the problems of the future, the prospect of a successful transition—of Russia's integration into the world of democratic, market-oriented nations—must remain the guiding policy for the West in the years to come. Likewise, Russia should remain focused on integration into the West. This process offers Russia its best hope of building a successful society and raising its status in the world. As was the case a decade ago, Russia's success is far from certain. The hope is that the lessons of the past will help both Russia and the West to pursue this common interest in a democratic and market-oriented transformation in Russia with greater intelligence and mutual respect. That in itself would raise the odds that Russia and the West will finally reap the full and still great benefits of Russia's success.

Meetings of the Russia Initiative

Saturday, December 11, 1999/ Working Group

Newark. Cosponsored by the Center for Global Change and Governance, Rutgers University; Carnegie Endowment for International Peace; and the Carnegie Corporation, New York

“Russia Initiative: Political Democratization and Economic Reform in Russia”

Thomas Graham, Senior Associate, Carnegie Endowment for International Peace, Washington, D.C.; Alexander Motyl, Deputy Director, Center for Global Change and Governance, Rutgers University; Blair Ruble, Director, Kennan Institute; Pilar Bonet, Berlin Bureau Chief, El Pais; Richard E. Ericson, Professor, Department of Economics, Columbia University; Steven Fish, Associate Professor, Department of Political Science, University of California, Berkeley; Adrian Karatnycky, President, Freedom House, New York; Olga Kryshstanovskaya, Director, Institute of Policy Studies, Moscow, Stephen S. Moody, independent investor, Pensacola; Peter Murrell, Professor, Department of Economics, University of Maryland, and Jonathan Sanders, journalist, New York

Friday, February 4, 2000/ Working Group

Cosponsored by the Center for Global Change and Governance, Rutgers University; Carnegie Endowment for International Peace; and the Carnegie Corporation, New York

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Friday, May 12, 2000/ Working Group

Cosponsored by the Center for Global Change and Governance, Rutgers University; Carnegie Endowment for International Peace; and the Carnegie Corporation, New York

“Russia Initiative: Political Democratization and Economic Reform in Russia”

Thomas Graham, Senior Associate, Carnegie Endowment for International Peace, Washington, D.C.; Alexander Motyl, Deputy Director, Center for Global Change and Governance, Rutgers University; Blair Ruble, Director, Kennan Institute; Pilar Bonet, Berlin Bureau Chief, El Pais; Richard E. Ericson, Professor, Department of Economics, Columbia University; Steven Fish, Associate Professor, Department of Political Science, University of California, Berkeley; Adrian Karatnycky, President, Freedom House, New York; Olga Kryshstanovskaya, Director, Institute of Policy Studies, Moscow; Peter Murrell, Professor, Department of Economics, University of Maryland, Jonathan Sanders, journalist, New York; Peter Reddaway, Professor of Political Science and International Affairs, Elliott School of International Affairs and Department of Political Science, The George Washington University, and former Director, Kennan Institute; Deana

Arsenian, Senior Program Officer, International Peace and Security, Carnegie Corporation of New York, Inc.; Rajan Menon, Director, Eurasia Policy Studies, National Bureau of Asian Research, and Monroe J. Rathbone Professor of International Relations, Lehigh University, Bethlehem, PA; Michael Mandelbaum, Director of American Foreign Policy, School of Advanced International Studies, Johns Hopkins University; Kate Schechter, Task Manager, Street Children Initiative, World Bank, Washington, D.C.

Friday, June 29, 2000/ Seminar

Kyiv. Cosponsored by the Kennan Kyiv Project

“Russia Initiative: Political Democratization and Economic Reform in Russia”

Ihor Burakovsky, Professor, Department of Economics, University of Kyiv-Mohyla Academy; Oleksandr Derhachov, Editor-in-Chief, Politychna Dumka; Oleksii Haran, Professor, Department of Political Science, University of Kyiv-Mohyla Academy; Volodymyr Kulyk, Senior Scholar, Institute of Political and Ethnic Studies, Kyiv; Olena Malynovska, Head of Division, State Department of Nationalities and Migration; Alexander Motyl, Deputy Director, Center for Global Change and Governance, Rutgers University; Oleksandr Pavliuk, Director, EastWest Institute, Kyiv, and member, Kennan Institute Advisory Council; Yaroslav Pylynsky, Project Officer, Kennan Kyiv Project; Blair Ruble, Director, Kennan Institute

Monday, July 3, 2000/ Seminar

Berlin. Cosponsored by the German Council on Foreign Relations

“Russia Initiative: Political Democratization and Economic Reform in Russia”

Pilar Bonet, Berlin Bureau Chief, El Pais; Tatiana Buschina, Junior Research Fellow, Daimler Chrysler Research Institute, Berlin; Jean-Pierre Froehly, Director of French Studies, German Council on Foreign Relations; Wolfgang Grabowski, Special Adviser on Russian Affairs, Party of Democratic Socialism; Thomas Graham, Senior Associate, Carnegie Endowment for International Peace; Michael Harms, Regional Director, Cooperation Office of the German Economy; Micheala H`nicke, Thyssen Fellow, German Council on Foreign Relations; Alexander Motyl, Deputy Director, Center for Global Change and Governance, Rutgers University; Heidi Reisinger, Head of Scholarly Division, Military Academy, Strausberg; Klaus Segbers, Director, Institute for Eastern Europe, Berlin; Michael Sthrmer, Chief Correspondent, Die Welt; Frank Umbach, Research Fellow, German Council on Foreign Relations; Vladimir Bosnik, Vice President, Planning and Technology, Krasbank, and Research Fellow, Russian Federation Council; Alexander Davydov, Head of Strategic Analysis and Prognosis Department, Russian Federation Council; Sergei Moskalev, Research Fellow, Russian Federation Council

Thursday, September 7, 2000/ Seminar

Irkutsk. Cosponsored by the Moscow School of Political Studies, Council of Europe, Open Society Institute HESP Programme, and the Irkutsk Regional Duma

“Federalism and Local Self-Government”

Pilar Bonet, Berlin Bureau Chief, El Pais; Thomas Graham, Senior Associate, Carnegie Endowment for International Peace; Sergei Alexeev, Deputy, Regional Duma, Novosibirsk; Andrei Andreev, Federal TV & Radio Company Kuzbass, Kemerovo; Lyudmila Antonova, Head, Public Relations Department, Irkutsk City Administration; Vadim Bondar, Deputy, Russian State Duma; Andrei Botov, Head, Executive Committee, Tumen Regional Branch, Union of Right Forces party;

Sergei Butakov, Mayor, Sayansk; Andrei Deryabin, Head, Media-group, Psychology University, Novosibirsk; Yulia Dolgopolova, Director, NGO Business-consulting, Irkutsk; Sergei Ertzenkin, Deputy Director, Novosibirian School of Civil Society, Novosibirsk; Yuri Faleitchik, Deputy, Irkutsk Regional Duma; Stanislava Garashchuk, Editor-in-chief, Segodnya in Irkutsk; Konstantin Gureev, Head, Department of Youth Policy, Krasnoyarsk; Evgeny Ineshin, Research Fellow, Irkutsk State University; Andrei Isachenko, Head of Department, BratskGEstroy Bank, Angarsk; Raisa Karmazina, Deputy, Regional Duma, Krasnoyarsk; Olga Kashnik, Assistant Professor, Siberian State University of Railroad Communications, Novosibirsk; Dmitry Kaverzin, General Director, Agency Nachalo Dnya, Krasnoyarsk; Vladimir Kazanov, Director, Dialogue-Angarsk company, Angarsk; Bogdan Kepshuk, Chairman, Committee on Public Relations, Tumen City Council; Pavel Khrapov, Head, Analytical Center Status; Alexei Kleshko, Deputy, Krasnoyarsk City Council; Vladimir Knyagin, Advisor to the Chairman, Krasnoyarsk Regional Duma; Elena Kondratenko, Editor, Tumensky Efir; Valentina Konyuhova, Deputy, Tumen City Council; Yuri Korenev, General Director, Business Invest company, Irkutsk; Elena Kostina, Section Editor, Soviet Siberia; Alexei Kozmin, Deputy, Svirsk Regional Duma; Alexei Krasnopeev, Deputy, Regional Parliament, Republic of Buryatia; Vladimir Kulesh, Deputy, Irkutsk Regional Duma; Sergei Kurgansky, Deputy Head, Movement of New Generation party, Irkutsk; Yuri Kurin, Deputy, Russian State Duma; Irina Lenshina, Argumenty i facty; Yelena Lykova, Deputy Head, International Department, Kaliningrad Regional Administration; Dmitry Lyustritsky, Political Section Editor, Vostochno-Sibirskaya Pravda; Andrei Makulov, Chairman of the Executive Board, Forbank, Barnaul; Valery Mankov, Deputy, Usolie-Sibirskoye Regional Duma; Galina Markova, Director, Center of Practical Psychology, Bratsk; Petr Mashitsky, Head, Yolochka, Sakha-Yakutia Republic; Mikhail Matkhanov, Deputy, Irkutsk Regional Duma; Vladimir Medvedev, Correspondent, Tribuna; Alexei Menshikov, Deputy, Krasnoyarsk City Council; Vladimir Mikhailov, General Director, Dina, Tumen; Mikhail Nekrasov, Chief Manager, Transpolyarny Airport, Bratsk; Nina Kekrasova, Head of Tax and Price Policy Department, Krasnoyarsk City Administration; Anna Nevzorova, Editor-in-chief, Irkutsk State TV and Radio Company; Sergei Nikitin, Deputy Director, Institute of Regional Legislature, Irkutsk; Elena Nizienko, Head of Education Department, Angarsk City Administration; Victor Novokshenov, Mayor, Angarsk; Vera Oskina, Chairman, Regional Branch of the Unity party; Galina Pashinina, Deputy, Krasnoyarsk City Council; Vladimir Pashkov, Deputy Head, Bratsk City Administration; Natalia Pavlova, Deputy, Krasnoyarsk City Council; Konstantin Pereladov, Assistant Professor, Novosibirsk State Teacher's Training University, Novosibirsk; Yuri Petukhov, Chairman of City Elections Commission, Novosibirsk; Alexander Popov, Consultant, Union of Right Forces party, Barnaul; Artur Pyanov, Head of Department, SM-number one company, Irkutsk; Alevtina Repina, Lawyer, Glaux company, Irkutsk; Anton Romanov, Deputy, Irkutsk Regional Duma; Yuri Ryabchenyuk, Chairman, Committee on Local Self-Government, Tumen; Alexander Ryabov, Deputy Editor, Irkutsk State TV and Radio Company; Sergei Rykov, Deputy, Krasnoyarsk City Council; Alexei Salmin, Director, TAC-GAZ holding, Tumen; Vladimir Samykin, Center of Practical Psychology, Bratsk; Svetlana Seredkina, Chairman, Movement of New Generation party, Irkutsk; Iliya Sheglov, Head, Novosibirsk Youth Union; Andrei Shuleptsov, Head, Regional Center on Human Rights, Tumen; Vyacheslav Sidorkin, Deputy, Tumen City Council; Yuri Sizykh, Assistant to the Director on Public Relations, Krasnoyarsky Kombayonovy Zavod, Krasnoyarsk; Vladimir Smirnov, Member, President's Advisory Council, Republic of Buryatia; Konstantin Sobolev, Deputy, Republic of Buryatia Regional Duma; Sergei Sokolov, Deputy, Ulam-Ude City Council; Lidia Suvorova, Director, Angarsk School of Entrepreneurs; Renat Suleimanov,

Deputy, Novosibirsk City Council; Elena Tkachenko, Head of Public Relations Department, Bratsk City Administration; Oksana Tomilova, Editor-in-chief, Atkis news service, Angarsk; Nikolai Trufanov, Deputy, Ust-Kut City Council; Galina Tyntueva, Consultant, Committee on Local Self-Government, Republic of Buryatia; Anton Tyrtyshny, Novosibirsk State University; Oleg Tumenen, Editor-in-chief, Vremya, Angarsk; Sergei Ubraev, Deputy, Barnaul Regional Duma; Maksim Ustinov, President, Mego youth organization, Bratsk; Maksim Valchenko, Senior Fellow, Bratsk City Administration; Igor Vashurkin, Director, Maidan, Tumen; Andrei Vasilev, Deputy, Krasnoyarsk Regional Duma; Dmitry Vinogradov, Section Editor, New Siberia, Novosibirsk; Yulia Yazovskaya, Correspondent, Kommersant; Konstantin Zaitsev, Deputy, Russian State Duma; Mikhail Zakharov, Deputy, Irkutsk Regional Duma; Artur Zakirov, Press Service, Irkutsk Regional Duma; Galia Zakirova, Director, Baikal Women's Center Obnovlenie, Irkutsk; Oksana Zapolskaya, ITAR-TASS; Andrei Zhirnov, Correspondent, NTN-4

Friday, October 20, 2000/ Working Group

Cosponsored by the Center for Global Change and Governance, Rutgers University; Carnegie Endowment for International Peace; and the Carnegie Corporation, New York

“Russia Initiative: Political Democratization and Economic Reform in Russia”

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Notes

¹ This report is prepared under The Russia Initiative Program of Carnegie Corporation of New York in cooperation with the Carnegie Endowment for International Peace, the Kennan Institute of the Woodrow Wilson Center, and the Center for Global Change and Governance at Rutgers University, Newark. The authors have, in part, drawn on the discussions of the Russia Initiative Program Working Group on Democratization and Economic Reform in Russia, chaired by Thomas Graham (Carnegie Endowment), Alexander J. Motyl (Rutgers University), and Blair Ruble (Kennan Institute). Working Group members are: Pilar Bonet (Berlin Bureau Chief, El Pais [Madrid]), Richard E. Ericson (Department of Economics, Columbia University), Steven Fish (Department of Political Science, University of California, Berkeley), Adrian Karatnycky (Freedom House, New York), Olga Kryshnanovskaya (Institute of Sociology of the Russian Academy of Sciences, Moscow), Stephen S. Moody (independent investor, Florida), Peter Murrell (Department of Economics, University of Maryland), and Jonathan Sanders (journalist, New York). Joseph Dresen and Allison Abrams of the Kennan Institute served as staff for this project.

The Working Group as a whole has endorsed the broad thrust of this report, but this endorsement does not signify that each individual member necessarily agrees with every point in the analysis or all of its recommendations.

² Strobe Talbott, "The End of the Beginning: The Emergence of a New Russia," Address delivered at Stanford University, Stanford, CA., September 19, 1997. Text available at <<http://www.state.gov/www/regions/nis/970919talbott.html>>.

³ These scores are on a scale of 1 to 7, where Hungary, the Czech Republic and Poland score in the 1.25-2 range and Turkmenistan, Uzbekistan, and Belarus score 7 or just below. For more on this report and methodology, see <<http://www.freedomhouse.org>>.

The Russia Initiative: Social Cohesion

Report by
Judyth L. Twigg and Kate Schechter¹

The people of Russia have endured an alarming degradation of health conditions and dramatic material distress since the collapse of the Soviet Union. Russian policymakers, worried about the impact of a declining quantity and quality of population on future economic productivity and armed forces staffing requirements, have repeatedly referred to this situation as a national security crisis. It would be easy to assume that these developments, while perhaps compelling from a humanitarian perspective, are far removed from United States national interests. But they are not. The declared policy of the United States government is to promote democracy, economic reform, and stability in Russia. In order for Russia to make meaningful progress in these areas, it needs a stable middle class engaged in the development of a robust civil society. Instead, the Russian social landscape has become one of stratification into haves and have-nots, with the majority of the population disengaged from a government it no longer trusts to provide even a minimal safety net of social protections. Chechnya, “loose nukes,” and controversy over ballistic missile defense may grab all the headlines, but it is this creeping and pervasive social and health crisis that may most starkly determine the future of Russia.

Russia’s social afflictions should merit international attention on humanitarian grounds alone. The growing health problems, the deterioration of living standards, the large numbers of homeless children begging in the streets, the hunger that has descended on poor isolated villages, and the consequent loss of a viable society that can engender trust cannot fail to provoke an emotional and sympathetic response. But Russia’s mounting social woes also carry economic, political and even strategic ramifications. Continuing depletion of the country’s human and social capital will make a Russian economic recovery all the more difficult. Further tearing of Russia’s social fabric will correspondingly impede the development of the trust-based civil society upon which stable democratic systems rest. And a social collapse—or explosion—in Russia could set in motion a series of grim events whose reverberations might be felt far from Russia’s borders.

The numerous problems afflicting Russian society have already begun to reach far beyond its geographic boundaries. Russian organized crime extends worldwide in areas such as narcotics, sexual trafficking, and money laundering. Environmental degradation results in an increased risk of transboundary pollution, including the threat of nuclear contamination. The Kursk submarine tragedy is only the latest demonstration of this danger. Economic deprivation threatens an increased flow of economic migrants, including scientists whose skills might aid rogue states in the

production of weapons of mass destruction.

The cross-border impact of infectious disease should also provoke U.S. and international concern about the future of Russia. Multi-drug resistant tuberculosis can infect anyone, not just in low-income or prison populations but on airplanes, and the cure is just as complex and expensive for a wealthy American traveler as it is for a convict in Siberia. The spread of HIV and other sexually transmitted diseases likewise cannot be stopped at the border. Many of the trans-boundary impacts of Russia's social ills affect Europe more directly than the United States, but the U.S. of course feels the imperative to help preserve European security from such threats. For all of these reasons, the United States has a strong national interest in helping Russia combat these problems.

