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contents

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Russia's Economic Transformation under Putin

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Abstract: A prominent specialist on the Russian economy presents a systematic account and analysis of Russia's economic transformation under President Vladimir Putin. The study covers the period from the financial crash of August 1998 through the years of spectacular growth leading to August 2004. The discussion encompasses the financial stabilization in the aftermath of the crash, the work of Putin's first economic team, the tax reform, tightened budgetary control, deregulation, land and judicial reforms, trade policies, the economic agenda for Putin's second term, and prospects for further economic reform. *Journal of Economic Literature*, Classification Numbers: E60, E63, F13, H20, H60, P21. 1 figure, 2 tables, 57 references.

In recent years, the Russian economy has experienced an extraordinary reversal. Suddenly, it has been transformed from an apparent basket case, with steadily declining output and chronic macroeconomic instability, to one of the world's most dynamic economies, with solid macroeconomic stability. How could this happen?

August 1998 stands out as a dividing line in recent Russian economic history. From 1989 until 1998, official Russian GDP fell by no less than 44 percent (ECE, 2004, p. 190). Since 1999, by contrast, Russia has achieved an average GDP growth of 6.5 percent for no less than five years (see Fig. 1). Everything else has improved accordingly—the budget balance, inflation, the trade balance, and lastly the current account balance. As so much changed simultaneously, it is difficult to single out the decisive factor. Thus far, five different interpretations have been advanced to explain the great improvement.

Initially, the dominant perception was that the causes were exogenous. From a low of less than $10 a barrel in 1998, the world crude oil price rose to above $40 a barrel,[2] providing a great profit windfall to Russian oil producers. Natural gas and metal prices have surged concurrently. At the same time, Russia benefited from a devaluation that reduced the dollar value of the ruble by three quarters in the fall of 1998.

A second group of explanations, representing the original view of the Washington consensus, is focused on the simultaneous recovery of most new market economies comprising the former Soviet Union. At long last, a critical mass of marketization, financial stabilization, and privatization had been accomplished.

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[2]The West Texas price reached a 21-year high of ca. $43 per barrel at the end of July/early August 2004 (e.g., Arvedlund and Fuerbringer, 2004, p. C1), and exceeded $45 per barrel during the second week of August (Arvedlund, 2004, p. C1).

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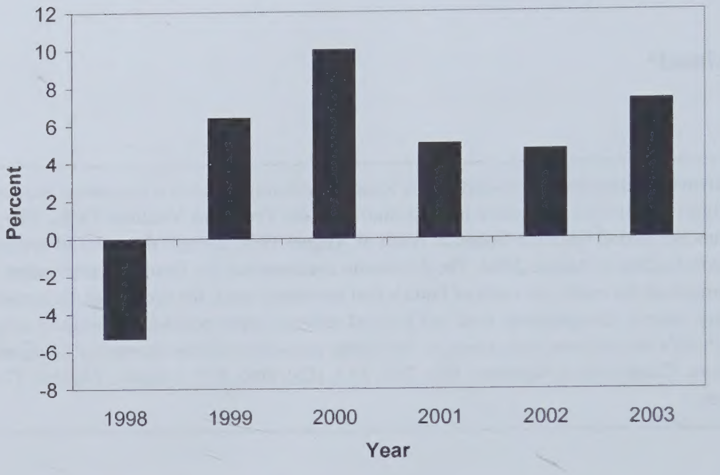

Fig. 1. Growth of Russia's GDP, 1998–2003.

A third suggested cause is that the crisis itself created opportunities for the political resolution of the underlying economic problems. Only when society realized how costly and dangerous a persistently large budget deficit could be did it find sufficient unity to address and resolve the problems (Alesina and Drazen, 1991; Drazen and Grilli, 1993).

A fourth related interpretation is that Russia had reached the end of its revolution, and was ready for its post-revolutionary stabilization (Mau and Starodubrovskaya, 2001). Yegor Gaidar has put it differently, arguing that Russia and the other post-communist countries were simply enjoying an economic recovery. After the revolutionary passion had abated, plenty of free capacity was at hand.[3]

A fifth explanation is that economic reforms instigated and promoted by President Vladimir Putin have turned the situation around. The drawback of that opinion lies in the fact that the strong growth started in 1999, months before Putin acceeded to power as prime minister in August of that year; he thus could not take credit for the early growth.

All of these explanations have some merit, so that no analysis can assess the true impact of each factor from a brief historical perspective. Admittedly, the direct impact of high oil prices can be ascertained, but had the oil price not been so high, the exchange rate would have been lower, and other industries, notably manufacturing, would have developed more rapidly. The main point is that many factors appear to have coincided to contribute to the high economic growth that began in 1999.

The purpose of this paper is to single out one of these factors for investigation—to examine changes in the economic system after the Russian financial crash of August 1998. The paper's coverage is guided by events that appear to have most visibly shaped the Russian economy. Its first section discusses the financial stabilization that occurred in the wake of August 1998. The second is devoted to the systematic and programmatic work of Putin's new team, led by the Minister of Economic Development and Foreign Trade German Gref. The third section reviews the tax reform, possibly the greatest of all the reforms. Subsequent sections deal with tightened budget control, deregulation, land and judicial reform, and Russia's trade policy. The penultimate section looks at incomplete reforms and the reform agenda for

[3]Yegor Gaidar in public lecture at the World Bank, Washington, DC, January 26, 2004.

President Putin's second term. A concluding section discusses prospects for further economic reforms.

THE FINANCIAL CRASH AND THE ENSUING STABILIZATION

The Russian financial crash of August 1998 has been extensively and rather heatedly debated. Fortunately, the facts surrounding that crash are relatively simple and readily evident. From 1992 to 1998, Russia ran a chronic budget deficit of over 8 percent of GDP. Inasmuch as the government had decided to combat inflation, it financed the budget deficit with domestic and foreign loans. The debt burden quickly mounted, as the loans carried very high interest rates—reflecting both the already excessive level of public debt (both domestic and external) and the lack of a credible financial policy (Åslund, 1998; Owen and Robinson, 2003).

This financial imbalance was aggravated by the proliferation of barter and other nonmonetary payment devices. In particular, large and powerful enterprises simply refused to pay taxes. Some did so with impunity, whereas in other cases negotiated tax settlements were common. Many enterprises offered to pay in kind, extracting public contracts on their own terms and securing large tax discounts in the process (Gaddy and Ickes, 1998). A World Bank study concluded that explicit and implicit subsidies amounted to no less than 16 percent of GDP in 1998 (Pinto et al., 1999).

In addition, Russia had an exchange rate that was perceived to be too high, although the country had never recorded a current account deficit, remaining for years an exporter of capital. One camp argued for a devaluation of the ruble (e.g., Illarionov 1998a, 1998b), which eventually became inevitable given failure to reduce the budget deficit and thus keep the public debt under control. Alas, any devaluation would bankrupt much of the Russian banking system, because most banks had a skewed balance between (a) large dollar liabilities and (b) assets valued in rubles (mainly treasury bonds).

After mobilizing a big package of emergency financing in July 1998, totaling as much as \$22.6 billion, the IMF, the World Bank, and the leading Western governments rejected Russian requests for additional loans. The decisive reason was the Russian parliament's refusal to accept government demands that more tax revenues flow into the federal treasury rather than into regional coffers. The Russian government thus was left with no choice but to devalue the ruble on August 17 of that year. Eventually, it let the exchange rate float, while at the same time defaulting on domestic treasury bills (GKOs), at the peak amounting to \$70 billion, and freezing Russian bank payments to foreigners for three months.

Although the exact causes of the crash were debatable, the culprits were readily evident. One group consisted of the so-called oligarchs, big businessmen who thrived on high interest rates carried by the government bonds. Another group was formed by regional governors, who resisted transferring a larger share of regional tax revenues to the federal government. A third group of culprits were the communist deputies in the parliament, who opposed all liberal reforms and favored large government expenditures.