The Soviet Legacy

During the Soviet period, the state claimed to provide a comprehensive system of social benefits. The social contract between the Soviet state and its citizens entailed cradle to grave security in exchange for individual freedom and token support for the communist regime. The Soviet government claimed to provide free and universally accessible health care, housing, education, and child care, guaranteed employment, and retirement pensions. The state, however, could not always fulfill its obligations under this social contract. The quality of benefits in particular was often barely adequate. Lack of concern for the social welfare of the population beyond the level of rhetoric, and consequent lack of funding, was the primary barrier to meaningful implementation of the state's end of the social contract. Although Soviet propaganda touted its system of health care, for example, as proof of the success of socialism, in an effort to convince its workers and foreign observers that the people's health was considered important, the reality in factories, hospitals, and clinics belied these claims. Throughout the Soviet period, health care never warranted more than six percent of GNP, and through the 1970s and 1980s it received around three percent of GNP.

Although quality standards of health and social services were dismal compared to their Western counterparts, the Soviet social contract was maintained. There was indeed universal access to a basic level of health services; all children received an effective primary and secondary education, resulting in almost 100 percent literacy rates; everyone had a roof over their head, even if this meant sharing a cramped communal apartment with several other families; and the pension system ensured that the elderly were fed and cared for. The Soviet social safety net may have been a shabby one, but it was comprehensive and intact, and people came to rely on it. Now, during the transition to a market economy, the state has significantly and rapidly withdrawn from even this meager level of basic social services, leaving a vacuum that thus far has not been replaced by a new social welfare system. Although the Russian government can arguably claim to have succeeded in establishing at least the trappings of democracy and a market economy, it has failed the vast majority of its citizens in an area most of those citizens still consider a state responsibility. The old state-funded system struggles to survive in an environment where funding has evaporated, policy is ineffective, and a functional privatized or self-help system has not yet emerged.

Loss of Social Cohesion

The rapid withdrawal of even this flawed social contract has produced a nationwide loss of social capital and collapse in social cohesion. Seemingly overnight, a comprehensive welfare system

that guaranteed basic needs changed into a competitive, dangerous environment where the rules of the game are far from clear.

Social cohesion and social capital are admittedly Western terms that have recently reemerged as fashionable. As Robert Putnam has pointed out, the phrase “social capital” has been “invented” repeatedly in the American social science literature over the course of the last century, and its definitions have varied widely. Nevertheless, the core concept—that a society that engenders trust, networks, associations, and communities is a more efficient and successful society—is arguably a universal one that can be applied to Russia despite its decidedly non-Western Tsarist and communist history. The failure of many post-Soviet bureaucratic state and market institutions would ideally provoke a compensatory cohesiveness at the individual and community level. Instead, Russian social decay has produced a situation in which even informal coping networks are largely breaking down. The collapse of the Soviet social safety net has both caused and been exacerbated by this loss of social capital.

The forces that held Soviet society together were coercive, and although the state tried to create community and cohesion, these were largely a facade that came apart rapidly as soon as the state withdrew from the social sector. Families and close friends confided in each other, but societal networks as a whole were based on suspicion and lack of trust and therefore remained static, unable to engender any genuine civic engagement. Even though there was underground cohesion (such as the famous “kitchen table” talks where people spent hours bonding with a close circle of family and friends), Soviet society was so repressed that civil society could not exist, the economy stagnated, and creativity was thwarted. It would be false to claim that social cohesion flourished in Soviet times and now has disappeared. On the contrary, what little social cohesion and trust existed amongst families and friends has eroded even further during the post-Soviet transition, when living conditions and the basic social welfare of individuals have reached crisis proportions. In the Soviet era, for example, “babushki” or grandmothers often felt it was their civic duty to scold and intervene when they saw children misbehaving in public, even if the child was a stranger—there was a sense of community and propriety which made these unsolicited comments commonplace. By contrast, in today’s Russia an orphanage for disabled children outside Moscow reports that the surrounding villagers, all elderly pensioners, regularly steal the vegetables planted by the children and sell them on the highway in plain sight of the hungry orphans.

Francis Fukuyama has argued that a nation’s well-being and ability to compete are dependent on the level of trust embedded in its society. Communities and individuals must trust one another in order to develop social capital, which Fukuyama defines as “a capability that arises from the prevalence of trust in a society or in certain parts of it.” Fukuyama identifies three sources of social capital. The first is the state, which in the Russian case has withdrawn significantly from its role in the public sector, and which in any case currently engenders hostility and mistrust from the population. Russia’s transition has been characterized by severe deficiencies in governance which have imposed additional costs on the population, over and above those that might have been expected as part of the introduction of market mechanisms and institutions. Notwithstanding its stated commitment to macroeconomic stability and the implementation of cautious fiscal policies, on a number of occasions during the 1990s government initiatives resulted in the granting of massive tax exemptions and/or tax deferrals to certain enterprises and lobby groups, with detrimental implications for budgetary revenues. In the context of nominal budget deficits agreed upon at the outset of the fiscal year, these initiatives necessarily led to the compression of expenditures, including in such areas as education, public health, and human capital investment. These sharp spending

cuts undoubtedly contributed to increases in social instability and an erosion of public support for market reforms and other government policies in general.

The second potential source of social capital, associations and civil society, hardly existed in the Soviet era, but something like it was provided through the network of state ownership of production. In the 1960s through 1980s, Soviet state enterprises constructed free-of-charge social support networks for employees through workplace-based hospitals and polyclinics, kindergartens, summer camps, vacation and rehabilitation centers, and even in most circumstances food and living quarters. During the last ten years this source of social capital has disintegrated, and new trends in this category are still in a nascent stage of development. Autonomous professional associations and independent organizations were forbidden in the Soviet period, and they have been slow to emerge in the present environment. Domestic philanthropy is also poorly developed, and non-governmental charities often face such complicated bureaucratic red tape that few functioning legitimate charitable organizations exist in Russia. The church undertakes some of this kind of activity, but there are not enough active believers and church-goers to constitute a stable source of social cohesion.

Third, families and circles of close friends could in theory constitute a source of social cohesion. In Russia, this source is even more important now than it was in the Soviet era, given the need for mechanisms to navigate the dramatic changes in the general economic situation. But in today's Russia the majority of families are not coping well and thus cannot provide a source of strength in society. These individual "cells" of social capital cannot compensate adequately for weakness at the state-based and group-based levels.

This erosion of social cohesion creates a vicious cycle where worsening health conditions, the breakdown of the family, the inability of the state or families to care properly for their children, and the myriad of other social crises facing Russia continue to grow and cause a further loss of social cohesion. Social cohesion is clearly linked to the health and welfare of communities. Studies have shown that civic engagement and social cohesiveness are statistically correlated with life expectancy. In Great Britain during World War II, for example, life expectancy among non-combatants actually increased despite the material and psychological stresses of wartime conditions. The health of the population improved because the nation was united in a common spirit and common purpose. According to Amartya Sen, in this case the system of food rationing, which provided basic sustenance to the poorest population groups, was also of particular importance for the improvement of health conditions; of course, the leveling of material circumstance implied by a rationing scheme would have contributed to that sense of common circumstance and sacrifice. Social networks and communities that work together can enhance the quality of life for a community and can help people protect each other.

It would be reasonable to expect that such a rapid withdrawal of the state from the social sector might have caused a general collapse of the Russian government. Logic would dictate that the Russian people march in the streets to protest such a dramatic degradation of their social and material circumstances. Even though this has not occurred, the lack of trust amongst individuals and the public distrust of the government remains deeply rooted. Instead of mass protest, people have been trying to cope at the individual and family level, exhibiting large-scale "opting out" behaviors such as binge drinking, the emergence of a powerful mafia, and a rise in crime and suicide (for the latter, an increase of almost 75 percent for men from 1989 to 1994, with an absolute rate far exceeding that of other industrialized countries). These are all indicators of a society that has lost its social glue.

The Health and Demographic Crisis

Precise operationalization and measurement of social capital and social cohesion is a difficult task. General health and social welfare can be used as a proxy in this discussion because of their close relation to the core concepts. In post-Soviet Russia, the picture painted by these indicators is a bleak one.

The Russian population is shrinking at an alarming rate. Currently, deaths are exceeding births by over fifty percent, amounting to about 700,000 people “lost” per year. The latest official statistics reveal a total population decline of 3.4 million, or almost three percent, since 1992, with the negative trends accelerating rather than abating. Adult male mortality increases have been particularly shocking. Annual death rates among men ages 15 to 64 climbed by 35 percent from 1990 to 1993, with an increase of over fifty percent for men ages 45 to 54 over the same time period.

Birth rates have plummeted from 2.2 children per woman of childbearing age in the late Soviet period to 1.24 in 1997, 40 percent below the population replacement rate of 2.1. These low levels are due not merely to conscious decisions to defer childbearing until socioeconomic conditions improve. If that were the case, then Russia might expect a “baby boomlet” should the economy stabilize and prospective parents therefore feel more secure adding the burden and responsibility of a new family member. But reliable estimates attribute at least part of the dismal birth rate to infertility, with 15 to 20 percent of all married couples unable to reproduce. The prevalence of infertility currently increases by more than three percent annually. These alarming figures are due in part to a skyrocketing rate of sexually transmitted diseases – new incidence of syphilis has increased by 77 times (not percent, but times!) since 1990 – and also to multiple abortions. The frequency of abortions remains extremely high in Russia. With the procedure still free on demand at most hospitals and clinics within the first trimester (and not difficult to obtain later in a pregnancy), and with virtually no social stigma attached to it, twice as many abortions as live births were experienced in Russia in 1997. This amounted to almost 2.5 million terminated pregnancies, with nearly 40 percent of those botched by the health care system to the point that the woman required antibiotics or hospital treatment.

Russian life expectancy at birth in 1998 was 67.0 years, a drop of 3.2 years from 1987’s figure of 70.2, but a rebound from the transition period low of 64.0 in 1994. Most dramatic were the life expectancy patterns for males in the early part of the 1990s, which plunged from 64.2 years in 1989 to 57.6 in 1994, including an astonishing one-year drop (from 1992 to 1993) of more than three years, from 62.0 to 58.9. This figure has since rebounded to 61.3 in 1998, regaining more than half of its recent loss. But considerable uncertainty clouds the direction of this vital indicator, particularly since it fell again in 1999, a potentially important reversal of a previously hopeful trend. The major difference between current Russian mortality patterns and those of the Soviet period is the extremely high death rate of young adults aged 15 to 35 from violent causes, alcoholism, acute cardiovascular conditions, and tuberculosis. The totality of these figures has led to well-publicized and apocalyptic predictions of an unmitigated population crisis, with well-known demographer Murray Feshbach, for example, speculating that there may be only 80 to 100 million people left in Russia by the year 2050 (down from 148 million in 1996).

The explanations for excess death in the 1990s lie predominantly in two categories: cardiovascular disease (heart attacks, strokes, etc.), and “external causes” (injuries, suicide, homicide, poisonings, and the like). Alcohol plays an important proximate role behind both these sets of factors. A recent individual-level study of mortality among men ages 20 to 55 in two Russian regions found

that about 40 percent of men who die from causes other than cancer do so drunk, and more than half that number die in an extreme state of intoxication, with a significant concentration of deaths on Saturdays or Sundays due to heavy drinking on weekends. According to a *Kommersant* report on the study, conducted by Vladimir Shkolnikov (formerly of Moscow's Center for Demography and Human Ecology), "Everyone is drunk: murderers and their victims, drowning victims, suicides, drivers and pedestrians killed in traffic accidents, victims of heart attacks and ulcers." Nationwide, adult men consume an average of 160 to 180 half-liter bottles of vodka per year, equivalent to a bottle almost every other day. The Ministry of Health estimates that 40 percent of adult Russian men and 17 percent of women are seriously affected by alcohol.

The obvious culpability of the vodka bottle for the demographic crisis has led some demographers, ironically, toward cautious optimism. They have argued that death from circulatory disease and external causes decreased following the start of the infamous Gorbachev anti-alcohol campaign in 1985. Mortality then skyrocketed in the early 1990s when alcohol consumption resumed with a vengeance, driven by the psychosocial stress of the political and economic transition. Put bluntly, the 1990-1994 plunge in male life expectancy can be explained by the fact that men who should have died earlier—during the 1985-1990 anti-alcohol campaign period—did not. According to this view, their deaths were temporarily postponed due to the Gorbachev-inspired expense and decreased availability of vodka. Once their drinking resumed a few years later, spurred by the sharp worsening of economic conditions and psycho-social stress of the unexpected and rapid transition from state paternalism to an unfettered market, those people all died at once. This behavior produced the unprecedented life expectancy and excess death figures experienced in the early 1990s. Once this dynamic played itself out, male life expectancy surged back to "normal," and by the end of the decade, it was approaching late Soviet levels.

Alcohol consumption, embedded in the general stresses of a chaotic social environment, breeds violence. Extremely high mortality from violence may be the most significant contributor to the present alarming mortality pattern. In 1998, the standardized mortality rate from homicide was twice that of the Soviet period, 39 murders per 100,000 population for men, and 11 for women. Russia is therefore now one of the murder capitals of the world, second only to Colombia, South Africa, and the African-American population of the United States. And a recent rapid increase in registered mortality from unspecified violent causes suggests that the real number of homicides in Russia might be substantially higher than the number of registered cases.

Overall, however, Shkolnikov has argued that recent positive trends point to a near future in which mortality in Russia will level off or slowly increase, albeit at a very high level. Feshbach and others instead emphasize new threats on the horizon, in particular, a rise in the spread of infectious and parasitic disease—an argument bolstered by statistical trends in the mid to late 1990s. In particular, concern is mounting about the contribution to mortality likely to be posed by tuberculosis and HIV/AIDS. While the absolute numbers for these diseases, in terms of their contribution to total causes of death in Russia, are still relatively low, their rate of growth is startling.

The Russian mortality rate for tuberculosis was 16.9 per 100,000 persons in 1997, 34 times that in the United States, and representing a doubling over the previous five years. In 1998, prevalence of the disease was reported at 74 cases per 100,000 population, which ranks Russia among the top ten countries in the world for tuberculosis infections. It is uncertain, however, whether even these official statistics capture the vast majority of Russians suffering from the illness—prison inmates—and they almost surely miss other likely infected populations such as the homeless, forced migrants, refugees, people living in railroad stations, and the like. International specialists have

called Russia's city jails "the focal point of the TB epidemic," with every third sufferer in a place of detention, one out of ten prisoners infected, and that number increasing by 25 percent a year.

The wildfire-like spread of the airborne disease within prison cells is easy to understand, given incarceration conditions. The average inmate has a living space "smaller than the size of a coffin," about one-third of a square meter, with prisoners taking turns lying or sitting on bunks. In terms of financial, pharmaceutical, and staff resources for treatment, prisons fall woefully short. As a result, many prison physicians stretch their scarce resources at hand, doling out partial doses or incomplete regimens of medication to infected persons. This well-intentioned approach ignores the fact that tuberculosis is a disease better left untreated than partially treated; drug-resistant strains proliferate if a steady and complete stream of antibiotic medication is not available to kill all the bacteria. As a result, at least one-third of infected prisoners are now estimated to carry a multi-drug resistant strain of tuberculosis, making a cure almost prohibitively expensive and the disease much more lethal. A recent trend among prisoners has been to infect themselves intentionally, in the hopes of being transferred to TB wards where conditions are perceived to be more comfortable than the astonishingly overcrowded main cells.

The potential threat from HIV and AIDS is even more alarming. Annual numbers of officially registered deaths from AIDS are unreliably small (about 100 cases per year in 1998 and 1999) due to under-registration; many deaths from opportunistic infections are not classified as caused by HIV/AIDS. An explosion in venereal diseases and rapid increase in morbidity and mortality from tuberculosis among young and middle-aged adults, however, suggests that Russia is on the verge of a major AIDS epidemic. Vadim Pokrovsky, the head of Moscow's Center for HIV/AIDS Research, forecast last year that Russia would be home to one million HIV-infected people by 2003. As of January 2000, officially reported data registered the number of confirmed HIV carriers at 25,000, but the primary means of contracting the disease in Russia – through intravenous drug use – has discouraged sufferers from reporting themselves to the authorities. Pokrovsky estimates that the official figures are understated by a factor of eight to ten, meaning that in reality approximately 200,000 Russians currently are HIV-positive. Whatever the absolute figures, it is clear that the spread of HIV is accelerating at an alarming pace. There were three times as many new cases in 1999 as in the previous year, and an amazing twelve-fold increase from 1997 to 1998 in the city of Moscow and the Moscow region. Arkadiusz Majczyk, the United Nations AIDS representative in Russia, predicts that a "second wave" of infection, based on heterosexual transmission, is right around the corner. Already fourteen percent of Russian prostitutes, who often use intravenous drugs, are infected.

Russia's health care system is ill equipped to deal with this situation. Chronically underfunded during Soviet times, and cut to barely more than half of Soviet levels today, Russian hospitals and clinics exist on a shoestring. A system of nationwide compulsory medical insurance instituted in 1993 held some promise for extra cash, but like the state budget it suffers from chronic underpayment and late payment of taxes due into its coffers. Despite the earnest efforts of most physicians and nurses, dreadful quality of medical care is the result. A shockingly high percentage of health facilities have no hot water or sewage systems, and most still use glass syringes and reusable needles, with sterilization procedures far below Western norms. Patients suffer long waits even for urgently needed care. A long list of medications is not only unaffordable, but unavailable. Perhaps most disturbing, a higher quality of services, in a system where comprehensive free medical care is constitutionally guaranteed, is now routinely provided only to the small number of people with the ability to pay for it. State-owned clinics openly (and illegally) demand money for such

basic services as a spot at the head of the queue, accurate diagnoses, routine attention from ward nurses, anesthetics and other drugs, and the like. One recent study found that one-fourth of St. Petersburg residents were required to pay more than twenty percent of their monthly incomes for their most recent medical encounter. Perhaps inevitably, health care has succumbed to market forces, but in a chaotic and uncontrolled manner that has left the most vulnerable parts of the population unprotected. One of the hallmarks of the Soviet system, universal access to some level of free medical care, has been destroyed.

Increased Poverty and the Social Welfare Crisis

Official statistics place about 30 percent of Russia's population at below the subsistence level. Some figures are higher; in the aftermath of the 1998 financial crisis, World Bank analysts estimated that about 45 percent of the population was living in poverty. According to the Bank's figures, in the mid-1990s about 14 percent of the population was "very poor," with monetary incomes below half of a government-defined minimum subsistence level (and many experts consider the definition of that level inhumanly low). About 17 percent are classified as consistently, longer-term, rather than occasionally poor. According to Brown University's Linda Cook, this situation has stemmed from declining incomes and increasing income disparities, delays in payments of wages and benefits, and unemployment, all the result of the harsh transition to a partially marketized economy. Pensioners living alone, most of them women, have been vulnerable, though the pension system has provided some protection for this group. Hardest hit are households with more than one child, households adding a child, and households affected by unemployment. The single largest factor associated with increased poverty is the birth of an additional child. According to household surveys, in the mid-1990s more than 50 percent of households with a newborn were poor.

One tragic consequence of the recent impoverishment and psycho-social stress has been an alarming increase in the number of abandoned children. The rate of infants and toddlers aged 0-3 living in an institutional setting has risen by 64 percent since 1989—and these are the lucky ones. The Russian streets are home to an estimated one to three million children. This number is a moving target that, for obvious reasons, will always be difficult to count accurately. The number of children actually living in the streets changes depending on the season, with a huge growth in the summer months. Almost 95 percent of these children are "social orphans," cast out or neglected by living parents who clearly have lost the material or psychological wherewithal to care for their offspring. According to recent government estimates, around 90 percent of Russia's 600,000 orphans in institutions are such "social orphans." The adult mortality crisis is also indirectly taking its toll on children. The premature death of parents contributes to the skyrocketing number of orphaned or abandoned children. UNICEF estimates that as many as 700,000 children in Russia have been affected by the premature death of a parent. The dramatic rise in crime during the transition period has also hurt these most vulnerable populations. The majority of violent crimes in Russia occur in the home, with an alarming number of women killed by their husbands every year. Divorce rates are on the rise, and there is little or no legal protection for women and children. Despite shrinking birth rates, fewer marriages, and a decline in the overall number of children, it is estimated that one million children are affected annually by divorce throughout the region.

Guardianship and foster care networks remain underdeveloped, a legacy of the Soviet preference for the orphanage system, and bureaucratic obstacles, financial disincentives, and social stig-

mas often discourage potential Russian adoptive parents. The “bargain” developed by the Soviet government created a society where citizens became extremely state-dependent. In the area of child care, a belief system evolved wherein many citizens came to see state institutions as more appropriate arenas for child rearing than individual families. The communist government encouraged ethnic minorities and poor families to give their children to state institutions, where many believed their children would be better off than at home. The USSR housed almost 300,000 children in institutions. These orphanages and boarding schools continue to struggle to operate and have become even more crowded during the 1990s. Still hoping to rely on the state, parents continue to bring their children to institutions in the hope that they will be provided with food and shelter. But state-run institutions are unable to accommodate the growing demand, and many children are turning to a life on the streets—begging, prostituting, and often turning to the use of drugs.

Many street children turn to prostitution simply as a means of survival. Moscow and Kiev are centers for networks trafficking in the sale and pimping of young women (the majority are thought to be between the ages of 15 and 20) as prostitutes. These women are then brought to “work” in the Czech Republic, Hungary, and other Eastern European cities, or they are moved to other parts of the world, stripped of their passports, and sold to brothels. Most of the victims are literally slaves. They are illegal immigrants, with no passports, forced to work as prostitutes and most often receiving little or no pay.

Regional Success Stories

In sum, the Russian population has experienced an unprecedented collapse in health and economic welfare in the last decade, and the Russian government in Moscow has had little success in alleviating the distress. But at the regional level, some success stories provide optimism that effective policies can be implemented to mitigate these circumstances. Some charismatic local leaders, for example, have helped children who have been abandoned or have run away from abusive parents. In Moscow and St. Petersburg there is a handful of small shelters that call themselves non-governmental organizations (NGOs) but get partial funding from the government. These shelters take any children who need assistance, whether or not they have identification papers (state institutions require *propiski*, or proof of nationality). Because they are not completely dependent on state funding, these “non-governmental” organizations can circumvent state rules such as a maximum stay of 30 days before a child must be moved to an orphanage or detention center or placed with a legal guardian. This kind of grassroots response to a severe social crisis reveals the potential goodwill and social capital that could be tapped if the socioeconomic environment were a little less severe. The people who run these shelters are paid almost nothing for their efforts. They are shunned by the government orphanage system and eke out an existence through foreign contributions and the meager funding they receive from the state, yet a number of them have persevered through the last few years as the demand for their services continues to grow exponentially.

The drawback of this nascent network of shelters is that it constitutes only a “band-aid” approach to a severe and pervasive social crisis. These shelters can manage a maximum of 30 to 40 children at any given time. They cannot absorb all the children who arrive at their doorsteps. Unless the state responds and begins to create preventive measures to help families in crisis, these small rays of hope can do little to stem the flow of children into the streets.

In the health care arena, a few regions are providing more comprehensive and promising examples of systemic reform. Samara, for example, is universally heralded as a pathbreaker in this area. Its progress seems to derive from the confluence of a variety of important factors. First of all,

regional political leaders have afforded health care top and consistent political priority. Diligent efforts by regional health insurance bodies and landmark legislation passed by the oblast Duma have resulted in practically full funding of health care budgets for the past two years. It is impossible to overstate the uniqueness of this situation. Literally every other one of Russia's 89 regions struggles with late or underpayment of health insurance taxes, leaving their coffers underfinanced and therefore their universal coverage promises impossible to fulfill. In contrast, Samara has voluntarily added benefits to the list of basic health services mandated by law.

Samara's success also stems from its creative efforts to spend each health care ruble efficiently and effectively. Having abandoned the Soviet-style, central planning-oriented provider reimbursement mechanisms that remain the norm in most of the country, Samara now has in place an array of incentive structures to discourage wasteful spending at hospitals and clinics. The region is also developing a network of general practitioners, in an effort to overcome the Soviet habit of unnecessary and expensive physician overspecialization. The presence of family doctors affords patients greater freedom of choice and a higher quality of comprehensive services on a cost-effective outpatient basis.

Samara also encourages state physicians to offer paid services within regular polyclinics and hospitals. Due to high start-up costs, there is still a relatively small number of physicians in private practice. But many state facilities now offer private, fee-based services alongside of those covered by the state, and patients can choose to make these legal additional payments either for treatments not covered by basic national insurance, or for higher-quality or more comfortable provision of state-mandated services. This mechanism has now, for the first time, provided physicians with an incentive to work harder and offer higher standards of care, despite the fact that their state salaries are still mandated according to rigid salary scales. They compete for the opportunity to provide these paid services, and they keep a portion of the proceeds earned from the business they attract. Visits to some of Samara's clinics that offer paid services and therefore enjoy this additional income, and those that do not, offer a striking comparison. The former contain at least some modern, Western equipment, and are undergoing significant capital repair, with evident new construction and remodeling. The latter continue to exhibit the shoddy construction and technical standards that were a hallmark of meager Soviet health care quality.

The success of Samara's reforms is difficult to dismiss, with dramatic reductions in infant mortality rates in recent years (12.2 infant deaths per 1,000 live births in 1998, compared with a figure of 16.5 for Russia as a whole) and an undeniably greater return on each health care ruble. The lessons of its experience—the importance of stable leadership and policy continuity in the health and social sector, and the magnitude of what can be accomplished when high political priority is assigned to these issues—should be instructive for other regions throughout the Russian Federation.

Russian reformers at the national level have conceptualized federal policies to regulate the health sector's transition to a market economy, taking into account the need for regulatory mechanisms that maintain access for the poor and discourage wasteful spending. These include reducing the Soviet-era focus on expensive inpatient care, instead performing routine tests, therapies, and even surgeries on an outpatient basis where appropriate; training a new generation of family practice physicians to overcome the Soviet habit of overspecialization; permitting patients to choose their own physicians, clinics, and hospitals, so that the benefits of competition can be realized; removing physicians from rigidly-set government wage scales, so that they feel a monetary incentive to provide more and better treatment; adopting provider reimbursement mechanisms other than

fee-for-service, or worse, Soviet-style fee-per-hospital-bed-occupied, which encourages inappropriately long lengths of stay and gross inattention to quality of care; and monitoring insurance company and provider behavior to limit adverse selection and eliminate or regulate the provision of paid services. In a handful of Russian regions, these and similar policies have been implemented to varying degrees, some with impressive results. Samara's example demonstrates that the key ingredients to success are attentiveness to the health sector and political will among leaders at the regional level, which should be applauded and encouraged where they exist. Certainly a significant increase in health budgets should be one of the first priorities of Russian social policy. However, given the obvious difficulties in achieving meaningful increases in health budgets, measures to improve fairness and efficiency are essential to "cure" Russian health care.

Policy to Combat Poverty

Government policies designed to alleviate poverty are similarly hampered by the legacy of Soviet practice. The Soviet government refused to acknowledge the existence of poverty or unemployment, and therefore universal benefits were simply distributed to recipients defined by ideology rather than need. Children's allowances, for example, were until very recently provided to all families, regardless of their income levels. Until the age of 16 (18 if the child remains in school full-time), each child was eligible for a benefit equal, on average, to the state-defined minimum wage, with additional payments if the mother was single or if either parent served in the armed forces. According to one recent study, however, 64 percent of households living below the subsistence level did not receive these payments, while 60 percent of total payments went to better-off families. For those poor families who have received the benefit, it constituted a significant share of their monthly incomes – 47 percent for those in the bottom income decile – while contributing less than five percent of income to those in higher deciles. In other words, the poorest of the poor have been the most dependent on this money, and yet they have been the ones most often not receiving it.

Pensions have been the primary mechanism for preventing and alleviating poverty among the elderly, who comprise nearly twenty percent of the total population. Although as a whole this group has weathered the transition better than the other end of the age spectrum, there is still plenty of room for concern about the impact and efficacy of the pension system. In particular, the minimum pension, distributed to about seven million people, is pegged at less than half of the minimum subsistence level, and its purchasing power steadily declined throughout the 1990s. According to former International Monetary Fund economist Augusto Lopez-Claros, from 1991 through 1996 the real value of the minimum pension fell by about 70 percent, and the corresponding value of the average pension by 35 percent. Compounding the situation is the fact that delays in pension payments are endemic, with arrears regularly totaling in the tens of billions of rubles. The impact of these figures is illustrated by consumption patterns. About three-fourths of pensioners' incomes is spent on food, with the diet heavily dependent just on basic staples. In order to make ends meet, many older Russians have continued to work well past retirement age (60 for men and 55 for women), which for several years for men meant past the average life expectancy.

The federal government has tried to restructure its social benefits system, to replace numerous universal schemes with packages targeted specifically at those in greatest need. Until recently, these proposals almost uniformly met with legislative defeat, as pensioners and especially the well-organized veterans' associations mobilized to retain and even increase their allocations. In addition, all too often the demand for financial stabilization has provided an excuse to postpone or avoid reform in the system of social benefit. But the Putin government has adopted an approach that, if

existing and pending legislation is implemented fully and as written, holds the promise of more efficient allocation of scarce resources. For example, the child benefit is now to be partially means-tested. Critics have claimed that means testing is administratively difficult, particularly given the Russian state's limited administrative capacity, and that it is impossible to measure "means" in a partially monetized economy. Yet those with shadow incomes—and their number may grow smaller under the new income tax regime—would be reluctant to apply for the benefit if it meant potential exposure of their questionably legal activities, effectively deterring those who neither need nor deserve the payments from greedily taking them. The Putin government is clearly gambling that the money saved by withdrawing benefits from the better-off will more than compensate for any additional administrative costs.

The pension system could also realize new efficiencies. A humane measure to alleviate poverty among the elderly would, for example, raise the minimum pension to the government-defined pensioner subsistence minimum, and/or link it predictably to the cost of living or to the average wage. Means testing of pensions may be politically unpalatable. But the costs of a minimum pension increase could be offset by raising the retirement age for women, a reasonable gesture given the fact that the current retirement age for women—55—is five years below that of men, despite female life expectancy outpacing men's by about twelve years, and very low by the standards of industrial societies. Cuts or changes in the myriad inherited special and privileged pension schemes might also be possible. Putin economic adviser Andrei Illarionov has proposed a Chilean-style partial privatization of the pension system, which would make pension provision partially dependent on financial markets and would require their stabilization. Cost savings could also be achieved through regional indexation, given that regional governments still provide direct subsidies for housing, transportation, utilities, and other essentials, resulting in wide differentiations in costs of living throughout the country.

What Can and Should the United States Do?

Why should American policymakers and the American public be concerned about these horrific trends in Russia? After all, Western nations have been providing monetary and technical assistance to Russia since the early 1990s, yet crises persist. The very real and most commonly cited cause for concern is obvious: the Russian state remains a major nuclear power that could pose a serious threat if provoked or weakened. But Western concern for Russia's welfare should extend beyond the barrel of a gun or the tip of a missile. The \$20.3 billion (including multilateral assistance and commercial financing and insurance) spent in U.S. financial assistance to Russia from 1992 through 1999 has engendered politically charged accusations of ineffectiveness and corruption. But only a small percentage of that aid was devoted to the health and social sphere.

A growing body of research indicates that health may be at least as important as education in fostering long-run economic growth, and that declines in health status such as the AIDS epidemic in Africa or Russia's mortality crisis can significantly dampen economic growth. The effect operates through declining labor productivity, in which less healthy citizens are physically less productive at work or require more care from working family members, and also through the reduced incentives created by declining life expectancy to invest in education and savings for the future. The failure to recover economic prosperity in Russia may affect not only political stability in the country, but may also have negative consequences for the economic and political stability of Russia's neighbors, a link clearly demonstrated by the impact on the region of Russia's 1998 financial crisis.

Even more startling may be the ramifications of the decline in human capital for Russia's ability to operate and maintain its sophisticated technological infrastructure, a dynamic illustrated starkly by the recent Kursk submarine disaster and the fire that consumed Moscow's Ostankino television tower. "It's as if we've angered the gods," wrote the weekly newspaper *Argumenty i Fakty* in the wake of the twin disasters. A front-page article in *Novaya Gazeta* just as the television tower fire was being brought under control only added to the almost apocalyptic mood. The bi-weekly newspaper published the comments of a chemical safety specialist, who noted that hundreds of spectators who had gathered around the tower as it burned had been exposed to highly toxic dioxins, which can cause genetic damage, given off by the large number of electric cables burning inside. The authorities, the author noted, had not said a word about the potential dangers of dioxin emissions from the burning tower. Meanwhile, *Argumenty i Fakty* estimated that it would cost \$40 to \$50 billion every year for a decade to repair Russia's crumbling infrastructure. The grim infrastructural situation, above all, was a ringing indictment of the spending priorities of both the Soviet rulers and their successors. According to Duma deputy Alexander Shokhin, no significant maintenance on the country's infrastructure has been carried out for at least twenty years.

Why haven't the Russian people protested more vehemently? Why have they not taken to the streets in anger? Historically, people who are going through such severe hardships do not have the time, energy, or material wherewithal to organize politically. Anger over the increasing impoverishment of the majority of Russians has been tempered by political apathy and a general sense of malaise and hopelessness about the future. The aftermath of the Kursk submarine tragedy is one of the first public displays of resentment of the abuse of power and waste of resources that have plundered Russia for the last decade. Political scientists have noted that public protests and marching in the streets often occur when conditions begin to improve slightly. People's rising expectations outstrip the slow betterment of their actual circumstance. Some analysts have speculated that this scenario may come to characterize the Russian situation. So far, the Russian government has responded to organized protest—strikes, for example—with a "fire brigade" approach, allocating resources locally and often temporarily to dampen nodes of dissatisfaction as they appear. As the mortality crisis appears to be stabilizing, however, and the economy improves even marginally, it may become even more critical to ask whether more widespread and politically significant protests will emerge.