During the first half year after the crash of August 1998, the new Russian government did not have a coherent policy in place. Russia was governed by sheer necessity, and by some of the previously drafted reform proposals. In July 1998, in the midst of the financial crisis, the reformist Russian government headed by Prime Minister Sergey Kiriyenko had concluded an understanding with the IMF and the World Bank to initiate a substantial new program of reform. However, after the crash, the weakened President Boris Yel'tsin had little choice but to fire Kiriyenko, ushering in a new government comprised mainly of left-wing oldtimers, led by Prime Minister Yevgeniy Primakov. In practice, however, Kiriyenko's program survived. No money was available for the expensive public investment program, for industry, or even for the formerly approved social transfers. Soon, the three groups of culprits (oligarchs, regional governors, and communists) themselves became victims of the crisis.

The default forced vital reforms on the country. Because financing other than tax revenues was no longer available, the Russian government had to live on taxes it could collect, meaning the chronic budget deficit had to be eliminated. Russia's apparent political inability to balance its budget no longer mattered. Aside from the sole remaining alternative of hyperinflation, there was really no choice. And there was an additional new threat posed by external default, prompted by Russia's inability to make upcoming payments on its foreign debt.

The first action the government had to take was a drastic cut in marginal public expenditures such as enterprise subsidies of little or no social benefit; their elimination also leveled the playing field for Russian business. The second step, considerably more controversial, involved a reduction of real pensions by not adjusting them for inflation. As a result, the real value of pensions fell by about half between the summer of 1998 and early 1999, and public expenditures fell accordingly. Total consolidated government expenditures dropped by no less than 11 percent of GDP in three years, sliding from 45 percent of GDP in 1997 to 34 percent in 2000 (e.g., see Owen and Robinson, 2003, p. 101). Thus, after the great financial crash, arguments that Russia could not reduce its public expenditures simply fell by the wayside.

The second government measure was to demand that all taxpayers from 1999 onward no longer pay their federal taxes in kind but solely in money; from 2000 the restriction was also applied at the subnational level. In parallel, the government insisted that all utilities forego payments in goods and services, and remit tax payments in cash as well. Bankruptcy legislation had long languished on the books, but now the government began to pursue its claims vigorously. A new bankruptcy law enacted in 1998 supported aggressive asset seizures. Apart from clearing up chains of arrears, this also led to changes in the ownership of many enterprises and their eventual revival. According to an enterprise survey by the Russian Economic Barometer (2004), barter payments between industrial enterprises fell from a peak of 54 percent of all inter-enterprise payments in August 1998 to 13 percent in the fall of 2001. The financial crash reinforced the central state's power so that barter and offsets ceased to assume the role of money. When large enterprises could no longer extract tax rebates by relying on offsets, barter became unprofitable, and the "virtual economy" began to disappear.

A third government measure was to apply the tax laws to large enterprises, especially to oil and gas companies, which had enjoyed special privileges in the form of negotiated taxes. This measure gained momentum because the oligarchs were now politically too weak to fight it.

A fourth undertaking was the radical centralization of government revenues, which began to flow from the regions and from extrabudgetary funds to the federal government. The fiscal problem in 1998 was not due to the magnitude of revenues collected, but rather to the fact that so little reached the federal treasury. Eventually federal revenues more than doubled from 9.1 percent of GDP in 1998 to 20 percent in 2002 (Brunswick UBS Warburg 2002, p. 13; BOFIT, 2004, p. 2). Among the many reasons, the devaluation caused foreign trade taxes, which were effectively valued in foreign currency, to increase sharply. In addition, the government introduced high export tariffs to tax the natural resource companies. Windfall gains from rising oil prices on world markets flowed primarily into the federal treasury. With

Table 1. Selected Indicators of Russia's Macroeconomic Stability, 1998–2003 (in percent of GDP)

Indicator	1998	1999	2000	2001	2002	2003
Inflation[a]	84	37	20	19	15	12
Federal revenue	9.1	13.2	15.5	17.6	20.3	19.4
Total revenues[b]	34.3	33.6	37.1	37.1	38.4	38.0[c]
Total expenditures[b]	40.8	37.2	34.2	34.1	37.0	36.0[c]
Budget surplus/deficit	-8.2	-3.1	2.7	2.9	1.8	1.7

[a]In percent at year's end.
[b]Of federal, regional, and local governments.
[c]Author's estimate.
Sources: Compiled by the author from Brunswick UBS Warburg, 2002; EBRD, 2003, pp. 59-61; Owen and Robinson, 2003, p. 10; and BOFIT, 2004, pp. 2-3.

the demise of barter and offsets, regional governors could no longer retain more money than they were legally allowed to hold. Extrabudgetary funds were first disciplined. Later, some were abolished, and the federal treasury eventually absorbed most of them. The previously sizable Road Fund and the small Employment Fund have been eliminated, while the social funds[4] are now financed by a unified social tax collected by the Tax Ministry to afford the federal government additional fiscal leverage (Owen and Robinson, 2003, pp. 34-39). At present, the country's fiscal dimensions are reminiscent of those of the United States, with total fiscal revenues of about one-third of GDP and federal revenues of ca. 20 percent of Russia's GDP.

Since 1999, Russia has had healthy budgets overbalanced by about 2 percent of GDP. Trade and current account surpluses are very large, and the public foreign currency debt has fallen from about 100 percent of GDP in early 1999 to 27 percent of GDP at the end of 2003. Russia's international reserves reached a reassuring level of $88 billion in June 2004 (see Table 1; BOFIT, 2004, p. 3). The seemingly intractable political problems were resolved in the aftermath of the financial crash, while rising oil prices and the ruble's devaluation straightened out the foreign account. Furthermore, Russia received a windfall of roughly $60 billion, as the government's default on its domestic treasury bills (GKOs) eliminated the bulk of its liabilities.

The financial stabilization and elimination of barter seem to have acted as the main catalysts of the ensuing growth, while the use of money stimulated competition. Although Russia has a steady government budget surplus of about 2 percent of GDP, inflation continues, albeit in the low double digits (see Table 2), chiefly due to the large current account surplus, which increases the money supply. However, inflation is not higher at present, because the demand for money and monetization of the economy have increased very rapidly. The government has tried to keep the exchange rate low by targeted currency purchases and a conservative approach to foreign loans. Nevertheless, even the nominal exchange rate has been steadily increasing, so that Russia doubles the average dollar wage every third year.

The financial stabilization has brought about a fundamental change in the structure of power that influences economic policy in Russia. The main losers were the former

[4]The Pension Fund, Medical Insurance Fund, and Social Insurance Fund.

Table 2. Russia's Foreign Account, 1998–2003 (in billions of current U.S. dollars)

Indicator	1998	1999	2000	2001	2002	2003
Exports	74	76	105	102	107	136
Imports	58	40	45	54	61	75
Trade balance	16	36	60	48	46	61
External debt[a]	158	155	140	127	119	110
International reserves[b]	12.2	12.5	27.9	36.6	47.8	76.9

Sources: Compiled by the author from BOFIT, 2004, pp. 1-3; and Brunswick UBS, 2004, p. 17.
[a]Debt of the federal government.
[b]Year-end gross reserves of the Central Bank of Russia.

businessmen, both the red directors and some of the oligarchs, who lived on subsidies and tax rebates extracted through barter or by outright collusion with the government. The second group of losers comprised the regional governors, who lost their power and financial resources to the federal government. In the third group of losers were the communists, who found themselves marginalized in the Duma after the parliamentary elections of December 1999. Their ideology favoring extensive government intervention had failed, and a much more liberal one prevailed. Before the December 1999 elections, the communists even revised their party program to embrace the tenets of a market economy.

Economically, the financial crash of August 1998 not only facilitated financial stabilization, but also leveled the playing field so that everyone now faced hard budget constraints. Big businessmen lost most of their nontransparent subsidies and their ability to repress competing entrepreneurs through their barter transactions. Better payment arrangements were introduced, which benefited both small and medium-size businessmen and the federal government. After 1998, the regional barriers that had been nearly insurmountable, even for the big industrial groups, collapsed (see Dynkin and Sokolov, 2002). All told, the side-effects of financial stabilization prompted the Russian market economy to straighten out.

Politically, the August 1998 crash broke the overwhelming resistance to market economic reforms, which had more or less stalled progress since 1994. The main opponents of structural change had been badly beaten by the pro-market forces that demonstrated their ability to face the financial crash (e.g., see Drazen and Grilli, 1993). A clear majority that favored a free market economy prevailed in the Duma for the first time. After years of vacillation, Russia finally began to undertake one major reform after another, some by design and some by default.

THE GREF PROGRAM

On December 31, 1999, Boris Yel'tsin resigned as President of the Russian Federation in favor of Vladimir Putin, who was subsequently elected to the office in March 2000. A new triumvirate emerged to share the power, namely KGB officers from St. Petersburg, a new group of young oligarchs in their early 30s, and liberal economists and lawyers from St. Petersburg. The KGB officers and the oligarchs appeared to hold the strongest cards, but this gave the liberals from St. Petersburg considerable leeway to operate, because they appeared to pose no threat to either of the two stronger groups. The KGB officers were primarily occupied with political issues, and had little interaction with the reformers. The oligarchs, by contrast, had frequent clashes with the reformers. When the latter two groups had common interests, substantial reforms could be implemented quite rapidly. But at other times, when their interests collided, the oligarchs usually prevailed, although sometimes the conflicts remained unresolved.

From the outset, President Putin relied on German Gref, a young liberal lawyer who worked for him in St. Petersburg, as his principal economic reformer. After Putin's appointment as acting president, he established the Center for Strategic Problems, with Gref as its Director. The "Gref Center" soon became the brain trust of Putin's reform program. Gref gathered the best and the brightest from Moscow's liberal think tanks, notably Yegor Gaidar's Institute of the Economy in Transition, the World Bank–financed Bureau of Economic Analysis, the Higher School of Economics, and the Carnegie Moscow Center. By April 2000, this relatively small elite group of liberal economists had already designed a "Gref Program" of economic reforms, and after Putin's installation as (elected) president in May 2000, Gref became his Minister of Economic Development and Trade. In July 2000, the "Gref Program" was adopted as the government's economic reform plan.

Russia has seen many reform programs, but Gref's was arguably the most comprehensive and detailed, unveiled as the action program of an incoming president. A rather typical bureaucratic document comprising about 200 pages (Osnovnyye, 2000), it features concrete proposals for the adoption of hundreds of legislative initiatives.[5] The main goal of the program was to raise economic growth to 8 percent a year. Financial stability had already been achieved and just had to be maintained, but the tax system required a serious overhaul, and the same was true of the banking system. Gref's people also worried about the excessive state intervention and the dearth of small enterprises. For the first time, Russia's political leadership became serious about joining the World Trade Organization (WTO). Regulation of natural monopolies had already become a major topic for debate, and many of the remaining state enterprises were slated for privatization. A number of major social reforms were proposed, including a labor code, pensions, health care, and education. In the Gref Program the state was perceived as one of the major impediments to reform, and its restructuring and renewal became a key goal; it envisaged, for example, a fundamental transformation of the entire legal system. The Program contained just about everything a reformer could dream of, but its tenor was overly bureaucratic, making it not very appealing to read or quote, all too frequently stating that something had to be reformed rather than how this should be accomplished.

When Putin formed a new superministry[6] charged with implementation of the Program, Gref took a sizeable group of his best people with him to his ministry, to proceed in earnest with the task. While Gref's ministry had a comprehensive plan of action, it tended to stand alone in favor of reforms against all other government ministries.[7] Strangely, Putin never appointed Gref to the powerful post of Deputy Prime Minister, which severely limited his bureaucratic clout. The key powers in the government rested with Prime Minister Mikhail Kasyanov and Head of Presidential Staff Aleksandr Voloshin, both perceived as reasonably liberal, but primarily inclined to promote the interests of the oligarchs.

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[5]The document in fact resembled a manual of instructions for civil servants.

[6]The Ministry of Economic Development and Trade.

[7]Admittedly, the Ministry of Finance was also reform oriented. Headed by Deputy Prime Minister Aleksey Kudrin, another liberal friend of Putin's from St. Petersburg who gathered a few liberals at the top of his ministry, it tended to advocate less radical reforms than Gref's ministry.

A typical pattern of bureaucratic infighting over reform emerged during Putin's first term. Gref would lobby for one reform or another, eliciting some sympathy from Kudrin and strong support from reformers in the State Duma. He would be opposed by the branch ministry concerned, and if the interests of the oligarchs were threatened, by their representatives in the State Duma. Eventually, Prime Minister Kasyanov or Chief of Staff Voloshin would descend into the fray to mediate the dispute, balancing the various interests. Often, Putin weighed in, usually tending to support the more reformist direction, but opting for caution in order to avoid decisions involving technical details that he did not master. By and large, the State Duma stood out as the most liberal force, whereas the Federation Council rarely mattered. The main conflict really occurred within the government rather than between the government and the parliament.

Since all parties except the branch ministries tended to be interested in some reform, a steady flow of reform legislation was adopted in 2000–2003. The most notable advance occurred during the first half of July 2001, when a very large package of important laws was enacted by the State Duma.

RADICAL TAX REFORMS

The new tax code has received more attention than all other reforms carried out during Putin's presidency. Radical tax reform became possible after government finances were balanced in late 1999. The former tax system was unwieldy, arbitrary, inefficient, and difficult to enforce. There were over 200 different taxes on the books: approximately 30 at the federal level, and more than 170 at the local and regional levels. Apart from the confusion caused by the proliferation of different taxes, the high rates of taxation encouraged evasion. Numerous exemptions existed for a number of companies favored by the state, and a multitude of tax agencies competed with one another in an effort to collect the same revenues (e.g., see Shleifer and Treisman, 2000).

Enforcement of tax laws was haphazard, frequently corrupt, and also brutal. Prior to the radical reforms, both the arbitrary tax inspections and tax police were the state organs that caused businessmen in Russia the greatest problems. The more a businessman paid voluntarily, the greater his fear that extortion might force him to pay even more. The rational response was to make a tacit deal with the corrupt tax authorities. The notorious tax police and other state agencies all too often preyed upon the most honest or weakest businesses in order to extract additional payments.

A new tax code had been awaiting adoption by the Duma since the early reform attempts of 1997. Its key provisions had been included in the IMF-inspired crisis plan of July 1998, which was only in part approved by the Duma. The first part of the code was adopted and became effective in January 1999. It incorporated all the definitions, procedural laws, and provisions that regulated the tax administration, replacing a large number of laws and decrees. The second part of the tax code, which embraced the major reform of key federal taxes, such as the VAT, personal income tax, excise tax, and the new unified social tax, became effective in 2001; the new corporate income tax entered into force in 2002 (e.g., see Owen and Robinson 2003, pp. 82-84). The Russian government has thus systematically transformed the entire tax system, and the liberal and progressive approach to taxation is becoming ever more radical, based on fairly clear principles that it should be fair, simple, stable, predictable, and efficient.

One of the fundamental principles involved a drastic reduction in the number of taxes, so that in 2000 only 33 remained. Relatively minor and inefficient nuisance taxes, which generated more corruption and hazard than revenues, were abolished. Another tendency has been a strong trend toward centralization: 15 of the remaining taxes are federal taxes, 6 are regional, and the other 22 are local.[8] Additional cuts, apparently no less drastic, are planned for the coming months. Russia's deputy finance minister, Sergey Shatalov, declared in April 2004 that of the 33 taxes currently collected, only 16 would remain in two years' time; of the 16, 10 will be federal, 2 regional, and 4 local (V techeniye, 2004). The reform would clearly undermine the regional autonomy developed during the Yel'tsin presidency. By further reducing the number of taxes, Putin clearly aims to kill two birds with one stone. On the one hand, his significant new measures will liberalize and likely stimulate the Russian economy, but on the other, he is strengthening his own grip (and that of the federal authorities) on power.