Another possible scenario is a return to a form of authoritarianism that might restore social benefits and more broadly, social "order," but which would come at the price of the hard-earned personal freedoms that the Russian people have experienced over the last decade. A poll taken in late June, 2000, by the All-Russian Center for the Study of Public Opinion (VTsIOM) among 500 Muscovites found a large majority saying they believe that social protection is more important for Russia today than freedom of speech (61 percent to 23 percent). At the same time, an even larger majority said they felt that economic growth is more important than social protection (66 percent to 24 percent). This suggests that the population would support a turn either toward a modified version of paternalistic Soviet-style authoritarianism or toward a Pinochet-like or East Asian growth-oriented model of authoritarianism—or a hybrid of the two. Whatever the case, President Vladimir Putin remains popular (his approval rating hovers around 65 percent) despite—or, perhaps, because of—his apparent determination to crack down on opposition media like Vladimir Gusinsky's Media-Most. If Putin opts once and for all for a "soft authoritarianism" to maintain his power, Americans should be very concerned about the ramifications.

What can and should the United States do to foster improvements in Russian health and social welfare? First of all, the situation is not so grave as to be hopeless. Russia's 1999 government

budget was the first in the post-Soviet era actually to be implemented as written, so even the low-priority health and social sectors may now be able at least to operate in a predictable financial climate. And there are glimmers of hope, success stories of reform at the local and regional levels that offer instructive lessons and potential models for adaptation and replication. The Samara region has already been mentioned; its combination of well-constructed policy reform and moderate international assistance has produced significant improvements in health status and cost-saving efficiencies throughout the health care system.

International donors have played a key role in other local successes. A modest U.S.-funded program in Dubna, a city near Moscow, for example, has substantially improved public health conditions by partnering with key officials at the grass roots level to construct and implement locally-defined quality control standards in hospitals and clinics. The key here, in contrast to some less notable foreign aid efforts in Russia, was the fact that local leaders identified the problems at hand and crafted the solutions. The project was supervised by governing boards consisting of representatives of Dubna's municipal government, health administration, relevant professional societies, and the media. The American partners provided guidance and some necessary intellectual and financial tools to carry out the work, but they did not attempt wholesale to impose a Western model on a Russian sister city. This grass-roots methodology gave the Russian participants a sense of ownership and commitment to the project, guaranteeing its sustainability and adaptability to changing circumstances.

These latter factors are important considerations and challenges for American policy toward the Russian health and social sector. Only a small handful of international aid projects continue indefinitely. Eventually, Western money will run out. When that happens, if projects in place are not sustainable, it is possible that they will have done more harm than good, addicting aid recipients to unaffordable policies and procedures. A partnership program between Moscow and Berlin to treat leukemia in Russian children illustrates this dilemma. Germany's efforts, which provided full funding to transplant literally its entire modern treatment regime for this disease—medications, clinical protocols, nursing procedures—produced amazing results, with dramatically enhanced survival rates. One cannot understate the importance of the lives that were saved. But now the cash flow has stopped. While the Russian clinics and patients may be better off than they were before in terms of knowledge about how to treat the disease, it is impossible to put that knowledge into practice without the money to buy the prohibitively expensive drugs that are crucial to the therapy. The program could have realized even more substantial benefits had it been accompanied by domestic fund-raising activities, and/or a search for ways to make the treatment cheaper without a sacrifice in quality of care.

The main mechanism for U.S. support for Russian economic reform during the 1990s has been funding through the international financial institutions. During the period August 1992 through July 1998, the International Monetary Fund alone disbursed about \$20 billion. These programs have woefully neglected social concerns, and may have unwittingly encouraged Russian government indifference to the worsening social situation. Moving forward, these programs must bring social concerns to the center, and the international financial institutions—the IMF in particular—must partly shift the focus of their conditionality from purely macroeconomic policy objectives (e.g., achieving lower inflation) to institutional and other policy improvements that will contribute more directly to addressing some of the weaknesses that have undermined the quality of life. A key focus could be reforms aimed at enhancing the efficiency of public spending, particularly in the social area. The World Bank, the major influence on substantive social policy reform, has pro-

moted a liberal “safety net” model based on targeting, individualization, and privatization of benefits. Its personnel have provided overall conceptions for restructuring the welfare state according to a liberal paradigm, helped set the terms of policy debate in Russia, and helped author legislative proposals. The Bank has sponsored projects in every area of social policy—pensions, employment, health, education, housing, and poverty alleviation—and worked at every level of government from federal ministries to local pilot projects. It has provided large, conditional loans for social sector restructuring. It has had some influence on policy reform, but many of its efforts have been frustrated by legislative resistance, the limited administrative capacity of the Russian state to implement proposed policies, and a legitimate fear that these policies would lead to state desertion of a population that remains generally too poor to provide for its own social security.

Against this backdrop, U.S. policymakers face a series of tradeoffs. Short-term, immediate interventions to solve acute problems could produce seemingly quick fixes. Longer-term strategies promise more lasting results, but these results may take much longer to germinate and develop. For example, the U.S. can pump money into the existing orphanage system to improve conditions there (short-term), or work to move away from the orphanage system toward a better alternative such as foster care networks (long-term). Creating an alternative system to handle the thousands of children in crisis situations will take many years and will not solve the immediate needs of the children living on the streets today; however, unless an alternate system is developed, the problem will persist and the orphanage system will continue to drain the public budget with less than optimal outcomes. Similarly, international donors can pump resources into the existing tuberculosis hospitals (short-term), or alternatively help to scrap this antiquated hospital system in favor of internationally accepted treatment regimes, such as DOTS (directly observed treatment—short-course). The latter would be cheaper and more effective in the long term, but would encounter significant political obstacles, eliminating many jobs and dismantling the vast tuberculosis sanatorium system that was developed over the last century.

The international community must also face the tradeoff of partnering with Russian NGOs or local governments versus dealing directly with the central government in Moscow. Working at the grass roots level has clearly proven more effective than working from the top down. There are limitations, however, to small-scale local-level interventions. Many NGOs, for example, are hampered by bureaucratic restrictions on their activities. They often do not have the legal right to implement their goals, particularly in the area of health care, and even if they do manage to circumvent the state bureaucracy, they often lack local resources to implement projects. Even under the best of circumstances, NGOs have only a limited infrastructural and geographic capacity and are seldom able to replicate their successful models in other parts of the country. Russia has no NGO tradition to build upon, and so caution must be exercised when thinking of transplanting American models of grass-root activity. Nevertheless, small-scale local interventions have proven far more effective and sustainable than large, government-sponsored projects that do not enjoy local participation or collaboration. The American government might fruitfully intervene with low-cost efforts to partner U.S. social service NGOs with new Russian counterparts, including local Russian government-private partnerships, providing a coordinating umbrella mechanism that would facilitate replicability of success.

Successful American aid programs will also recognize that Russia is far from a homogeneous country. Its 89 regions literally amount to 89 different health and social welfare systems, each with its own political, legislative, economic, demographic, environmental, and other peculiarities. What works in one area may fail in the next. This fact confronts U.S. policymakers with more tradeoffs.

We could identify those regions where the political environment is most amenable to new ideas and reform, bypassing the areas still dominated by old-guard, corrupt, or incompetent officials. This approach promises the greatest immediate return on “investment” and rewards good behavior. On the other hand, we could focus our energies on the worst-off, neediest areas, perhaps making end runs around problematic governing structures and instead working with non-governmental organizations. Here the assumption is that the more progressive regions are on the mend by themselves, and that it makes no sense to punish suffering Russian people for the poor quality of their leadership. Alternately, we could identify those regions that, for a variety of economic or national security reasons (such as the presence of critical military installations, or proximity to key allies), may “matter” most to the United States, and target our efforts in those directions.

One important, often overlooked fact is that sometimes the very process of reform or change is as valuable as the stated goal or end product. Should the focus of an intervention be on the process or results? In the quest to rebuild social cohesion and to develop trust in society, the process may be far more important, as it builds habits and traditions ultimately enabling the recipients themselves to create the desired results. George Soros recognized this distinction when he founded the first Open Society Institutes (OSIs) in East and Central Europe and the Former Soviet Union. He realized that the very process of institution-building—creating an independent entity, developing a democratic board of directors, managing a budget, and forming a real non-governmental organization in an environment where NGOs had never existed—would be as important as the specific objectives of each OSI. By electing officers and maintaining the OSIs in the post-socialist environment, Soros helped lay the foundation for broader development of democratic values in the society at large.

Specific Recommendations

Given the current political environment in both countries, it seems improbable that large-scale aid programs, aimed at overhauling entire social benefit systems along Western lines, are appropriate. These kinds of solutions were attempted in the early 1990s, not only in the social sphere but with the Russian economy as a whole, leaving in their wake accusations of waste, fraud, corruption, and failure. It is important now to recognize that Western models of finance and management cannot be transplanted wholesale into the Russian environment, given the unique and lasting legacies of past Soviet and Russian institutions, norms, and cultures. Instead, more modest efforts, capitalizing on local-level diagnoses of key problems and home-grown solutions, hold the promise of more positive and lasting results. These need not be exclusively U.S. government efforts. In fact, health and social problems are probably best addressed through public-private sector partnerships that take advantage of the wealth of experiences, resources, and good will present in American society. Our allies in Europe and Japan have also accumulated years’ worth of experience in this area, providing fertile ground for multilateral action.

The model of the Russia Small Business Fund, currently supported by the EBRD, is instructive. Since 1994 this fund, operating on the Grameen bank model, has made more than 26,000 loans totaling more than \$350 million to entrepreneurs in locations across the Russian Federation, with a pre-August 1998 repayment rate of 99.7 percent. This kind of seed money has enabled thousands of small businesses to grow to the point of self-sustenance, and also through its work with Russian partner banks has strengthened the capacity of Russian banking institutions to operate independently in the small business sector. With an average size of \$14,000, and some as small as \$30, these loans have created or protected a half million Russian jobs. Applied to the

health and social sector, this lending model could realize a large payoff on a relatively small foreign aid investment.

In terms of personnel with whom to work in Russia, in contrast to a decade ago, there now exists a well-trained cadre of Russian specialists, fluent in the nuances of market economics and social science methods. These people are capable of state-of-the-art policy analysis and formulation in the areas of health and social welfare. They know more about the Russian situation than Western consultants possibly can. Members of this new generation of analysts and practitioners deserve to be treated as partners, rather than merely as objects of charity, by their Western counterparts. Well-crafted American policy would therefore best serve its own and Russian interests by seeking to support promising young Russian specialists and to increase their numbers. Training and education programs, which provide opportunities for the study and observation of Western practice, and then incorporation of lessons learned into the Russian context, have met with great success and deserve to be maintained and augmented. Most productively in the health and social sector, Russian students could be supported to earn Master of Public Health, Social Work, or similar degrees in American institutions of higher education. Such programs inevitably produce a “training of trainers” effect, as the lessons learned by direct participants disseminate throughout Russian professional communities. Small-scale alliances between Russian and American health facilities (on the model of the American International Health Alliance, for example, which supports hospital-to-hospital partnership programs), health and social policy analysis institutions, and non-governmental organizations could have a similar long-term impact.

Russia could also benefit significantly from Western experience with public health education campaigns. A public information campaign analogous to the U.S. surgeon general’s report on smoking and the periodic reports to the U.S. Congress on alcohol and health, to educate the populace on the dangers of cigarettes and vodka, could produce widespread and cost-effective benefits. American experience has demonstrated that the focus should be on promotion of health and fitness rather than on stopping bad behaviors. Health education would not stop the use of alcohol and tobacco, but it would begin the process of educating the public about the epidemic proportions of this problem. As in the U.S. twenty or thirty years ago, the resistance to such measures is huge, especially from the Russian government which benefits from alcohol and tobacco taxes, but the costs of doing nothing are beginning to outweigh the benefits of these revenues. Of course, raising American awareness about the dangers of alcohol, tobacco, driving without a seat belt, and the benefits of car seats for children took many years, but in the long term the U.S. public health education campaign model has proven its effectiveness.

The U.S. government should also consider how its regulation of American companies doing business in Russia impacts the social sector there. For example, American tobacco and alcohol manufacturers and distributors selling their products in Russia are presently free from the kinds of regulations that restrict their activities in the U.S., with disastrous results for public health in Russia. While alcohol and tobacco marketing is clearly an issue that the Russian government should address in the first instance, the U.S. should also consider taking the lead. Otherwise, the issue may be decided by American or Russian courts; the Russian government has recently commenced litigation against American tobacco companies in the United States. As another example, Russia faces economic barriers to the purchase of American pharmaceuticals similar to those faced in Africa and other developing countries. To help combat HIV in Africa, the United States recently announced a policy not to seek enforcement of certain intellectual property rights for drugs used to treat HIV in Africa. In the case of HIV, tuberculosis, and other infectious and parasitic diseases,

Russia might be a candidate for similar policies.

The U.S. could also provide essential assistance in the simple task of gathering data about health and social conditions on the ground in Russia. A hierarchical, administratively centralized system of information collection and dissemination is another legacy of the Soviet regime, and it has left most regions and municipalities lacking in independent capacity. When the national Ministry of Health, as is so often the case, shuns discovery or discussion of the country's dire health and demographic problems in order to avoid taking responsibility for them, regional officials are frequently left in the dark. Public health agencies in the United States, from the Centers for Disease Control and Prevention down to local public health agencies, take for granted physical and intellectual data collection and analysis "toolkits" that their Russian counterparts are lacking. Local and regional-level partnerships to share Western experience could arm Russian regional officials with an important weapon—information—that could enable them to devise and implement locally appropriate strategies for reform.

Finally, and perhaps most importantly, assistance and partnership programs can generate the most effective long-term impact by targeting those most in need—children. Both the Russian government and international agencies have given primary consideration to those, like the elderly, with well-organized political representation. Children have no political voice, but their health and general welfare are, of course, the key to the productivity and vitality of Russia's future. Absent a significant change in current trends, Russia is now raising a "lost generation," plagued by illness, malnutrition, substance abuse, and general neglect. Without help, this generation cannot constitute the human resource Russia will need to regain its status as a great power, successfully integrated into the global economy and community of nations.

Conclusion

In sum, the breakdown of those Soviet institutions that served crucial social functions has left a vacuum in Russian society. Few new guarantors of social capital—government policies, organizations of civil society, charitable and religious groups—have stepped in to fill the void. As a result, the health services, health inspection and occupational and other public safety standards, and the general capacity of much of the population to maintain some minimum level of economic dignity, have disintegrated, to the extreme detriment of the Russian people's health and social welfare, and therefore to the economic and political well-being of society as a whole. These trends are important for American citizens and American policymakers, and not merely from a humanitarian perspective. The deterioration of health and social conditions may not produce thousands of Russians marching in the streets. But already it has left millions of Russians either unable or unwilling to continue to engage actively in civil society, a crucial ingredient to sustained economic reform and democratization. In response, the international community could do nothing. As a result, this country spanning eleven time zones will continue to crumble, resulting in probable cross-border contagion of organized crime, communicable diseases, refugee flows, and the like. On the other hand, modest Western interventions could help produce a ripple effect of positive results throughout Russian society. A politically, economically, and militarily stable Russia is much more likely to emerge as a friend and partner to the United States than is a Russia filled with uncertainty, insecurity, and continued collapse and decay.

Notes

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Russian State-Building: The Regional Dimension

Report by
Robert Orttung and Peter Reddaway

Executive Summary of the Main Argument

On coming to office on December 31, 1999, President Vladimir Putin inherited a system of federal-regional relations that was working badly. Most significantly, the federal government lacked the ability to implement many of its policies in the country's regions. It often prescribed one set of policies, while regional leaders pursued others. In response, Putin and his closest associates, who coexist in a divided, heterogeneous ruling coalition with various business oligarchs and the Yeltsin family's entourage, are waging a difficult battle. In addition to other measures, they are trying to take back from the regional leaders federal powers that these leaders acquired over time, often by usurping them. They hope that a stronger, more centralized federal government will be able to address the deep-seated political and economic problems that developed under Boris Yeltsin's corrupt and inefficient administration. To this end, they have created new institutions to help them re-acquire these lost federal powers.

However, while Putin's team would like to use these powers to integrate and revive the Russian economy, to create a uniform system of law, to subdue the rebels in Chechnya, and in general to strengthen a perilously weak state, the new measures pose many threats to Russia's fragile democracy and civil society. We should also note that Putin's team is operating in—and is by no means insulated from—a system of national elites in which the personal interests of politicians, bureaucrats, and businesspeople are often corruptly intertwined, and the interests of the mass of the population are routinely ignored. In this setting, they are trying, *inter alia*, to promote the interests of their rather narrow political base in the so-called "power ministries,"¹ especially the security services. Given the authoritarian traditions of these organizations, their pursuit of this goal helps to explain the seriousness of the threat to the already weak structures of Russia's democracy.

Clearly, Russia needs a state in which federal and regional laws do not contradict each other. To achieve this goal and others, centralizing some powers is necessary. However, in a highly diverse country with eleven time zones, creating a clear and effective division of powers between central and regional government is crucial to good government. This remains true, even if federalism as such may not—if other safeguards are in place—be essential.

Countries like Canada and Russia have adopted federalism as a way of protecting the interests of ethnic groups. In Russia, a second purpose has been to prevent the country from backsliding

into tyranny. Dividing authority between federal and regional governments, however sloppily this was done under Yeltsin, created some checks on the power of the federal government. In turn, the main safeguard against potential tyranny by regional governments has been, in theory, the ability of civil society at the regional and local levels, hopefully supported by sub-regional governments, to mobilize people against any threat of authoritarianism. However, this civic capacity does not appear to exist in today's Russia. This is suggested by the absence of significant opposition to the recently passed law that entitles regional governors to remove most heads of local administrations if they wish, even though these individuals have been elected.