The key reform undertaken by President Putin was the abolition of the progressive personal income tax (up to 30 percent of income) and the introduction of a flat income tax of 13 percent. Russia had introduced a progressive tax system as late as 1991, so it was neither a tradition nor a popular measure. In the summer of 2000, the progressive income tax was abolished in a single stroke, ignoring the firm opposition of IMF representatives, who feared that tax revenues would decline as a result. In fact, Estonia, Latvia, and Georgia had already introduced flat personal income taxes in the 1990s, but they ranged from 20 to 26 percent (Aslund, 2002). The low rate of the Russian flat income tax turned out to be a major breakthrough. It greatly diminished disincentives to work and encouraged Russian citizens to bring their income earnings into the open, thus reducing illegal tax evasion schemes and corruption. In effect, it provided a positive shock to the state by weakening the shadow economy and expanding the transparent tax base. Even in relation to GDP, the revenues from personal income tax rose from 2.4–2.5 percent in 1999–2000 to 3.3 percent in 2002 (Gaidar et al., 2003, p. 193).

The corporate profit tax was reduced from 35 percent to 24 percent one year later, on January 1, 2001. Out of that 24 percent, 16 percent went to the regional budgets, and two percent to local budgets. Furthermore, the regions received the right to offer tax breaks of up to 4 percent to enterprises, thus reducing the overall profit tax to the level of 20 percent. Foreign companies operating in Russia are subject to the same tax rates (Glava 25, n.d.). But far more important for enterprises than the 9 percent drop in the corporate profit tax was the major increase in the deductible business costs. Formerly, only "material costs," such as wages, amortization, insurance, and other production and sales costs had been deductible, but not repairs, technical servicing, natural resource exploration, research and development, advertising, and personnel training costs, as well as interest paid on loans. Now, all these business expenditures are no longer taxed, as "practically all necessary business expenses are considered deductible from the tax base" (Gaidar et al., 2003, p. 197).[9] The overall tax burden on companies has thus fallen significantly. Before the reforms, a large number of enterprises had been exempted from the corporate profit tax. Almost all such exemptions were eliminated, except for the relatively mild tax on small enterprises. As a result, tax levies became more uniform for small, medium, and large companies, and again the playing field has been leveled.

Social taxes, in effect payroll taxes paid by employers, have been among the highest, but have aroused less controversy because collection was less harsh and employees were hardly aware of them. In 2001, the payroll tax, of 39.5 percent of wage earnings, was reduced to a

[8]Of the local taxes, 15 are either never collected, or collected without federal approval (Selivanova, 2003).

[9]Formulation of the Institute of the Economy in Transition in Moscow.

top rate of 35.6 percent and became regressive. Renamed and newly identified as the Single Social Tax, it was no longer recognized as an insurance fee, but was treated as a federal levy to be collected by the Tax Ministry. In the past, social insurance fees were administered by four extrabudgetary funds. One of them, the Employment Fund, was simply abolished because the administrative costs of the Fund exceeded its tax revenues. The unified social tax is as regressive as the payroll tax levy in the United States; it falls to 5 percent for high-income wage earners (Gaidar et al., 2003, p. 194). The average social tax is assessed at 29 percent of the workers' payroll, but the government intends to reduce the rates by an average of 10 percent from 2005 onward. The top rate is schedueld to fall dramatically to 26 percent, and the lowest rate to a mere 2 percent (Zakonproyekt, 2004).

Increases in tax revenues as a share of GDP have enabled the government to cut taxes even further. The top VAT rate, formerly at 20 percent, was reduced to 18 percent in January 2004, and the government intends to reduce that rate further to about 16 percent in 2006 and at the same time eliminate some exemptions. Also, on January 1, 2004, the 5 percent sales tax, introduced in 1999 as an emergency measure to fill regional and local coffers, was abolished (Snizheniye, 2003).

Prior to the tax reforms, the tax inspection and tax police were among the most feared enforcement organs of the state, but the situation changed quite radically. The fewer, lower, and more simplified taxes left little room for discretion by the authorities, while the tax burden became bearable for taxpayers. It thus became possible to be an honest taxpayer in Russia, and most Russians appear to have grown accustomed to and even prefer to pay taxes in accord with the law. Relatively minor tax violations have been decriminalized, and are referred to civil courts that mete out fairly moderate fines. However, "large" and "especially large" violations of tax laws are handled by criminal courts within the legal framework of the Russian Criminal Code, so that a company executive found guilty of "especially" large-scale tax crimes can face imprisonment of up to six years (Stat`ya, 2003). Finally, the tax police, then headed by current Prime Minister Mikhail Fradkov, was abolished by a presidential decree of March 2003, which declared that the tax police had failed to "detect, prevent, or interdict tax crimes," and extorted money from businessmen, mostly from those who had already paid their taxes (Ukaz, 2003).

Russia's tax system has now become an effective mechanism for raising revenues, without placing an undue burden on individuals, households, and companies. Contrary to expectations, the lower tax rates have not precipitated a shortfall, but rather have yielded higher public revenues as a share of GDP. Quite unexpectedly, Russia has a very reasonable tax system, which can serve as a model for many countries, including some in the West.

TIGHTENED BUDGET CONTROL

Another important change in Russia's financial policy is the tightening of budget control by reinforcing the country's treasury. Measures and accomplishments included the elimination of barter and offsets, increased budgetary control over regional governments and extrabudgetary funds, emphasis on orderly fulfillment of government obligations, reduction in misappropriation of government funds, and virtual disappearance of arrears in state pension and wage payments. The principal watershed was the budget adopted in February 1999. It stipulated that offsets could no longer be used in transactions and transfers involving the federal government, which deprived large enterprises and regional governments of previous advantages (see Owen and Robinson, 2003, pp. 37-38).

The Federal Treasury was established by presidential decree as early as 1992, but had limited powers and played a marginal role through 1998. In 1999, it acquired greatly expanded powers of budgetary oversight—especially with the adoption of the important new Budget Code in 2000. From 2000 onward, the government also improved its financial control by prohibiting deposits of public money in interest-bearing commercial bank accounts (Papernaya, 2004). Instead, each authority, federal as well as regional, must deposit all its revenues in a single account at the Federal Treasury, and make all disbursements from this account (see Diamond, 2002).

In practice, however, the treasury's control applies solely to the federal budget and to the budgets of the 34 regions that are net recipients of federal money. Net donor regions have been granted more freedom to manage their finances, and the annual budget bills of 2003 and 2004 included explicit exceptions for their benefit. No less than 42 of Russia's 89 regional governments continue to resist relations with the federal treasury, and still use commercial banks that pay interest, offer credits, and keep federal fiscal oversight at bay, providing them with a degree of autonomy (Papernaya, 2004). Yet, these exceptions may well end soon, because the new State Duma is now almost completely dominated by Putin's United Russia Party. The Ministry of Finance proposed in 2003 that all budget money, without exception, be moved to the Federal Treasury, and the Duma may reconsider this proposal in the summer of 2004. If the proposal were to become law, all regions will have to place their budgets under federal supervision and control as early as the beginning of 2005.

Under President Boris Yel'tsin, the republics of Tatarstan, Bashkortostan, and Sakha (Yakutia) managed to negotiate preferential tax revenue disbursement arrangements. Thus, according to a February 15, 1994 five-year (through 1998) agreement between the governments of the Russian Federation and Tatarstan, the republic had to transfer to Moscow 13 percent of the corporate profit tax it collected, and 1 percent of the personal income tax raised. Many other regions signed similar agreements, but only Tatarstan, Bashkortostan, and Sakha were able to implement their special deals. The federal government extended its agreement with Tatarstan for five additional years on March 17, 1999—before Putin became Prime Minister. Under Putin, the agreement with Bashkortostan was dismantled on July 1, 2003, depriving the republic of special treatment with regard to tax revenue disbursements (Gaidar et al., 2003, pp. 244-246).

Two significant problems with Russia's budgetary system persist. The state still promises to spend more than it intends to pay for, and although in recent years, the government attempted to eliminate its unfinanced mandates, their total amount still equals several percent of GDP (especially in the social sphere). A major attempt is now under way to excise most of these unfinanced social expenditures. Another similar problem is that the Russian government continues to budget in a highly detailed way for specific items rather than using program budgets. As a result, government agencies are not allowed to reallocate funds to mandates left unfunded, even if surplus funds in other accounts are available for the purpose. Typically, state agencies have adequate amounts of money to meet wage payrolls and to purchase real estate, but not enough to buy materials, equipment, transportation, or services. To escape this dilemma, many state agencies try to earn some money illegally in order to finance necessary expenditures for their operations.

All told, the new Budget Code has done much to improve the management of state finances. Much more of the planned state expenditures are actually paid and disbursed on time, whereas corruption and misappropriations have visibly declined. For better or worse, federal control over overall state finances has been securely extended.

BROAD BUT NOT OVERLY RADICAL DEREGULATION

A typical feature of the second wave of economic reforms initiated under President Putin[10] was greater attention to details involving the functioning of government. Government officials began to take their legal rights and obligations more seriously than during the near anarchy of the early 1990s, so that the actual content of legislation became increasingly important. Nonetheless, vestiges of the Soviet bureaucratic system persisted, and needed to be brought under control. In Putin's first term, Gref personally devoted considerable energy to attempts to reduce state harassment of business by limiting the arbitrary powers of state officials, reducing state intervention, and simplifying various procedures. Most of these measures cannot be considered radical, as they involved reduction rather than outright prohibition of state obstruction.

A package of laws, enacted by the Duma in July 2001, constituted a major step toward the deregulation of the Russian market, especially for small and medium-sized enterprises (SMEs). The government endeavored to simplify procedures of registration, certification, and licensing of such enterprises. Another objective was to reduce the number of inspections Russian companies must endure from numerous government agencies. Inasmuch as registration, licensing, certification, and inspection represent costs that are inversely proportional to company size, SMEs appear to be the prime beneficiaries of the new laws.

All enterprises in Russia are required to register with the state. Prior to the reform package in 2001, each company had to be approved by several government agencies in order to secure registration, a bureaucratic and time-consuming process that was especially deleterious for small enterprises. According to a CEFIR–World Bank (2003) survey of 2,000 small firms in 20 Russian regions, the average small business in Russia required one month to complete the registration process, time that certainly could have been used more productively on other pursuits. The August 8, 2001 Law "On the State Registration of Legal Entities" (Federal'nyy, 2001a) addresses this problem, mandating that the registration of a business not take more than five working days, and that henceforth the process of approval be handled only by a single government agency (CEFIR–World Bank, 2003, p. 4); other government agencies are then to be informed of the completed registration by the registering body. These changes not only accelerate and simplify the process of registering a business, but they also reduce opportunities for extortion by bureaucrats.

Another element of the legislative package on deregulation was a new licensing law. Roughly 2,000 business activities in Russia must be licensed by the government, and in February 2002, as many as 37 federal agencies in Russia were authorized to grant business licenses (Perechen', 2002). As in the case of registration, the large number of licensing agencies increased the potential for corruption. The Law "On the Licensing of Certain Types of Activity" specified that one of its main objectives was "the maintenance of legality in the course of licensing" (Federal'nyy, 2001b). Even when applied honestly, licenses created unnecessary business costs, especially if frequent renewals were required. Thus, the new law stipulated that a license would last at least five years (ibid.), two years longer than the previous licensing law. The new law also lowered the cost of a license from 3,000 to 1,300 rubles, and reduced the number of business activities subject to licensing (CEFIR–World Bank, 2003, p. 3).[11]

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[10]The "first wave" consisted of the reforms focused on the private sector and directed toward financial stabilization, taxation, deregulation, and land reform, most already discussed above.

[11]Such reductions had been implemented several times in the past to little effect, as officials and agencies continued to insist on the use of licensing as a mechanism to extract additional payments from businesses.

The licensing law has produced mixed results since going into effect in February 2002. Whereas 29 percent of small enterprises applied for licenses and permits in the first half of 2001, only 19 percent did so over the same period in 2002. The average actual cost of a license fell from 10,500 rubles in 2001 to 8,000 in 2002, still well above the maximum allowed by law. The mean duration of a small business license issued in early 2002 was 2.7 years—also contrary to the law. Finally, 33 percent of licenses issued to small businesses in the first half of 2002 were for activities that did not even require licenses under the 2001 law (CEFIR–World Bank, 2003). Thus, the new, well-intentioned licensing law to date has not succeeded in reining in rent-seeking bureaucrats who continue to see licenses as a source of personal gain. According to an INDEM Foundation (2001) survey conducted in 2001, the average entrepreneur paid 2.3 bribes per year in order to obtain licenses, spending an average of $4,686 for that purpose. It is thus no surprise that 14 percent of small businesses surveyed by CEFIR and the World Bank in early 2002 declared licensing to be "a very serious problem for the development of small business" (CEFIR–World Bank, 2003, pp. 2-3).

As noted above, Russian businesses are often plagued by inspections, another tool utilized to extort money (INDEM, 2001). This is even acknowledged in the title of the August 2001 Law on inspections: "On the Protection of the Rights of Legal Entities and Individual Entrepreneurs during the Conduct of State Control or Monitoring." This law stipulates that a government agency cannot conduct more than one planned inspection of a firm or entrepreneur during a two-year period. However, a firm may face any number of unplanned inspections as a result of dangerous or illegal activities that come to the attention of a government agency (Federal'nyy, 2001c). As a result of the new law on inspections, their number involving small businesses fell by 27 percent between early 2001 and early 2002. In late 2002, 61 percent of small businesses responding to the CEFIR–World Bank survey did not report a single inspection by the fire brigade, whereas 73 percent did not face any inspections by the sanitary-epidemiological control agency, which had been identified as the "most problematic" for small businesses (CEFIR–World Bank, 2003, pp. 2-3). It is of note, however, that the prosecutor's office and other law enforcement agencies were excluded from the limitations of the new law (Article 3 of Federal'nyy, 2001c).

A fourth important law on deregulation encompassed standardization and technical regulation measures. Enacted in December 2002, its purpose was to improve the functioning of these complicated bureaucratic routines [http://nalog.consultant.ru/doc40241.html].

The broad front of deregulation efforts is impressive, and the situation has clearly improved, despite the fact that a patriarchic surveillance system remains in place. While more radical deregulation efforts are needed before small enterprises will have the freedom to prosper, the net effect of the new policy focus is positive and likely conducive to more far-reaching liberalization in the future.

LAND REFORM AND PRIVATIZATION

From the outset, Russian reformers have viewed private ownership as one of the basic tenets of market reform. The new Russian Constitution of 1993 proclaimed citizens' right to own land as private property, but until 2001 the dominant left wing in the State Duma (agrarians and communists) blocked the introduction of a new Land Code that would have effectively legalized private ownership of land. President Putin avoided taking a public stand on such a pivotal ideological question, leaving the task of securing passage of land legislation to the liberal Union of Right Forces. After repeated efforts in the State Duma, its deputies succeeded in early 2001. First, a chapter in the Civil Code was adopted to provide the legal basis for private transactions involving land. After a prolonged legislative battle, both in the Duma and the Federation Council, a new capitalist Land Code was finally adopted on October 25, 2001, although it excluded farmland (Remington, 2002). By July 2002, the sale of agricultural land was legalized as well.