At the end of October 2000, it is too early to give a definite assessment of the Putin team's regional reform efforts, much less to measure them against an ideal model of what the Russian state should in our view look like. Nevertheless, at this early stage we believe that while the reforms are regaining some power for the Kremlin, they may well not be increasing the cohesion and effectiveness of the state. While some centralization of control over federal institutions in the regions was needed, the selective and heavy-handed methods that are currently being used are undermining federalism. In addition, by adding an extra layer of bureaucrats in the seven newly created federal districts—bureaucrats located in a presidential hierarchy that, although it includes the “power ministries,” is not part of the other ministerial structures that hold the federal and regional governments together—the reforms are creating confusion as to where political and administrative authority really lie. Overall, therefore, they may be decreasing the state's efficiency more than they are increasing it.

In addition, the changing of old structures and creation of new ones is being carried out in a rather ad hoc way, without careful enough thought being given to the consequences. The federal districts are functioning in ways that lack uniformity and depend in part on the personalities of the men that head them, rather than on clear and consistent rules. Also, Putin and his representatives, when interacting with regional leaders, often still operate through deal-making and bending the rules to appease powerful interests.

Finally, many observers suspect that the current reform of federal-regional relations is, as suggested by Sergei Kirienko, Putin's representative to the Volga District, only a first stage. They see signs that the Putin team is preparing—whether against the contingency of political and economic conditions worsening, or for other reasons—a second stage that would be more explicitly authoritarian and anti-federalist in nature than the first.

Introduction

As an essential introduction to this report, we discuss first the most fundamental weaknesses of the Russian political system, namely the fragility of state institutions at all levels. We then briefly review the complex and rather irrational nature of Russia's administrative division into 89 small units, and the added complications for its rulers that stem from its marked economic, ethnic, and religious diversity. From there we discuss how the complexity and fragility of Russia's institutions impinge on Western interests—for example in the Caucasus region—and also highlight the Western stake in Russia's achievement of long-term stability, an achievement that we believe should not be taken for granted.

Next, we present a short analysis of how relations between Russia's federal government and its 89 regional governments have evolved since 1991, followed by a summing-up of the situation that Putin inherited in 1999. That leads to an analysis, first of the institutional innovations that, supported by the Duma, the Putin team has introduced since Spring 2000 with the goal of reform-

ing federal-regional relations. Then we examine the policy initiatives launched by the Presidential Administration in the hope that their implementation will be much facilitated by the new institutions.

After venturing some tentative overall judgments on how these institutions and policy initiatives are developing, we consider how they might play into various scenarios for Russia's future. Finally, we present some broad guidelines and recommendations that may be useful to Western governments and NGOs in their dealings with Russia, in as far as these touch on federal-regional relations or the state of government and society in the regions.

In accord with conventional Western theory, we view the Russian state as including the federal, regional, and local governments. When a representative of Russia's federal government says that he wants to "strengthen the state," he often means that he wants to increase the power of the federal government over the lower tiers. However, most regional and local leaders would hold, as we do, that their governments are also part of the state, and it does not necessarily follow that strengthening one part of the state at the expense of the others will make the state stronger overall.

An effective state in any country that has, or aspires to, a democratic political system and a market-based economy, must perform several key functions. It must guard the country's borders, protect property rights, enforce contracts to facilitate the efficient and fair operation of markets, ensure the safety of its citizens against crime, collect taxes to pay for public services, maintain a stable currency, and provide mechanisms to address the concerns of societal groups, so that social justice can be served and a civil society that is largely independent from the state can flourish. During the Yeltsin era, Russia had a weak state that did not perform these functions adequately. The state was weak because its institutional underpinnings were fragile. And the institutions were fragile because, as shown by numerous opinion surveys, they and the rulers were largely corrupt and enjoyed little public support. More than under communism, Russia became a class society that was deeply divided between a rich and powerful upper class and an impoverished and powerless majority, with only a small and precarious middle class between them.

A major symptom of state weakness in Russia has been, and remains, the chronic and poorly regulated struggle for the control of scarce resources. The main competitors are groups which overlap with each other in their membership and their activities. The Putin team's first priority is to consolidate power in the Kremlin, while the Russian government is more interested in asserting the autonomy of its various ministries, the regional governors and republican presidents want to concentrate as much power as possible at the regional level, and the federal and regional-level "oligarchs" work to maximize the power of their business empires. Sometimes all these groups are able to co-opt or "privatize" pieces of the state for their own purposes. The outcome of this largely self-interested activity is a state in which the different component parts are working at cross-purposes. While fighting among themselves, federal officials lack the ability to exercise authority in the regions. Also, regional officials tend to lobby for federal legislation that will serve the interests of their "clan", not those of their region as a whole.

Naturally, a weak state hurts the economy because it cannot provide the institutional basis for an integrated market. For example, under Yeltsin, the weak Russian state, even though it had marked authoritarian tendencies, could not enforce a common set of economic rules across its large territory. Likewise, his weak authoritarian state was bad for democracy, because it could not—or did not want to—enforce the rules required for the smooth operation of political institutions. It also inhibited the development of civil society, i.e., political parties, labor and environmental groups, professional bodies, consumer protection associations, and similar organizations. Sometimes it was too disorganized for these groups to be able to interact with it, and sometimes it was too

authoritarian, and therefore had no wish to enter into dialogue with them. The latter circumstance, as Vladimir Gelman of the European University in St Petersburg argues, is even more prevalent under Putin. If the state cannot or will not accept input from such groups, then citizens have little incentive to organize them. They become alienated from the state and its rulers, with the result that the legitimacy of both declines. (For the time being, Putin appears to be an exception to this generalization. If key Russian opinion polls are still fairly accurate—a proposition increasingly open to question—popular approval of him remains high.)

By markedly centralizing authority in Russia, the Putin team is seeking to change the balance of legal and fiscal decision-making power between the federal government on one side and the regional and local governments on the other. To repeat, we recognize that centralization of real control over some governmental functions is clearly necessary as a response to the poorly regulated, often haphazard devolution of power that occurred in the 1990s. However, Putin's reform package is centralizing power in a way that is probably—because it has created confusion about how power is now divided between the ministries, the presidential representatives, and the governors—reducing the effectiveness and cohesion of the state. (We define a state's effectiveness as its capacity to implement the decisions it makes, and its cohesion as the fruit of a high degree of consensus between the three levels of government that the division of power between them is reasonable.)

The reform package is also unsatisfactory because it does not conform to widely accepted conceptions of the rule of law. For example, the seven federal districts are not mentioned in the constitution, their status being defined only by presidential decree, not even by a federal law. Further, they are, in practice, taking power from such constitutional bodies as the federal government and the regional governments. In addition, Putin's team is wielding the courts as a political weapon, using selective prosecution—a tactic that does not provide a good basis for democratic governance or a rule of law state.

We should stress that any Russian leader, no matter how talented, faces daunting problems in dealing with the diversity of Russia's 89 federal units. Economically, the difference between the richest and poorest regions in terms of average household income is greater in Russia than in the European Union, let alone the U.S. Still more worrying, while the market system has evolved in some areas, so that cities like St. Petersburg, Nizhnii Novgorod, Samara, and Yekaterinburg are now viable business hubs, at the same time life in areas like the Far North, which has approximately 11.5 million inhabitants, has become almost impossible to sustain without enormous subsidies that Moscow cannot, in many cases, afford to pay. There are also enormous economic differences *within* regions.

Geography, too, complicates the picture. For example, the remoteness of the far eastern regions from Moscow raises questions about the Kremlin's long-term control over them. As Vladimir Kontorovich of Haverford College has shown in a new analysis, these questions are sharpened by the strong likelihood that the population of these regions will continue to decline at an even faster rate than that of Russia as a whole.

Further, the Russian Federation is administratively divided on ethnic lines. Thirty-two of the regions are ethnically designated, with the 21 republics holding a legally privileged status in the federation, while the remaining 57 are territorially defined. To make matters more confusing, the titular population makes up the majority in only 7 of the 21 republics. The regions are also split religiously, with Islam dominant in the North Caucasus (except for North Osetiya), Tatarstan, and Bashkortostan, and Buddhism the main religion in Kalmykiya, Tyva, and the Buryat regions.

Chechnya, which seceded from Russia in 1991 and has yet to be reincorporated by force or

any other means, is a rather special case, but one of great importance that we discuss at more length later in this report. Putin has held that if Russia does not force it to submit, the threat of further separatism will spread through the North Caucasus and even into the Volga region. While these fears seem somewhat exaggerated, at least for now, the Kremlin's primary reliance on military means, as it tries in vain to stamp out the Chechen rebellion and bring the republic back into the federation, is backfiring, and is almost certainly, when all factors are considered, weakening the Russian state.

In light of the above facts, it is not clear that the Putin team's reforms, with their heavy emphasis on centralization, will be able to adequately accommodate such a wide range of regional diversity.

Significance to the West

How relevant are Russia and its regions to Western interests? Are these interests limited to pressing for an end to the Chechnya war, and thus stabilizing the oil-bearing Caucasus region? We believe not, because there are additional reasons why Russia's future evolution is highly uncertain.

In broad terms, Russia could evolve in four ways. While pursuing a domestically defined agenda of change toward a stable democratic and market system, Russia could adopt a foreign policy that allows it to compete and/or cooperate with the West in a constructive way. However, Russia could also evolve along two other paths that would pose serious challenges to the West. An aggressive, united Russia under authoritarian rule would force the West to take vigorous precautions to counter the various threats that such a Russia would pose. Also conceivable is a scenario in which—whether because of terrorism or other reasons—Russia starts to fragment. Such fragmentation would dramatically reduce the level of Moscow's control over the country's nuclear arsenal, and could create parts of Russia that behaved like rogue states. Finally, if Russia continues to muddle through, as at present, the potential for its slipping into one of the threatening scenarios will remain high, and the West will face many dilemmas in trying to prevent this from happening.

Since the level of cohesiveness or incohesiveness of the Russian state will play a big part in determining which of these scenarios comes to pass, we believe that Western governments should monitor Russia's federal-regional relations carefully, and facilitate, where possible, their constructive evolution.

The Development of Federal-Regional Relations, 1991-1999

To gain perspective on the current upheavals in federal-regional relations, we need to review how these evolved prior to 2000. The Russian state that developed in 1990-91 possessed most of the typical Soviet-era structures, but lacked even the weakest tradition of acting autonomously. Unlike the other republics that made up the Soviet Union, Russia did not have a republic-level Communist Party organization. A specifically Russian (as opposed to Soviet) Central Committee was created only at the end of the Gorbachev era. Even if Yeltsin had not banned the party in August 1991, it would not have been ready to serve as a strong foundation for future state building.

In order to build his power in 1990-91, Yeltsin cut a bargain with various regions whereby they would support him against Gorbachev, and he would give them extensive autonomy. Aware that the Russian state lacked the capacity to administer its territory in the comprehensive way that the Soviet regime had been doing, he also told the regions repeatedly to "take as much sovereignty

as you can swallow.” In this way he encouraged the “parade of sovereignties,” during which many of Russia’s ethnically defined republics asserted their “sovereignty” in ways they had never done before, and some of the regions imitated them. The republics had taken their cue from the 15 union republics of the Soviet Union, which soon, in December 1991, became independent countries when the USSR collapsed.

The three Russian Federation Treaties signed in 1992 codified the changes that took place in the wake of this collapse. Most importantly, the treaties put in place an asymmetrical, in part ethnically based, federal system with three tiers of regions. Of the 89 regions in Russia, the 21 republics designated for minority ethnic groups gained greater autonomy from the center than the Jewish autonomous region and the 57 regions that were not ethnically designated (federal cities, oblasts, krajs), while the 10 ethnically defined autonomous okrugs, except for one, were subordinated to the regions on whose territory they were located. In most instances, the republics were able to elect their own presidents, while the great majority of the other regions had governors appointed by Yeltsin.

Republics had additional advantages in comparison to the other units because they had more control over the natural resources on their territory, a greater say over their internal arrangements (such as the right to create a second state language), and more latitude in the conduct of foreign policy. The Constitution entitled the republics to adopt their own “constitutions,” while the other regions could only adopt “charters.” Having a constitution appeared to give the republics greater weight in the country’s political system.

The drawn-out struggle between Yeltsin and the Russian legislature in 1993, which culminated in Yeltsin’s abolition of the federal parliament through tank fire, fueled a competition for the regions’ favors. This resulted in the regional leaders’ acquiring additional power for themselves. However, once Yeltsin had disbanded the legislature, he closed the regional legislatures (elected in 1990), because they had mostly opposed him. By doing this, he strengthened the hand of the governors. After a few months during which no representative bodies existed to check their power, they proceeded to set up new “pocket legislatures” which they could, in many cases, completely control.

The conclusion of this period saw the ratification of the 1993 constitution, which set the tone for Russia’s further political development, even though many observers credibly charged that the vote was falsified. Formally, the constitution created a powerful president who had extensive power to regulate almost all aspects of Russian life by decree. In practice, however, Yeltsin did not use these formidable powers to keep the regions in line, because he felt the need to trade some of them away in return for governors’ support for him in elections. Additionally, the constitution made a muddle of the federal system. On the one hand, it declared that all regions were equal. On the other, it basically preserved the three-tiered system set up by the federation treaties, which gave some regions, i.e., the republics, more powers than others.

Shortly after the constitution was ratified, the federal government further exacerbated the existing asymmetries by starting a process of signing bilateral treaties with the regions. These often gave the regions powers that constitutionally belonged to the federal government. Yeltsin signed the first treaty with Tatarstan, which had been using secessionist threats against the federal government, in February 1994. This treaty gave the republic extensive control over tax revenues collected on its territory, and over its foreign policy. Other republics, such as Bashkortostan and Sakha, soon worked out similar deals. Not surprisingly, the regions resented the special treatment accorded to the republics and demanded that the federal government sign treaties with them as well. In January 1996, as he was launching his campaign for a second presidential term, Yeltsin signed the first of

many federal-regional treaties with Sverdlovsk. However, these treaties gave away much less than the earlier ones had. Consequently, the regions soon lost interest in the process and the last treaty was concluded with the city of Moscow in June 1998. Today, there are clear signs that the Kremlin would like—in the interests of creating a uniform system of central control of the regions—to dismantle the whole treaty system as soon as possible.

Yeltsin's most important innovation came in the fall of 1996, when he allowed essentially all the Russian regions to elect their own governors. This move toward formal democracy was the result of a compromise between Yeltsin and the State Duma, the lower chamber of the national parliament, on the procedure for choosing members of the upper chamber, the Federation Council. Whereas in 1993 voters in each of the 89 regions had elected two representatives to the Federation Council, in 1995 Yeltsin wanted the upper chamber to be made up, *ex officio*, of the 89 regional governors and legislature chairmen. The Duma would only go along with this, if each of the governors was directly elected. Thus, in fall 1996 more than 50 regions held their first gubernatorial elections. By the end of that year, Russia had made a transition from a country where the president directly appointed most of the regional governors to one where constituents chose their regional leaders in elections.

The Federal-Regional Situation in Late 1999

At the end of 1999, federal-regional relations were working badly and required significant reform. Notwithstanding the president's constitutionally enormous powers, Russia had a weak federal executive. The government lacked the ability to implement its policies across the country. In particular, it could not maintain an integrated economic space. Often, regional leaders adopted laws that blocked the sale of goods produced in other regions, and prevented their own producers from selling elsewhere locally produced goods such as foodstuffs. They blocked imports so that they, not the authorities in another region, could collect taxes from the producers. And they blocked exports to ensure that the local food markets would be well provisioned. In practice, the policies simply stimulated corruption.

By the end of the 1990s, large parts of the state machinery were seriously inefficient or corrupt. The federal bureaucracy suffered from ministries that duplicated each other's functions and lacked an effective chain of command. It performed its basic functions, such as collecting taxes (a purely federal responsibility) and enforcing laws, inadequately. In addition, the federal government was overstaffed in the regions. Some 50 agencies had branches there, employing a total staff of 460,000. This army of federal bureaucrats was a potentially powerful force, but it was poorly coordinated and organized. According to the Federal Office of Personnel Management, the U.S. employs 728,000 federal employees outside Washington, DC. Thus, on a per capita basis the Russian government employs somewhat more people in the regions than the U.S. does in the states.

Beyond the lack of coordination, the Russian bureaucracy often employed poorly qualified personnel. In many cases, officials did not have the skills they needed to deal with an increasingly complex economy.

Nevertheless, despite its overall weakness, the federal government still made it difficult for the regions to help themselves. For example, it set all the tax bases and rates for the key revenue-raising taxes, while the regions were authorized to collect only about 7-8 percent of their revenue without first gaining permission from Moscow. Since the regions had few ways of raising money on their own, they frequently resorted to lobbying the center as the only way to gain funds. At the

same time, federal efforts to help the regions, such as development programs, usually existed only on paper.