The Land Code divided all Russian land into seven categories: agricultural, inhabited, industrial, forest, water, protected territories, and reserve. It permitted the sale of only industrial and inhabited land—that is, the land occupied by urban and rural housing. This was a significant development, for it was the first time Russians were allowed to buy and sell land since the Bolshevik Revolution. Under the code, a building and the plot of land on which it stands were declared indivisible, which meant that the owners of houses and factories no longer had to lease their plots of land from the state (as long as the state agreed to sell them these plots).

The privatization of agricultural land was the last ideological barrier to be broken. On July 24, 2002, the law "On the Turnover of Agricultural Land" was adopted. This law opened up Russia's vast agricultural lands for sale, but only after the region concerned adopted its own law on implementation of the federal law. Thus, the federal law was essentially a compromise that allowed pro-Communist regions to withhold agricultural land from sale for an indefinite period, while permitting more reform-oriented regions to sell land more rapidly. Regions could also specify the maximum size of a land plot that a single family could own, although the federal law stipulated that such an upper limit could not be smaller than 10 percent of a region's total agricultural land. This gave the regions control over land concentration, but prevented subdivision of land into tiny micro-parcels (Kirchik, 2004).

Despite its seemingly liberal character, the new law contains a provision affording regional and local authorities priority rights to purchase any agricultural land offered for sale. Therefore, in practice, private ownership of agricultural land is developing only gradually, reflecting the wishes and intentions of the governing regional authorities. Good connections with regional governors are key to land purchases; as a result major businessmen have accumulated hundreds of thousands of hectares of farmland in huge estates, whereas family farmers not infrequently fail to acquire land. The market in both land and real estate is developing rapidly, although it continues to be obstructed by administrative and legal hurdles.

Privatization has not been a major priority under President Putin. Admittedly, most privatization had already been completed (1992–1995), but the the process is now proceeding slowly. The remaining state-owned enterprises are strongholds of powerful vested interests, providing additional evidence that the radical and early large-scale privatization in Russia was the correct policy. The most significant privatization that has occurred since 2000 involved the oil company Slavneft, which was auctioned off in December 2002. However, many potential bidders were blocked from participating, and in the end two large Russian oil companies, TNK and Sibneft, successfully conspired to jointly submit the winning bid. Since 2003, the government has emphatically resisted nascent attempts to privatize the major possessions of its domain, notably the pipeline systems and the majority stakes in major resource companies, most prominently in Gazprom.

In parallel with land legislation, private property rights have been greatly reinforced with the promulgation of a Civil Code, which enunciates the basic property rights. In October 2002, a new bankruptcy law was adopted, as the old law had become a vehicle for hostile takeovers of companies that were actually still solvent (EBRD, 2003, p. 184). As in the case of land, rights to private property are being reinforced only gradually, and remain tenuous because of excessive state intervention and a weak judicial system.

COMPREHENSIVE JUDICIAL REFORM

Demands on the judicial system have steadily increased after communism. The total number of commercial (*arbitrazh*) court cases has increased sharply, by 125 percent from 1995 to 2000. New types of cases also are being brought to court, such as bankruptcies and tax issues. Furthermore, due to the weakened state administrative power, the government itself is increasingly in the courtroom, filing suits against enterprises. By and large, the petitioner wins in two-thirds of the cases, lending increasing credibility[12] to the courts (Hendley, 2002, pp. 124, 126, 138, 144-145). As the courts have gained some significance, their efficacy has become more of an issue. With little doubt, they have become more corrupt since the fall of communism, because the market value of their judgments has risen at the same time that the independence of judges has increased. Accordingly, the reputation of courts has remained at a low level.

From the outset, President Putin pronounced that judicial reform would be a key item on his agenda. Himself a lawyer, he asked one of his closest aides, Dmitri Kozak, a Deputy Head of his presidential administration and a fellow lawyer from St. Petersburg, to lead a presidential working group on judicial reform. It produced a package of new laws adopted by the Russian parliament in December 2001 and put into effect the following year. Major elements include a law designed to enhance the status of judges, the improvement of the extent of the financing of courts, and the renewal of all legal procedural codes, including those for the criminal and arbitration courts.

In an effort to achieve the first of these objectives—strengthening the independence and autonomy of courts and judges—and as part of the ongoing consolidation of federal power, judges were to be made fully independent of regional authorities, which in the past had exercised the right to vet candidates for all judicial positions in their regions and regularly contributed to the financial support of those positions. Although judges already possessed firm tenure,[13] there was a need to make them more accountable. Thus, the law on the status of the judges of December 2001 (Federal'nyy, 2001d) eliminated the requirement to consult regional legislatures in the process of appointing or promoting a judge, and significantly weakened their protection from prosecution for criminal offences (ibid., Article 1, Paragraph 5; see also Solomon, 2002).

Another central measure in strengthening judicial independence and efficiency was to boost judges' salaries and judicial budgets substantially. Putin raised the salaries of judges by 60 percent by presidential decree on January 1, 2002, and further increases are planned.[14] In addition, the government has increased funding for a variety of needs in the court system, ranging from new housing to clerical assistance and computerization (ibid., Appendix/List of Projects under the Program).

Augmenting the increase in salaries and funding as an element of judicial reform, the 2002 Criminal Procedure Code of December 2001 reinforced the powers of judges in the courtroom (e.g., see Buchanan, 2003). In the Soviet system, judges were relatively minor

[12]"Credibility" here is used in the utilitarian context; i.e., that filing a suit is not a useless gesture but rather an effort that can produce the desired outcome of redressing a grievance.

[13]Judges are appointed without term limits, but are compelled to retire at prescribed ages (65 on regular courts and 70 on the top courts).

[14]They are set to quadruple to about $1,000 a month over five years, according to the Federal Target Program for the Development of the Judicial System of Russia from 2002 to 2006 (Federal'naya, 2002) to strengthen their resistance to financial pressures exerted by vested interests.

state functionaries subordinate to prosecutors. Their position improved greatly under Yel'tsin, but prosecutors retained rights that are reserved for judges in Western countries, including the issuing of arrest and search warrants, and releasing prisoners on bail. Now, Russian judges sign arrest and search warrants, and decide on pre-trial detention. With the powers of the prosecutor's office curbed, the incidence of frivolous arrests and detentions has declined.[15] Furthermore, the practice of sending cases back to the law-enforcement authorities for additional investigation has been curtailed under the new code, raising a defendant's chances of acquittal, although old habits die hard. Judges have been slow to adopt the new rule concerning additional evidence (Solomon, 2002, p. 121), but as they grow more accustomed to their enhanced freedom and responsibility, the fairness of decisions rendered by Russian courts likely will rise.

A boon for defendants is the spread of jury trials in serious criminal cases from a trial project tested in nine regions of Russia to the entire country under the 2002 Code. The acts for which the accused is to be tried by jury include murder, terrorism, and espionage. These crimes often carry heavy sentences, and it is thus especially important in such cases to make certain that only the guilty are punished. Juries in Russia are much more sympathetic to the arguments of the defense than are the judges. This has resulted in a 15 percent acquittal rate in jury trials in 2003,[16] as opposed to corresponding rate of only 0.8 percent in non-jury trials. In 2003, only 8.3 percent of all criminal cases were tried by a jury (Tsifry, n.d.), although this situation could change once juries become a more generally accepted facet of the Russian legal system.

The caseload of the economic (*arbitrazh*) courts has increased substantially. The new procedural code for the economic courts is designed to make them more independent, competent, impartial, and efficient. A key question is how many judges should attend to each case to balance the needs for fairness and efficiency. One of the most positive developments is that business litigation is quite speedy, although enforcement remains abysmal. Kathryn Hendley (2004, p. 374), in a study tracking 100 cases involving failure to pay debts in 2000, reported that only 6 debtors paid voluntarily, although many others could have done so.

Despite overall progress in judicial reform, one major government action is casting a shadow over the entire endeavor—the Yukos affair. There can be no doubt that the origins of the case are political, enhanced by the opportunity to seize valuable assets cheaply (e.g., see Yasin, 2004). The main accusation against the company is that it has utilized a large loophole in the new Tax Code. Although both the company and its owners have credibly offered to pay the entire tax claim within a reasonable time, the authorities have not responded, underlining that taxes are not the real issue. Nevertheless, the government has won practically all of the court decisions rendered to date, further providing ample proof that the courts have not acted independently from government in this case. Arbitrary and omnipotent enforcement of the law thus appears to pose the greatest general threat to Russia's judicial reform.

TRADE POLICY FAVORING GLOBALIZATION

In the 1990s, Russia hardly had a trade policy. Although the country applied for membership in the World Trade Organization (WTO) in June 1993, little headway had been made

[15]In the first year of the new Code's operation, the number of arrests fell by as much as 33 percent (MacDonald, 2003).

[16]Roughly 15 percent of acquittals produced by jury trials, however, were overturned when the prosecution appealed to a higher court (Tsifry, n.d.).

until Putin became president, because up to that time WTO accession had been viewed not as a political but as a bureaucratic matter. German Gref clearly understood that WTO entry represented a major political issue, and Putin and Gref placed Russia's WTO accession squarely on their international economic policy agenda.

After lengthy negotiations, Russia adopted dozens of laws (most in 2002 and 2003) designed to accommodate Russian legislation to WTO specifications. These include: a new Customs Code enacted in May 2003, new legislation on intellectual property rights, and substantial legislation on technical standards and certification (mentioned above in the context of Russia's domestic deregulation). In the spring of 2004, both the European Union and China concluded vital bilateral protocols on Russia's accession to the WTO. The main task that remains to be done is to conclude a bilateral protocol with the United States, and negotiate key hurdles involving enforcement of the new law on intellectual property rights and access to the country's agricultural market. Russia will need to make substantial concessions to the U.S. to gain its consent to join the WTO, a course of action requiring political will on the part of President Putin. However, most of the technical preparations have already been completed, so the last step can be undertaken relatively easily. Only after Russia joins the WTO can it conclude free trade agreements with such prospective partners as the European Union (Åslund, 2003; EBRD, 2003).

In parallel, however, Russia's foreign trade establishment has focused on a new Common Economic Space to be formed jointly with Ukraine, Kazakhstan, and Belarus. It is envisaged as a free trade area, a customs zone, and eventually a currency union. Given that these countries already have a free trade zone (that does not work) and all but Ukraine also belong to a common customs union (that also does not function effectively), it would appear a more urgent task to make the old agreements work properly rather than create another dysfunctional entity. All four of these countries lack a mechanism for conflict resolution in trade disputes (a major problem), yet the WTO has one that works well. Consequently, instead of attempting to re-invent the wheel at relatively great cost, it appears more rational for Russia and its neighbors to focus on WTO accession as soon as possible. Thus, this part of the trade policy is confusing and quite ineffective. Nevertheless, a four-nation agreement on a Common Economic Space was adopted in September 2003 and ratified by all four parliaments, with no less than 62 agreements concluded within this new community. Meanwhile, trade reintegration within the former Soviet Union has accelerated with the recovery of manufacturing, and especially the machinebuilding industry.

INCOMPLETE REFORMS AND THE REFORM AGENDA FOR PUTIN'S SECOND TERM

The reform agenda during President Putin's first term was in part oriented toward completion of the first wave of reforms (financial stabilization, fiscal policy, deregulation, and land reform). Progress in these areas contributed to the economy's average annual growth of 6.5 percent during the period from 1999 to 2003. The most significant improvements occurred in the private sector, as growth results overwhelmingly came from the initiatives of private and privatized companies, particularly in the resource industries, and has been driven by enterprise restructuring. A group of new young entrepreneurs has emerged that has consolidated ownership of each large-scale mature industry (such as oil, steel, aluminum, nonferrous metals, and coal) into a handful of large companies, as is typical in the West. After severe cost-cutting, these new owners have invested in their best production facilities at a steadily rising pace. A score (~20) of large private enterprise groups now account for

40 percent of Russia's industrial production. They are no longer haphazard collections of enterprises but conglomerates streamlined within a few industries that have adopted international accounting standards and have become quite transparent (Dynkin and Sokolov, 2002).

The major problems that remain to be addressed in a second wave of reform primarily concern failures of the state, and fall broadly into three groups of tasks. The first is oriented toward improving the state apparatus proper. While budget reform, federal reform, and judicial reform are all elements of that task, Putin's principal assignment for his second term is administrative reform. An effort involving many individual components is now under way to streamline the government apparatus. It includes dismantling or at least minimizing the purview of the old branch ministries, which directly supervised the management of enterprises, and to replace them with a smaller number of functional ministries. The number of deputy prime ministers has been reduced to one, and in many ministries the number of deputy ministers has been limited to two. Another initiative seeks to replace benefits in kind with monetary payments to boost salaries and to gauge remuneration more accurately so that it could be better regulated. In April 2004, the salaries of thousands of top Russian officials were approximately quintupled (to up to $5,000 a month for the President himself) (see Zarplaty, 2004). The intention is to establish an effective and reliable civil service based on merit. A more difficult task is to reform the enormous law enforcement organs, which recently have received greatly expanded powers, but remain under minimal supervision.

A second major group of second-wave reforms involving the state are broadly social in nature. By and large, the social sector is state owned and in very poor condition. The main problem appears to be inefficiency, with many resources being squandered or misdirected toward non-essential tasks. Inasmuch as the social sector employs millions, and serves an even greater number of recipients, any change is both complicated and controversial. Typically powerful interest groups (e.g., presidents of universities or heads of health care units) benefit from the discretion embedded within the old non-transparent systems and oppose any reform. The social-sector reform agenda has been on the books for some time, having largely been drafted as early as 1996, primarily by Mikhail Dmitriyev, First Deputy Minister of Economic Development and Trade during Putin's first term.

Two substantial social reforms were carried out during Putin's first term. One was the adoption of a new Labor Code in February 2002 (EBRD, 2003), which brought labor-market regulations closer to conformance with market principles, while reaffirming a commitment to protecting the rights of workers. Still, it represents an improved version of the old Soviet labor code rather than any embodiment of the principles of the more liberal Anglo-American labor market philosophy. Most of the old Soviet-era social benefits remain, despite the excessive costs they pose for employers. The most striking example is the persistence of a provision that severance pay equivalent to three months of salary be given to departing workers. However, because of the very limited unemployment benefits available in Russia, the labor code does not constitute a major impediment to the development of a flexible labor market. Russia's unemployment rate recently has fallen below 8 percent of the labor force despite the far-reaching economic restructuring of enterprises.

The most significant social initiative during Putin's first term was the pension reform, embedded within a number of laws in accord with the World Bank "three-pillars" model.[17] The old pension system was too expensive, extending coverage to too many people and

[17]These "pillars" are: a minimal compulsory state pension for all, compulsory private pension insurance, and possible voluntary private pension insurance.

allocating too little to each pensioner. The distribution of benefits was nearly egalitarian, dispensing pensions to all that were barely above the subsistence level. According to the pension reform legislation enacted in 2002, 28 percent of the payroll was to be withheld for pensions, of which 14 percent would be used (as before) for the basic state pension, 8–14 percent for the state insurance portion (which is to vary with the contribution), and 2–6 percent for individual pension savings accounts (see Aron, 2004). With respect to the latter, thus far the public is being encouraged by the state to deposit private savings in a large state bank (Vneshekonombank) rather than the 55 institutions it has licensed as repositories for private pension savings. Most of the latter are completely new and do not pass any reasonable test of reliability or soundness in a Western sense. Another means of dissuading savers from opting for private funds was to provide minimal time and virtually no information about how to set up a private pension savings account. In the end, the state successfully managed to limit the number of contributors to private funds to a mere 2 percent of those eligible (ibid.). Thus, the private element is quite limited and pension reform remains nascent.