Beyond this, in many cases the federal government simply failed to meet its responsibility to protect the social welfare of citizens. To “solve” this problem, it simply imposed the burden of doing so on the regions—in the form of unfunded mandates. Since the regions did not have the necessary money, they accumulated enormous arrears in the payment of pensions, public sector salaries, and various benefits. The OECD estimated that unfunded mandates in 1998 equaled about 5 percent of GDP. The mid-nineties can be seen as a period when federal officials cynically sought to offload social programs onto lower levels of government, but without surrendering the powers that would enable them to raise the money to finance the programs.

Corruption afflicted all levels of the Russian state. Many bureaucrats used their state position for personal gain, often stealing state resources. Since law enforcement agencies were often part of this criminal activity, these crimes usually went unpunished.

As for the governors, with a weak president and constant executive-legislative conflict at the federal level throughout the 1990s, they had been able to acquire considerable autonomy. They often behaved as if they were not accountable to anyone. According to Justice Ministry estimates, by the end of the 1990s about one third of regional laws did not conform to federal norms. For example, regions arrogated state sovereignty to themselves, as if Russia were a confederation rather than a federation, and usurped federal powers by defying federal laws and decrees. They used natural resources belonging to Moscow, applied electoral procedures that violated federal law, legislated on topics constitutionally reserved to the center, and, in some cases, imposed restrictions on the performance of military service, and conducted unauthorized foreign policy. Given the close links between the governors and the regional business community, the governors often acted to protect the interests of the local business elite, ignoring the cost to the region as a whole.

On the crucial issue of fiscal flows, on paper the federal government had extensive control, but in practice this control was limited. Governors promoted the use of barter and other forms of non-monetary exchange to escape federal fiscal control and gain the power to introduce their own policies. Anything that was not money was more easily withheld from the center. As a recent OECD report shows, federal attempts under Yeltsin to reassert greater central control over regional finances often backfired, leaving regions the de facto power to pursue their own policies, and absolving them of responsibility for formal budgetary and debt management.

The governors also had considerable control over the appointment of federal officials working in their region. For example, in the late 1990s the federal authorities could not appoint or remove a regional police chief without the support of the regional administration. Moreover, since the governors rather than the federal government could provide or withhold office space, housing, and additional perquisites for locally-based federal officials, they were able to exert enormous influence on the way these officials behaved.

Finally, non-governmental organizations were very weak. Except for the Communist Party, national political parties had little or no influence at the regional level. Other groups such as labor unions and environmental and consumer protection associations existed, but had little if any impact on official policy. Most such organizations lacked sufficient funding. The regional governments gave priority to the local elite’s business and power interests, which, typically, the NGOs challenged. The latter, which usually tried to promote the public interest, were almost invariably ignored.

While Russia’s problems were numerous and severe at the end of 1999, we should also note

some more positive factors. The external borders of the country were generally accepted. The economy had gone through a long decline, but had not, even after the major financial crisis of August 1998, completely collapsed. The political system still had some gains, as compared to the communist period. Formally, at least, Russia and its regions elected leaders through a democratic process, even though the level of freedom and fairness in the elections tended to decline as the 1990s progressed. And elements of real federalism existed, in that each region had its own budget, and, at least on paper, the law required the federal and regional governments to divide tax revenues equally.

The Institutional Reforms of 2000

Given this background, the Putin team faced a difficult challenge when it came to power. Ideally, in our opinion, it needed to generate policies that addressed national, rather than personal or elite interests. In this way it could hope to build a federal state that would regularly perform basic functions like maintaining an integrated market. In its regional policy, while sharply tightening vertical discipline within federal hierarchies, it needed to preserve the regional governments' autonomy, so that the regions could address issues in their jurisdiction without federal interference. The national interest also demanded that the new administration foster constructive interaction between civil society and state institutions at both national and regional levels.

To date, the Putin team has put heavy emphasis on strengthening discipline in the federal hierarchies, while otherwise acting contrary to the other prescriptions sketched above. On taking office, it moved quickly to consolidate a working majority in the Duma, an asset that Yeltsin never gained. Its quick success allowed it to put plans for centralizing power into law or decree form by the end of the summer. These plans focused overwhelmingly on increasing the power of the federal government. They did little or nothing to ensure either that the regions would serve as a healthy check on this increased power, or to promote the interaction of civil society and government.

Removing Governors from the Federation Council

The legislative reform of federal-regional relations consists of three key features. First, it means that when the governors and chairs of regional legislatures finish their terms—at latest by January 2002—they will lose their membership in the Federation Council. This will clearly reduce their national stature. In their place, the regional executive and legislative branches must now select full-time representatives to the Council. The governor is free to appoint and remove his representative, subject to only one restriction: that a two-thirds vote of the regional legislature can veto his choice. The legislature appoints and removes its representative by voting procedures it defines itself.

Up to now, the governors have been nationally significant politicians. Without membership in the Federal Council, they will be merely regional officials, albeit elected. Also, the governors and legislative chairmen have typically used the monthly Council meetings as an opportunity to come to Moscow and lobby the federal government for their interests. In the future these officials will, at least in theory, have fewer excuses to travel to the capital. Nor will they get the national publicity that the media coverage of the upper chamber's monthly meetings have given them.

Membership in the Federation Council also gave the governors limited immunity from prosecution. When they lose this immunity, the federal authorities will be much freer than before to put them on trial for alleged crimes. Since the presidential administration collects information on the governors' legal violations, a job Putin himself once held, this change represents an implicit threat that the federal government might jail some of the governors. In summer 2000 the

President's Representative to the State Duma, Aleksandr Kotenkov, explicitly foreshadowed this. He said that when their immunity expired, the police would arrest 16 governors at once, and others soon thereafter.

While this reform does take the governors down several notches in terms of their status, it may end up—unintentionally—actually increasing the regions' role in federal policy making. Since the governors and regional legislative chairmen served in the upper house in addition to their duties in the regions, they had little time to scrutinize federal legislation. Now the Federation Council will be filled with full-time members who will be able to devote much more time and thought to their work in the upper chamber. Thus, since the governors and regional legislatures will exercise tight control over their representatives, the Council will to a large extent be under the regions' sway.

As regards the Council's new members, the governors are most likely to appoint those deputy-governors who are currently responsible for relations with Moscow. These individuals head the offices that most regions have in Moscow, and essentially function as lobbyists for their regions. Now they will also have the title of "senator," which will likely give them even better access to the federal bureaucracy.

The President Gains the Right to Fire Governors

Second, the reform legislation gives the president the right to remove governors from office and, in coordination with the State Duma, disband regional legislatures. So far, Russian political debate has focused on the president's increased influence over the governors because they have much more power than the legislatures. While this weapon sounds like a potent one, in practice it is likely to be blunt and unwieldy. To remove a governor, the president needs to have at least a criminal indictment alleging that he has violated federal law. However, the governor has the right to appeal a removal order to the courts. Also, even if the president does force a governor out of office, the region will hold new elections within six months, and there is no guarantee that the new governor will be any more pleasing to the federal government than the old one. Removing a governor may simply anger the local population and make it hostile toward Moscow.

Of course, by gaining such powers even if only on paper, Putin has secured a psychological advantage over the governors, who do not know which of them he might choose to fire or have jailed. On the other hand, the reform does not cut at the heart of the governors' power. Most governors won office because they are closely tied to the business elites of their regions. Removing a governor in a particular region does not, in itself, affect the power of the regional elite: the business leaders who backed that governor can exercise their clout again. Thus, taken alone, the reform does not promise to change the power structure in the regions. Additionally, it remains unclear if the president can remove a lower-standing elected official constitutionally. Chuvashiya Governor Nikolai Fedorov has already challenged this idea in the Constitutional Court, which now must make a determination. Most likely Putin will seek other ways to remove governors. A recent example was the Kursk regional court's decision to act on the basis of charges brought against Governor Aleksandr Rutskoi by the Federal Election Commission, and to remove him from the gubernatorial race less than 24 hours before voters went to the polls on October 22, 2000. The decision effectively removed Rutskoi from power. In this case, the voters then backed a Communist as their new governor rather than a Kremlin-sponsored FSB man.

Giving Governors the Right to Fire Mayors

Third, the reform legislation gives governors the right to remove some, though not all, of the mayors within their jurisdiction. This seriously undermines local democracy. Significantly, however, governors cannot remove the mayors of their regional capital cities. These mayors have often proved to be a potent threat to sitting governors seeking to be reelected. They and the governors often fight over the distribution of tax revenue generated in the capital city. To secure their electoral base, the governors want to use this urban money to help residents of poorer, rural regions, while the mayors want to spend the money exclusively within city limits, where their voters live.

Overall, the change is clearly a concession by Putin to the governors, giving them more control over their regions to compensate for some of the power that they will, as individuals at least, soon be losing.

Here Putin is giving up the chance to use local governments as a potential check on the power of the governors. Yeltsin had tried sporadically to organize the mayors as a force to deploy against the governors, but his efforts never amounted to much. Strengthening local government is totally absent from the Putin reform agenda.

Establishing a State Council

On September 1, Putin established a new State Council, which he chairs and which includes all 89 regional heads, as an additional form of partial compensation to the governors for their coming loss of status and parliamentary immunity. The body is purely consultative and meets at least once every three months. It has a presidium, which includes seven governors whose membership rotates once every six months. Since Putin established the new institution by presidential decree, it does not have the backing of a federal law or the constitution. Its purpose is to discuss key issues facing the country and give the governors a direct channel to the president. On its own, it does not restore the powers the governors will lose personally, if not institutionally, in the Federation Council, particularly because its purpose and significance remain relatively undefined. However, since, as noted above, the governors will largely control the actions of their representatives in the Federation Council, the likely weakness of the State Council may not matter to them much. In sum, the overall effect on power relationships of the governors' removal from the upper chamber of the national legislature may well not be great.

Reorganizing the Presidential Administration

In addition to these initiatives, Putin radically reorganized the presidential administration, seeking to make it more powerful in dealing with the regions. Yeltsin's use of his representatives in the regions had proven to be ineffective. Rather than asserting the president's interests at the regional level, the loyalty of the representatives usually had been captured by the regional authorities. Also, because the federal government had few resources with which to support its officials, they depended heavily on the governors for office space, housing, drivers and other necessities. In most cases, they had a staff of only a few individuals. Yeltsin tried to strengthen their position in 1997, issuing a decree that gave them much greater power to coordinate the activities of federal employees in their regions, but it never had the intended effect. The test case came in the far eastern Primorskii region, whose governor, Yevgenii Nazdratenko, was locked in constant combat with the federal authorities. Yeltsin named the local chief of the Federal Security Service (the successor to the KGB) as his representative. However, this official was never able to assert his authority, and the reform ultimately failed when Nazdratenko was able to have him replaced with someone more to his liking. The whole problem stemmed from the fact that there was usually no regional politician

influential enough to limit the power of the governor, while imported presidential representatives usually lacked the kind of local knowledge necessary to work effectively.

Today, Putin has addressed these problems by withdrawing his representatives from the 89 regions, creating seven huge federal districts, and appointing “commissioned representatives of the president” to them. These men stand above the governors and cannot therefore be coopted by them—except, potentially, through collective action. Since the new representatives report directly to the head of the presidential administration, Alexander Voloshin, their rank is high—comparable to that of a presidential administration deputy-head or a deputy prime minister. Also, each of the seven is a member of the Security Council, a powerful body that advises the president on all issues relating to national security and is headed by one of Putin’s closest associates, Sergei Ivanov. Also, the president meets with them regularly, both as a group and one-on-one. The aim is that they should supervise, though not actually administer, all the federal agencies working in their districts. In many ways, therefore, though with less emphasis on the economy, they are called on to perform for the Kremlin the crucial monitoring and disciplinary role that was performed for decades by the all-powerful hierarchical apparatus of the USSR Communist Party. More specifically, their tasks include drawing up an inventory of all federal property in their districts, and reviewing the enormous amount of “deviant” regional legislation in order then to supervise the relevant federal bodies as they bring it into line with federal norms. In addition, the representatives seek to promote financial order by monitoring tax collection and the flow of federal money in the districts, and instructing the law enforcement organs to take whatever punitive actions are needed. They also monitor regional budgets, which are still controlled by the governors, to the same end. Beyond these legal and fiscal functions, the representatives must approve all appointments to federal agencies in their districts of key officials proposed by the agencies’ head offices in Moscow.

The boundaries of the seven federal districts and the backgrounds of their heads make clear that the Putin team’s number one priority was imposing greater federal control on the regions. They modeled the districts on the country’s districts for the military and the internal security troops, rather than on the territories of the eight inter-regional economic associations that functioned, albeit with little effect, under Yeltsin. Of the seven district heads, five came from the “power ministries”. Two had served in the KGB, one in the Ministry of Internal Affairs, and two were generals with extensive service in Chechnya. Only former prime minister Sergei Kirienko and the diplomat Leonid Drachevskii, who has a mixed background, possessed more direct experience of making civilian institutions work and, in Kirienko’s case, of dealing with economic matters.

Although it is too early to assess the representatives’ work with any confidence, there are considerable grounds for suspecting that they may not have a major or long-lasting impact. Since the federal districts add a new level of bureaucracy to the presidential hierarchy, which is separate from the regular governmental hierarchy, it is not at all clear how successfully Putin’s representatives will coordinate decisions with officials in the ministerial hierarchies at the federal and regional levels. Already, signs of tensions abound. Rather than creating a stronger vertical hierarchy of authority leading from the central government to the regions, Putin has created a triangle, with the ministries, the presidential representatives, and the regions making up the triangle’s three points. Even within the presidential administration itself, officials in the Moscow-based Territorial Department, are jealous of the powers now being transferred from them to the seven districts.

Further uncertainties concern the amount of power or influence the representatives should wield over the flow of federal funds and the appointment of officials. This is only vaguely defined on paper. More generally, there has been considerable confusion among the representatives and

within the presidential administration in Moscow, about what the representatives' priority tasks are. Already the representatives feel that they do not exercise enough real power and are trying to increase the range of their authority. As they do, officials at the Finance Ministry will not want to give up the power they currently exercise over Russia's money flows to officials at the federal district level and below. Such conflict between the ministries and the representatives will limit the latter's ability to monitor the regions. Additionally, the governors and ministry officials clearly do not want to give up the power they currently wield over appointments. While the representatives may have some success in the sort of tasks emphasized by Kirienko—resolving immediate crises and devising standard procedures for improving inter-agency cooperation—overall, they seem likely to create more confusion than light in the day-to-day administration of the state.

Each representative must deal with a large and complicated territory. Even with a staff of approximately one hundred assistants, it is hard to see how he will be able to generate good information on the regions under his jurisdiction, much less take well considered action to ensure that federal policies are implemented. Putin's representative to the Central Federal District, Georgii Poltavchenko, even said that he would encourage experts in areas such as the economy, law, and education to contribute their advice for free. Clearly, relying on volunteers is not a good way to run a state. In short, from the administrative viewpoint the whole project appears hastily constructed. It puts individuals who are poorly qualified for the job in vaguely defined positions, and therefore seems unlikely to have a beneficial effect.

Further Policy Initiatives

Beyond the institutional reforms discussed above, the Putin team launched further initiatives in its regional policy. We will examine the most important of these, in each case after briefly reviewing the situation that obtained under Yeltsin.

Financial Flows between Moscow and the Regions

Under Yeltsin, the money flowing between Moscow and the regions was notoriously hard to track. Even experts in the Finance Ministry have not been able to assemble all the relevant data in one place to analyze them. A large amount of money was channeled through off-budget funds that were a black hole even for these experts. Many officials at the federal and regional levels preferred to keep the system opaque so that they could more easily hide the various flows from other officials and the public. While Finance Ministry official Aleksei Lavrov shows in his recent work that there was some progress in making the system more transparent, especially in the establishment of a treasury system to distribute federal money, entrenched interests prevented much improvement.

Today, the federal government is reducing the amount of money flowing to the regions by taking a larger share of tax revenues for itself. According to the budget code, the federal and regional governments must split the overall tax revenue 50:50. However, in July 2000 the federal parliament approved the second part of a new tax code, which gave the federal government control of the largest and most easily collected taxes. Moreover, federal officials admit that the new code makes the balance more like 52:48 in favor of the federal government. Some governors have complained that the real figure is closer to 70:30. Whatever the actual numbers, the trend is clear. The Putin team and the Duma are trying hard both to reduce the ability of the governors to influence the economic situation in their regions, and to transfer this power to the federal government.

In self-justification the federal government claims that it has to centralize funds so that it

can more fairly distribute resources among the regions, in particular giving more aid to poor regions so as to correct the wide disparities in benefits available in different regions. These disparities meant that residents of rich regions had much better access to state services than residents of poor regions. Now the governors of the rich regions are complaining that the federal government is unfairly taking money from them and handing it over to their poorer neighbors. They charge that the policy of making such transfers deprives both the richer and poorer regions of any incentive to earn money through their own efforts. Whatever the merit of this charge, there is, more broadly, no reason to believe, at least as yet, that centralizing control over tax revenues will improve the state's overall efficiency in providing social services to the already almost half of the population that is living below the official poverty line.

Law Enforcement Agencies

During the Yeltsin era, regional leaders had a substantial say over who was appointed to head the federal law enforcement agencies in their regions. The well-known Russian analyst Aleksandr Tsytko charged that this provision gave governors "the opportunity to cover up the real criminal situation in their regions and to feel safe in the face of the law." The governors got this power from the constitution, which put "judicial and law enforcement personnel" under joint federal and regional jurisdiction.

More specifically, a law of March 1999 on the Ministry of Internal Affairs gave the regional executive a strong voice in appointing and dismissing the regional police chief. In practice, the law virtually gave the governors the right to use the police for their own purposes. Some governors, for example, ordered the police to block food exports from their regions, or to arrest and imprison inconvenient individuals during elections. However, soon after Putin came to power, the Duma took away the governors' right to have any say in the dismissal of police chiefs.

In principle, the Putin team's efforts in this area make some sense. A more centralized police force ought in theory to be able to reduce the amount of corruption at the regional level. However, if the top layers of the federal police are themselves corrupt, as the Russian press has repeatedly alleged, then real improvement in the regions will have to await serious action by Putin at the federal level.

As regards the Prosecutor General, the regional leaders (soon to be replaced by their representatives) in the Federation Council must approve his appointment and dismissal. This power became important in 1999, when Yeltsin sought to remove Yurii Skuratov, who was investigating Kremlin corruption. The Federation Council resolutely blocked Yeltsin's move, and ultimately agreed to dismiss Skuratov only when Yeltsin had left office. However, the Federation Council's opposition could not prevent Yeltsin from squashing Skuratov's investigation. This signaled to top regional officials that probably they too could block investigations of their own crimes without the Kremlin objecting.

The regional procurators are the key officials in identifying legal deviations at the regional level. Thus, for the Putin team to implement its plan to make the regions bring their legislation into line with federal norms, it needed to make sure that the regional prosecutors henceforth take orders from Moscow rather than the governors. To ensure the regional prosecutors' loyalty, the Putin team got the prosecutor general, Vladimir Ustinov, to establish prosecutor general's offices in each of the federal districts, and then create a new layer of prosecutors to run them. The key job of these men was to turn their subordinates, the regional prosecutors, into instruments of Moscow against the regional elites. Again, these moves can in theory be justified, but in practice they appear

to be further politicizing the whole institution.

Under Yeltsin, the Federal Security Service, or FSB, maintained more autonomy from the regional leaders than did other “power ministries”. Today, therefore, the Putin team can use it without too much difficulty to pursue their regional policy. The FSB’s most important task is gathering information on many matters, but notably of late on regional officials who oppose the implementation of federal policy. The Putin team can then use evidence of the governors’ or their subordinates’ wrongdoings to force them to stay in line. Not surprisingly, the Putin team took advantage of the fact that more than thirty Russian governors sought re-election in fall 2000. Some of those whom the Kremlin wanted to replace found themselves pursued by the FSB and the prosecutors. Some observers believe that such developments potentially foreshadow the growth of a police state.

Regional Security Councils

Under Yeltsin, many governors set up regional security councils to coordinate a wide variety of security and law and order policies. Besides the governors, the councils included the regional heads of the power ministries. The councils thus provided an excellent forum in which the governor could capitalize on the material perquisites he was already giving these individuals by winning their loyalty in other ways too. To the extent that he succeeded, he reduced their loyalty to their bosses in Moscow. In October 2000 the federal authorities began taking action to remove the governors from the councils and subordinate them to the federal districts.

Court System

Under Yeltsin the governors usually controlled the regional courts. With the federal government unable to provide services the courts needed to function, the judges often had to rely on help from the regional government, making them beholden to the governors. Accordingly, the governors and their associates in both legal and Mafia-type business could expect the courts to rule in their favor. Such access allowed these people to enrich themselves by using the courts to gain control of lucrative enterprises in their regions. Among other problems, the close ties between these people and the courts limited the amount of investment in a region, because potential investors saw that the courts could not be relied on either to enforce contracts or to defend the legal order more generally.

However, the hierarchical structure of the courts sometimes did serve citizens’ interests. If a plaintiff was unhappy with a court decision at the regional level, he could appeal to a court with higher standing. The increased amount of litigation under Yeltsin suggests that at least some well-off individuals found the courts a useful way to defend their interests. However, a big problem was that court decisions were often not enforced. For example, the courts ruled repeatedly that Moscow Mayor Yurii Luzhkov’s residency permit system is unconstitutional, but he has, with impunity, refused to abolish it.

The members of the Putin team clearly see the federal courts as a weapon they can wield against the regions. In June 2000 the Constitutional Court issued two rulings that sharply limited the ability of the 21 republics to declare their “sovereignty” within the Russian Federation and control natural resources located on their territories. These decisions erased many of the concessions that Yeltsin had made to the republics in the early 1990s.

Reform of the court system, which recently began, will be a long and difficult process. Unprecedentedly the 2001 budget includes housing funds for judges and modest increases to their salaries. On April 11 the Constitutional Court ruled that courts of general jurisdiction could deter-

mine whether a regional law violated federal laws. This act restored the situation that existed before 1999. Beyond this, however, plans for court reform so far have been partial, rather than comprehensive. The Putin team intends to restructure the regional court system along the lines of the seven federal districts, so that the governors' ability to control it will be reduced. They have introduced legislation that would create 21 administrative court districts (working within the seven federal districts), which will deal mostly with cases involving the regional authorities. These new administrative courts would be in a position to issue rulings against the regional elites. Also, local prosecutors filing suit against laws they think violate federal legislation would have a better chance of success. Most likely, the Putin team will use a few well-publicized cases to signal the governors what they expect them to do. In present circumstances the main danger of their likely reforms is the same as the one we have been highlighting in other spheres of law enforcement: most of the political manipulation may simply move from the regions to a higher level, that of the federal districts.

Military and Nuclear Industry

Not surprisingly, the security of Russia's regionally based nuclear weapons is one of the few regional issues that has aroused Western concern. However, much myth surrounds the relationship between the governors and the military. It has been fueled by episodes like that of July 1998, when Krasnoyarsk Governor Aleksandr Lebed sent a letter to Moscow deploring the abominable conditions at the local base of the strategic rocket forces. The letter provoked widespread fears that he might try to take control of the nuclear missiles in his region in order to pressure Moscow. It is true that governors often pay for food and other assistance to military troops in their regions, giving rise to concern about whether the troops' primary loyalty is to the federal government or the regional leaders. However, after predictably sharpening this concern, Lebed took no action to seize military assets, and informed observers do not believe that governors will be able in present circumstances to assert authority over military units based in their region, much less over military or civilian nuclear resources.

However, as the 1990s drew to a close, regional authorities gradually were acquiring greater influence over Russia's nuclear infrastructure, both civilian and to a lesser extent military, as well as over the armed forces. Nikolai Sokov of the Monterey Institute for International Studies has argued that this process is not a straight devolution of power from the center to the regions. Instead, it takes the form of an emerging alliance between governors and powerful, federal-level interest groups, particularly Russia's nuclear industry and the military. Although this nuclear regionalism probably makes some economic sense, the Kremlin seems to be uneasy that it does not fully control it. It may be the first stage of a hitherto weak type of integration, i.e., cooperation between federal and local elites. This cooperation could in the future have a significant influence on the country's national security policy.

Although the full impact of the Putin team's reforms is not yet clear, the governors will continue to be influential in many aspects of routine policymaking. And however much or little the political landscape is realigned, in the future Russia may have an increasingly powerful nuclear industry and military, which may enjoy growing support from the governors and the Federation Council.

Media

Under Yeltsin, while Russians benefited from a wide freedom of speech, the freedom of the media was less extensive. At the national level the government and a small number of politically active oligarchs controlled the major publications and broadcast media. None of the big newsgathering organizations was able to turn a profit just from selling ads. The state owned 80 percent of the typesetting plants and more than 90 percent of the mass communications' infrastructure. While national television penetrated most of the country and was particularly important, the major national newspapers were rarely available in the provinces on a timely basis. Regional audiences usually turned to local broadcasters and press for their news.

At the regional level as at the national level, the broadcasters and newspapers were generally loyal to one or another group—either the ruling authorities or powerful business groups that had strong political interests that were sometimes opposed to those of the governor. In regions where the governor had been able to marginalize his political opposition, he had almost exclusive control over the media. Often the regional authorities paid the salaries of the major regional broadcasters and thus got television and radio coverage that supported their point of view. Additionally, they usually controlled newspaper office buildings and the only printing press in the region, with the result that they could expect favorable coverage in the press as well. By accrediting some sources and not others, and by doling out information to favored journalists, the authorities could put the rest at a disadvantage.

In addition, the governors often used their control of regional media to blame federal authorities for the many unresolved problems in their regions. Such tactics gave them some popularity at home and helped them in their struggle to extract resources from Moscow. With few exceptions, the press suffered from a lack of legislative support, poor backing from the courts, little public demand for better analysis, and low levels of professionalism among journalists, many of whom, with low incomes, have been happy to take money from government bodies, according, for example, to Dmitri Strovsky, a journalism professor in Yekaterinburg, and Robert Coalson, who headed the National Press Institute's office in St. Petersburg.

Predictably, the Putin team's strategy vis-à-vis the media has been to centralize control, a process begun in 1999. It is working to put the Kremlin's stamp on the major TV channels. At the regional level, each of Putin's seven representatives is setting up a "unified information space" in his district. Each district is opening a federal center for information and analysis, which will be supported by the local branch of the state-owned news agency RIA Novosti. Additionally, Putin has decreed that his seven representatives, not the governors as in the past, will approve the appointment of the regional chief for the country's second most important state-owned national TV network, Russian Television. On 28 September the government, working closely with Gleb Pavlovsky, a long-time political strategist and organizer of dirty tricks for the Kremlin, set up a new current events website (www.strana.ru) that will provide a uniform source of news and analysis for the federal districts. This effort appears to be only one part of a multi-pronged strategy for introducing government censorship of the major media.

Also, since the loyalty of the media is determined primarily by who pays the bills, the Putin team is emphasizing to regional editors that their paycheck comes from the federal government, not the governor. In July 1999, the State Press Committee was upgraded to the status of a ministry. It has offices in every region. Now federal media subsidies are passing through the ministry rather than, as before, the regional administrations. The Kremlin is also tightening media licensing procedures to further insure that the press and broadcasters do not exceed narrow limits in criticizing

state bodies. Since the federal government owns the regional printing presses that have hitherto been controlled by the governors, it is likely to reassert its ownership rights.

As their partners in controlling the media, the Putin team look to such giant semi-private corporations as the gas company Gazprom. In June 2000 Gazprom appointed a Kremlin loyalist, Alfred Kokh, to run its media holdings, following pressure from Press Minister Mikhail Lesin. Gazprom appears to own as many as 200 regional TV stations and 100 newspapers. In the past, the company has purchased media outlets and then turned control over to mayors in exchange for behind-the-scenes support. Now Gazprom may be ready to turn over control of this network to the presidential administration in exchange for concessions to Gazprom's business interests.

In these circumstances, the Internet becomes more important as an outlet for independent news analysis. But here too the Federal Security Service has been active, taking measures to monitor and potentially control electronic information flows.

In sum, then, the Putin team's reforms are not making the media freer. Rather, the Kremlin is trying to replace the control once exercised by the governors and some national oligarchs with levers more easily and aggressively exercised by the Kremlin or its surrogates.

Increasing State Control over the Economy

The Putin team has consistently favored, as part of its state-strengthening strategy, increased Kremlin control over the economy. Whether or not the president's representatives should play a substantial role in this regard has been a controversial issue. In August, sharp differences of view flared in the media between two deputy prime ministers. Since then, it has become clear that the representatives and the federal districts will indeed be involved. Among other things, the transport ministry and the official trade unions have started creating a new layer of bureaucracy in the federal districts, following in the wake of non-economic agencies like the MVD and the Prosecutor's Office. Reports also suggest that the representatives will soon be managing in their districts such things as targeted federal programs, the state's shareholdings in major stock companies, and development plans for strategic sectors of the economy. If this trend continues, the representatives will cross a Rubicon: their role will no longer be one primarily of monitoring and coordinating, carried out from a hierarchy separate from the governmental hierarchy. It will expand to include typically executive functions, and their presidential hierarchy will become intertwined with the ministerial hierarchies.

Business Groups

During the Yeltsin era, there was usually a cozy relationship between the directors of large enterprises in a region, the governor, and regional legislators. Many of these ties go well back into the Soviet era. Often it is the regional business elites who put the governor in power and the governor relied on his relationship with these elites to rule. According to research by Kathryn Stoner-Weiss of Princeton, regions where business elites have the greatest influence were also the regions most likely to defy Moscow's policies.

These elites helped to stall macro-economic reform during the last half of the 1990s. In particular, enterprise directors did not want to have a transparent tax system since they did not want to pay taxes. Additionally, they worked to prevent fair business competition. They sought a personal relationship with the governor so that they could have special access to privileges and prevent the implementation of federal policy designed to regulate their activities.

The Putin team's policies address some aspects of this deep-seated problem. Rhetorically, the

president has stressed the need to create a level playing field so that all businesses can flourish, not just those with political ties to national or regional authorities. Using the tax code and other measures, the Kremlin is trying to establish a unified economic space. However, in Russian conditions it is almost impossible to separate out legal from illegal businesses. Doing business means paying for a “krysha”, or “protection”. The governor’s office represents one kind of protection, and his friends may run others. In sum, the Kremlin is still a long way from rooting out the crony capitalism and corruption that existed under Yeltsin and continues today.

Political Parties

In general, political parties have not played an important role in post-communist Russia, partly because of voter alienation from the system. Also, Yeltsin felt that he did not need a party organization to rule. Instead he set up a string of transient parties for parliamentary elections that effectively lasted only one cycle. The Communist Party of the Russian Federation remained the largest and best organized party, but although its popular vote has largely held up, its representation in the Duma has declined. At the regional level, the governors have largely blocked the development of parties, because they do not want to have powerful institutions that can influence and monitor their actions. Since much of regional politics takes place behind closed doors, they prefer that the political process be shielded from public scrutiny. Nor do they intend to submit themselves to the dictates of party discipline, when they can generally win elections without party support.

The Putin team is not encouraging the formation of real parties. Putin himself is a technocrat by nature, who regards the messy rivalry and bickering between parties as a wasteful distraction from the real business of governing. The pro-Kremlin Unity party, whose relative success in the 1999 Duma elections helped to persuade Yeltsin to resign in favor of Putin, does not improve the situation, because it is a party designed to facilitate Kremlin control of the Duma, rather than to aggregate and articulate the interests of different social and political groups. Until grass-roots parties develop and can elect candidates to office, the electorate will have few levers to exert control over politicians.

Labor Unions

The coal miners’ strikes of 1989, organized by strike committees rather than trade unions, helped lift Yeltsin to political power. They were a clear example of a social group that had organized itself to achieve political change. However, throughout the 1990s independent trade union activity declined, while the official unions remained, in general, subservient to employers and the government.

Union organizers faced enormous obstacles, often caused by the weakness of the rule of law. Often the government broke agreements that it signed with the unions and deals concluded with enterprise management remained on paper. In many cases, the government illegally refused to recognize that a union existed, even though the Justice Ministry is in theory required to register unions upon notification that they have held a founding congress. The state and other employers also harassed union members by, for example, juridically liquidating a factory where an independent union existed, transferring its assets to a new legal entity, and, in the process, firing union supporters and/or using violence against them. Unions have often had trouble determining who their employer-negotiating partner should be when different groups are competing for the ownership of a plant. As a result, union numbers have dwindled as members realize that their activities do not produce results and also put their jobs in jeopardy.

Nevertheless, new union leaders usually appear when their elders give up or get co-opted. While mass actions are now unusual, the unions have had some successes through the first stages of litigation. Although local courts tend to support the employers, the unions have some chance of winning a favorable verdict on appeal when the case is heard outside the local jurisdiction. However, such verdicts rarely lead to the desired outcome, because in most cases the appropriate authorities avoid enforcing them, using various pretexts, and the unions then have no recourse.

Today, the independent unions face increased problems and threats. Most of them opposed the Kremlin's decision to implement a single social tax, fearing that the bureaucracy would not be cut and the government would simply swallow up the tax. Additionally, the introduction of the 13 percent flat tax hurt most workers because they previously paid only 12 percent. Most importantly, if the government's draft of a new Labor Code is passed, it will take away many of the rights the unions currently enjoy and make it impossible for new, minority unions to represent workers on the factory floor. Also, the draft allows a situation where, if an employer does not like a union, he can set up his own "workers'" organization and conduct negotiations with it, thereby circumventing the union.

Independent unions need a strengthened rule of law and more liberal legislation. The Kremlin's reforms are moving in the opposite direction. They are further weakening civil society, making workers more dependent than ever on the mercy of employers. However, the latter, with some exceptions, feel unrestrained by the law, public opinion, or the level of unemployment (currently estimated at about 15-20 percent in real terms), and are more inclined to exploit workers than to treat them well.

Chechnya and the North Caucasus

The Kremlin's most urgent and difficult regional problem is the secession of Chechnya. Putin and the power ministries have been using massive force in a seemingly futile effort to bring the republic back under Moscow's authority. In the process, however, they have further alienated both the great majority of the Chechens and also sections of other Muslim communities in Russia and abroad. The latter groups may not sympathize much, or at all, with Chechen secessionism, but see the Kremlin's war as a form of anti-Muslim genocide. Thus the war, which can probably never be won definitively, is stimulating the growth of nationalistic and religious attitudes that are hostile to Moscow. In the next few years, these attitudes will probably—though expert opinions on this question differ—increase the danger of separatism among the non-Russian peoples of the Russian Federation. Also, they may well increase the level of anti-Russian terrorism by Russian and foreign Muslims. Thus there will likely be more bombings in Russian cities, continuing a trend that includes the destruction of apartment buildings in Moscow, Volgograd, and Buinaksk in September 1999, in which over 300 civilians died, and the attack on a crowded pedestrian passage in Moscow in August 2000. (The exact authorship of these bombings is still unclear. While FSB involvement is quite widely suspected, it would be surprising to us if Muslim terrorists were not in some way implicated.)

For these reasons, it is hard to see the Caucasus becoming anything but more unstable in the coming years. Already the war's ripple effects are destabilizing much of the area, especially Dagestan, Ingushetia, and, in the south Caucasus, Georgia. It is true, as Makhachkala-based journalist Nabi Abdullaev reports, that the 1999 attacks on Dagestan from Chechnya made most of the Dagestani population sharply anti-Chechen. Also, many citizens in that ethnically diverse republic

believe they could not survive outside Russia and have no desire at present to seek independence. Nevertheless, Dagestan has seen the rise of the fundamentalist, so-called Wahhabi Islamic sect, which, though still probably numbering less than 100,000 in Dagestan, has strong separatist tendencies and tends to sympathize with the Chechens. In August-September 1999 the sect's most militant Dagestani groups were subjected to sustained air and ground attack in two regions. In the attack in central Dagestan, some 20,000 army and MVD troops fought for three weeks a well trained and well dug-in Wahhabi force of about 500, which used prepared air defense installations. In the end, the federal troops prevailed and occupied the three villages the Wahhabis were defending. About half the Wahhabis were killed.

However, these Kremlin tactics have inevitably created martyrs, and, in the longer term, probably only exacerbated an intensely difficult problem. Also, Wahhabi communities have been growing up in other parts of Russia in addition to Dagestan, for example in Karachayevo-Cherkessia and Astrakhan, and have attracted support from Muslims with similar beliefs abroad.

As for Ingushetia, its leader Ruslan Aushev has clashed repeatedly with the Kremlin, and has shown some sympathy for the Chechens. Nonetheless, the Ingush are unlikely to seek independence for their republic, at least in the near future. Ingushetia now hosts some 200,000 refugees from the Chechnya war, and is heavily dependent on Russian subsidies.

How much concern should this Caucasian instability arouse in foreigners? Clearly there are both acute humanitarian concerns and also the issue of a nation's right to seek independence from an oppressive colonial situation that has lasted for 150 years. Beyond that, though, since Caspian and Kazakstani oil needs to transit the Caucasus as one of its key export routes, re-stabilizing the whole area is clearly in the West's material interest. The West also has a strong military and political interest in countries like Turkey, Georgia, Armenia, Azerbaijan, and of course Russia, being—or becoming—stable and prosperous.

As for Russia, the ultimate question raised by the north Caucasus situation is whether Russia wants to be a multinational federation or a unitary state. If it wants to be the latter, and to survive, it is almost certainly obliged to be authoritarian, to hang on to restive minorities. The Chechens have been willing and able to fight. Other Muslim nations may eventually follow.

As the Putin regime seeks to make the Russian regions conform to its wishes, it will increasingly face this profound question about Russia's identity. It is a question with which Russians of the most diverse views have been wrestling—passionately but inconclusively—for some three hundred years.

Regional Foreign Policies

As the world becomes increasingly globalized, regions within Russia are playing a greater role on the international stage. Throughout the 1990s, many of Russia's regions developed and maintained relations with foreign countries, regional governments within foreign countries, transnational corporations, international non-governmental organizations, and international financial institutions. The increased foreign outreach by these regions is not surprising, since 46 of them now have an external border (up from 29 during the Soviet era). These relationships naturally have an impact on the relationship between the regions and Moscow. For analytical purposes, these ties can be divided into political and economic categories.

On several occasions in the 1990s, regional leaders opposed the federal government on political and national security questions. Primorskii Krai Governor Yevgenii Nazdratenko unsuccessfully fought against the adoption of a border treaty between Russia and China, objecting that it

should not transfer Russian territory to China. Likewise, Nazdratenko and Sakhalin Governor Igor Farkhutdinov protested against any moves by Russia to return the disputed Kurile Islands to Japan. Moscow Mayor Yurii Luzhkov criticized the federal government's policy toward Ukraine, arguing that the Crimean Peninsula rightfully belonged to Russia. Several regions established closer ties to Belarus's Aleksandr Lukashenka than the federal government seemed to support. And some of Russia's ethnic Turkic regions have developed closer ties to Turkey than has the federal government. While these deviations are worth noting, their importance should not be exaggerated because the regions play only a small role in the formation of Russia's foreign policy.

In the realm of economics, most of the regions' relations with foreign countries did not elicit any significant protest from the federal government. In fact, in most cases the latter encouraged the regions to seek outside investments, because these reduced the pressure on tight federal resources. The Foreign Ministry even set up regional offices to coordinate Russian foreign policy with local actors. In this vein, Tatarstan has representations abroad, which, according to its *de facto* foreign minister, work quite harmoniously with the Russian foreign ministry on issues like investment promotion and trade.

Nonetheless, under Yeltsin there were some real problems. In particular, the regions could borrow money from abroad and the federal government, which had no involvement, was held responsible if the region defaulted. In September 2000 Putin addressed the problem by proposing legislation that would forbid the regions to borrow abroad. Regional leaders suspected that the Kremlin was also working to end the regions' rights to sign foreign agreements. Tatarstani political scientist Midkhat Faroukshine complained that the reform went too far because it punished all regions for the sins of a few. He argued that it would make more sense to place limits on the amount of debt that a region could take on.

Conclusions

The central dilemma regarding the regional dimension of Russian state-building is how to hold the governors accountable to the people and the law (such as it is), without at the same time giving the Kremlin *carte blanche* to interfere wherever it sees fit. In our view, the Putin team's reforms err on the side of concentrating too much power in the hands of the federal executive. In the post-Yeltsin situation, building an effective state requires centralizing some powers so that the Kremlin could carry out the tasks appropriate for the national level. However, by aiming to reduce the powers of the regions so sharply, they are probably not strengthening the Russian state—at least not in ways that will promote flourishing social, political, and economic systems—and may be doing it harm. By adding an additional layer of bureaucracy between the federal and regional governments, they have not created a coherent institutional mechanism to facilitate better coordination between the center and the regions. Rather, the establishment and strengthening of the federal districts threatens to cause administrative confusion.

The Putin team's changes to the Federation Council and the sudden creation of the State Council demonstrate the *ad hoc* nature of its institution building. The moves to weaken the Federation Council seemed to lose their logic when Putin caved in to pressure from the governors to allow them to have extensive control over their replacements in the upper chamber. Likewise, the president did not make clear what the role of the State Council would be *vis-à-vis* other institutions. While such institutional maneuvers suggest a certain flexibility on Putin's part, they also imply that he lacks a coherent plan for how to make the state function more effectively.

Of special note, Putin has continued a long Russian tradition of making individual rulers more important than institutions. He appointed men with backgrounds in the KGB, military, and police to key positions in his administration. Since the very responsibilities of these positions remain poorly defined, it has been partly up to the individuals to decide how to proceed. While personalities will always shape institutions in even the most developed political systems, the Putin team's new institutions seem to rely too heavily on their individual leaders to determine their role in the federal system.

More fundamentally, to date the Putin team's reforms do not even begin to tackle the deepest problem of the Russian state. This is the almost complete disengagement from the state of the alienated majority of the population. If this crucial issue remains unaddressed, the Russian state will continue to rest not on rock, but on sand.

Scenarios of Future Development

It is too early to say how the current reforms will evolve, but it may be helpful to lay out some hypothetical scenarios for Russia's evolution. A clearly dangerous one centers on the emergence of an aggressive, centralized state. How might that come about? Several Russian observers we consulted believe that Putin may already be planning a "second stage" in his federal-regional reforms, which would go much further in the direction of simply abolishing federalism and creating a unitary state. Such an initiative might proceed in parallel with the introduction of a more mobilizational approach to the economy, increased restrictions on parliament, and much tougher censorship of the media. Evidence for these potential developments exists in each case. Most suggestive in the field of federal-regional relations is the Kremlin's growing tendency to give the presidential representatives some full-blooded executive powers. The apparent goal is that they should be able, for example, to make government appointments, directly control financial flows, close down overly independent media, and have greater power over the economy in their districts.

With a stronger federal executive that used police, secret service, and judicial powers to keep the country's regional and financial interests in line, the president (Putin or, if he proved too indecisive, a tougher replacement) could assert his authority in an authoritarian manner designed to preserve his and his clan's political power regardless of the reaction from the domestic opposition or foreign observers. Such a system would be unstable, as it would clearly rest on the president's ability to maintain the loyalty of the power ministries rather than a broad base of social support. To strengthen his domestic base in such a system, the president might behave aggressively in foreign policy, threatening Western interests, for example, in the Baltic, Ukraine, or the Caucasus.

Another scenario posits the disintegration of Russia. Such an outcome would present the West with a much different kind of challenge. If the current reforms prove ineffective and the economic situation worsens following a drop in oil prices, Putin could lose control of the country. If the Chechen war continues to drag on, the level of terrorism could increase. Regional leaders, sensing that Moscow lacks the ability to preserve order, could start to act on their own in defiance of the president. The result could be political or even territorial fragmentation, which would create potentially serious instability among Russia's neighbors too. Of greatest concern would be the level of control maintained over Russia's nuclear arsenal.

On the other hand, Putin might succeed in freeing himself from Yeltsin's entourage and troublesome oligarchs, and then consolidate his gains by making progress on some of the worst problems inherited from the Yeltsin era. By listening to new advisers, he might, for example, suc-

ceed in creating greater fiscal transparency, reducing corruption, and dividing power in a more balanced way between the federal and regional levels. Clearly, success in state-building along these lines would serve Western interests because it would make Russia more stable and predictable, and greatly reduce the possibility of a serious state breakdown

Our final scenario sees Russia as changing little and somehow muddling through. The federal-regional reforms now underway would not gain momentum and would end up having little positive or negative impact. In this case, Russia would not particularly threaten the West through its strength or weakness, but would be unpredictable and would not contribute much to the world's councils. Also, the door would remain open for an eventual slide into the aggression or fragmentation scenario.

Recommendations

In dealing with today's Russia, Western governments and NGOs would do well, in our view, to keep firmly in mind that Anti-Westernism, which was weak a decade ago, is now very much stronger—though not as strong as it was in the wake of the August 1998 financial crash, the NATO bombing campaign against Serbia over Kosovo, and the expansion in NATO membership. Anti-Americanism is quite a lot stronger than anti-Europeanism. In both cases the emotion is directed less against ordinary people and much more against governments and international financial institutions. This is because, apart from the NATO issues, the latter two groups are believed to have given Russia bad economic and other advice, either out of a mixture of arrogance and ignorance, or out of self-interested malice. In these circumstances, useful watchwords for Western advisers and aid-workers are humility, low-key, grass roots, modest sums, and careful monitoring.

A second general point is that while these are not easy times for assisting Russia, if the West remains quietly but persistently engaged, easier times may perhaps return before too long. If the current authoritarianism brings poor results, as seems likely, then, in a few years, it is possible that a greater openness to the West will re-emerge, encouraged in part, perhaps, by the perception that the West has by then learned some lessons from its mistakes in the 1990s.

As regards federal-regional relations, a key long-term goal for Russia is, of course, greater transparency. Quick results should not be expected, because powerful individuals and institutions, in both Moscow and the regions, are intensely concerned to preserve the present opacity, which hides a multitude of sins and crimes. In working toward the goal, the improved transparency of those Russian companies that market, or plan to market their shares in the West, and therefore hire Western auditors, can serve as a useful model. Corruption and authoritarianism can both be gradually undermined by independent financial auditing, and also by something else that the West can foster in a quiet way, namely the political sort of auditing of local and regional government that civil society groups can do.

More specifically, the West could for example help train auditors in internationally accepted techniques. It could also encourage civic groups to press governments to publish financial information in local newspapers and post it on the Internet. Ultimately, information on the transfer of funds between different levels of the state, planned and actual, should be made easily accessible to those who want it.

Such goals may seem unrealistic, but over the long term the situation is not in fact without hope. The federal government does have an interest in publishing the amount of money it sends to the regions, so that it can then ensure that the regional governments use the funds for the intended

purpose. If the public knows how much money arrived from Moscow, it can try to ensure that local officials spend it appropriately. By publishing such information, the Kremlin would be encouraging citizens to organize themselves and play an active role in monitoring official activities.

Our second recommendation, which concerns NGOs in a broader context, is closely related to the first. Since the Russian state at the federal, regional, and local levels would, in principle, benefit from an increased capacity to handle input of many types from groups working in Russia's nascent civil society, the West should patiently help these groups to that end. For most NGOs, local governments are the most logical partners, because, even though their powers are limited by the dominating ways of both central and regional governments, they stand closest to Russia's social problems. The West should quietly seek ways to facilitate cooperation between these governments and NGOs.

Part of this task involves helping Russian NGOs to tackle their numerous problems of winning public support and conveying their message to the authorities. For example, some tax code revisions would encourage, rather than discourage NGO development. The existing legislation has harmful effects on such organizations. For example, travel expenses for non full-time staff of NGOs are currently taxed as personal income.

The West could also help by developing programs that encourage more interaction between the federal, regional, and local governments, the private sector, and non-governmental organizations. Such programs should not be limited to simply facilitating dialogue, but could also draw in low-key ways on Western experience in developing state capacities through interaction with civil society.

Third, the West can encourage the Russian government to be flexible in dealing with the regions. For example, rather than forbidding the regions from taking foreign loans, the federal government could simply tell the regions and potential lenders that it will not back the loans if the regions default. Just forbidding the regions to take loans is regressive.

Fourth, Western aid agencies should be extremely cautious about supporting regional governments. Both the U.S. government and the European Union have developed aid programs that focus on specific regions. However, it is extremely difficult to pick appropriate regions for targeted aid. Favoring Novgorod, for example, gives support to an authoritarian regional governor and thus encourages other regional executives to become more authoritarian in the hope of obtaining similar support. Also, most regional governments have a high level of corruption. Thus, "going to the regions" in a simplistic way can create as many problems as it solves. In general, the best approach in our view is to work with small grass-roots groups that have a record for reliability and honesty, and to monitor carefully their use of Western funds.

Fifth, regarding the seemingly intractable problems of Chechnya and the Caucasus, we believe that it is deeply in the interests of Russia, the West, and all the states in or close to the Caucasus, to cooperate and seek ways to end the war and stabilize the region. Just because these tasks are profoundly difficult is no reason to neglect them—as many of the relevant states are currently doing. The most immediate difficulty is that the Putin regime is committed to winning an unwinnable war. This requires delicate, multilateral diplomacy by loose groupings of states, probably for an extended period. A second dilemma, created originally by the Yeltsin administration's decision to invade Chechnya in 1994 and then use brutal tactics in a long war, is that some of the Chechens now want to liberate the north Caucasus from Russia. To that end, they have begun to use military force and terrorism, and to receive aid from terrorist leaders abroad like Osama bin Laden. While many governments have a common interest in combating such leaders, the West

would in our view be wrong if it accommodated the Kremlin by helping it fight Muslim terrorism in ways that facilitated its war against Chechnya.

Sixth, just as the Russian government should operate in transparency, so should Western aid agencies. Often Western aid providers do not know which regions have benefited from the aid programs of other organizations. Additionally, choices have been made that show either ignorance of the political characteristics of the chosen region, or a lack of concern about this important factor. For example, the European Bank for Reconstruction and Development decided to invest in Vladivostok even though it was aware of the repressive nature of its regional administration.

Seventh, the West should encourage better monitoring of regional and federal elections in Russia. Flying in foreigners the day before an election to observe voting booth procedures does not do an adequate job of ensuring an election's integrity. Publishing more information beforehand about media coverage and the course of the campaign, and publicizing legal violations as soon as they occur, would help to increase public scrutiny of these problems. Also, at the regional level we advocate, as an experiment, bringing in Russians from other regions to monitor voting procedures. Such Russians would have a better sense than foreigners of how election results can be falsified, and, like the foreigners, would not have a strong stake in the election's outcome. So they could serve as relatively neutral third parties.

Finally, concerned Westerners should in our view take any suitable opportunities that may arise to talk quietly with Russians whom they know and trust about the Russian state's deepest weakness, its lack of popular legitimacy. Educated Russians can relate to this topic, partly because this was also the deepest weakness both of the Tsarist state in the early 20th century and of the Soviet state in 1990-91. Unless Russians address this issue before too long, the present state, too, may be in danger.

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<<http://www.iew.org/rrrabout.nsf>>)**

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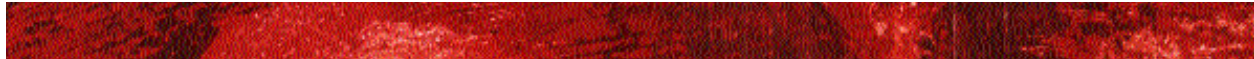
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Notes

¹ The most important of these are usually considered to be the military, military intelligence (GRU), the police and internal security troops (MVD), the secret police (FSB), the communications' monitoring agency (FAPSI), the Foreign Intelligence Service (SVR), the tax police, the Emergencies' Ministry, the Prosecutor-General's office, and the Ministry of Foreign Affairs. Putin made his career in the FSB.



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