Several other major social reforms are slated to occur during the course of Putin's second term. An immediate task is to abolish many social benefits that are on the books but in fact have never been disbursed. A related issue is the transformation of a large number of non-transparent social benefits disbursed in kind (e.g., free transportation and medications) into cash payments. Politically this is a quite controversial issue, as current beneficiaries suspect they will not be able to purchase nearly the same level of benefits after in-kind benefits are converted into cash supplements.[18]

Communal and housing services, which have remained state owned, constitute a very substantial target for reform. Heavily subsidized, they function quite poorly, and thus are very costly to local authorities. A similar situation prevails in education and health care, which are of vital importance for future economic development. Despite substantial public and private funding, their performance is quite inadequate. In both sectors, large amounts of black or grey financing continue to exist. A major objective is to make this funding transparent, a goal that is resisted by the administrators controlling the grey funds. Another goal is to link state financing to the demand or delivery rather than supply of services. In the schools, a system of national testing has been tried in a number of regions in an effort to improve standards and eliminate corruption. During Putin's first term, reforms in housing, health care, and education have been piecemeal, mainly involving partial, regional experiments. Consequently, the education and health sectors, together with housing services, remain among the least reformed parts of the Russian state.[19]

A third large group of "second-wave" reforms concerns the state-dominated natural monopolies (telecommunications, electricity, railways, and natural gas). Here, the key policymaker has been another of German Gref's deputies, Andrey Sharonov. The general idea has been that the telephone lines, grids, rails, and pipelines should remain under state ownership, whereas the generating and distributing capacities should be gradually privatized. Therefore, the natural monopolies should be broken up and divided according to their different functions: regulation, transportation network, generation, and distribution. As an initial

[18]Legislation terminating the in-kind benefits passed the Federation Council in early August 2004 and was sent to Putin for signing as this paper goes to press (Bill, 2004). The payments reportedly would range from \$5.10 to \$53 (U.S. equivalent) per month (ibid.).

[19]Author's interview with First Deputy Minister of Economic Development Mikhail Dmitriyev, February 2004.

step, an agency for the regulation of natural monopoly tariffs was established in September 2001. The first reform to gain real momentum was reorganization of the regional telecommunication companies, which proceeded more or less according to plan, as the telecommunications market was already functioning well and the share of private ownership in the industry was substantial.

The most heated and protracted debate involved power sector reform. Eventually a package of six laws constituting the legal foundation for that reform was adopted in March 2003. Even so, the restructuring of the Unified Energy System is proceeding slowly, in part because the system is exceedingly complex, and in part because enormous profits can be made or lost in the details. In parallel, a law on railway reform was adopted, the main result of which was that a fully state-owned company became independent from the Ministry of Railways. In the final analysis, little changed except that all but the regulatory functions of the ministry were corporatized. Gazprom, the state-dominated monopoly company for natural gas, is undergoing only slow reform. The most notable development to date is that private natural gas producers are allowed to use the Gazprom-owned pipeline system to transport their output. With respect to oil pipelines, the government has resolutely opposed any proposals to construct new private pipelines since December 2002.

DIMMING PROSPECTS FOR FURTHER ECONOMIC REFORMS?

One of the most plausible forecasts for a country is that economic growth will continue to expand at approximately the same pace as in prior years. Countries maintain different growth trajectories for fairly long periods, and there are good reasons to suggest that Russia is likely to maintain a growth rate of about 7 percent a year. At the enterprise level, thousands of successful entrepreneurs have taken over, consolidating, restructuring, and developing old enterprises with an abundance of underutilized capacity. Human capital is still plentiful, and Russia is also located in a vast region with steady and high economic growth of about 8 percent a year—a region extending from Ukraine in the west to India in the south and China in the east. These countries stimulate each other both through trade and by emulating the successful reforms of the others. As this paper argues, the Russian economic reform wave has been more comprehensive and deliberate than perceived by many observers. When an economy gains momentum and speed, many previously intractable problems become possible to resolve. The former zero-sum game becomes a matter of locating appropriate synergies. What comes to mind is pervasive corruption, which usually tends to subside with economic growth (see Treisman, 2000).

Although positive inertia might dominate the course of events, it is by no means a foregone conclusion. More obvious is that the forces that are now being challenged represent the most deeply ingrained, vested interests. In hindsight, one might view the first wave of reforms as a relatively easy process, because financial stabilization and the benefits of market economy accrued to the vast majority of citizens. The first force to be challenged by the second-wave reforms are the stalwarts of state bureaucracy and the law enforcement *siloviki* at a time when the former's strength has recovered and the latter's may be stronger than ever. The second threatened force comprises the huge social sector, and the third—the powerful state monopolies. Under any circumstances, these three forces are very formidable opponents.

One is entitled to wonder who will counter such strong vested interests against economic reform, at a time when the proponents and advocates of reform have been weakened. Liberal reformers and the Russian intelligentsia are barely represented in the Duma, and their voices in the media have been effectively silenced. The big businessmen who supported some reforms have been firmly told to stay out of politics. At the same time, international influences have been greatly diminished, because Russia no longer needs any assistance from international financial institutions. Thus the roles of the IMF and of the World Bank have been marginalized. While the latter represents a sign of success to be welcomed, it also means that most of the effective international influences have been lost. The WTO might yet exert some pressure, but far less than the IMF did in the past. Finally, the reforms were to counteract fears that a new financial default was around the corner, but that threat, as well as the fears, have by now subsided.

All that being said, there are good reasons to wonder whether President Putin is about to abandon the very model that led to the nearly spectacular Russian economic growth during his first term. Now that the balance of power between the *siloviki* and big businessmen has been replaced by centralized power exerted by an alliance between the same *siloviki* and big state companies, it is difficult to postulate that such securely entrenched vested interests would support reforms that might precipitate their weakening. Similarly, Putin's first term was characterized by a balance between the rising federal government and the still strong regional governors. Now, there are reasons to worry that the drift toward centralization of state powers will weaken the regional supports of reform as well. Russia's economic growth has been generated by the large competitive private companies that controlled the resource sector. But a major player, Yukos, is now on the verge of expropriation by the state. If the role of the state in the country's economy does not decline, but rather continues to rise, the engine of Russia's new economic growth and strength may be incapacitated and the reforms, old and new, might be aborted.

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Putin and Russia's Economic Transformation

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Abstract: A British specialist on the Russian economy comments on economic policy under Putin in reference to a paper on the subject by Anders Åslund. The relation between economic reform and growth is examined in light of international comparative data. The implications of the Yukos affair for Russian policy and performance are reviewed by the author with particular regard to property rights and business expectations. *Journal of Economic Literature*, Classification Numbers: E63, K0, P26, P27. 2 tables, 20 references.

Is Russia's transformation into a well-functioning market economy safe in Putin's hands? Anders Åslund (2004) offers a succinct and thorough analytical account of the economic progress made so far. That account suggests, until the last three paragraphs, that the answer should be "yes." The successes since 1998 in macroeconomic stabilization and in institutional reform are set out clearly and persuasively. At the end Åslund suggests, however, that a politically straightforward phase of reforms has been carried through, and a new and more troublesome phase now looms. The central state is now more powerful than before, and the forces that would be challenged by further reforms are closely linked to it: the bureaucracy, the law enforcement agencies, the unreformed social sector, and the state monopolies such as Gazprom. The treatment of Yukos, he suggests, could undermine not just one company but large private businesses in the resource sector more generally. And these have been the engine of Russia's recent growth.

Recent developments and future prospects can—and, I shall argue, should—be seen in a somewhat different perspective. Russian economic reform from the year 2000 on has indeed been more "comprehensive and deliberate" than is usually suggested (*ibid.*, p. 416), and Russian economic growth has indeed been rapid during that same period. It is, however, unlikely that there is a close and positive link between the institutional reforms and the contemporaneous rapid growth over such a short space of time.

If that is so, the implications for medium-term prospects of what looks now like a shift toward interventionism are less simple than Åslund suggests. Putin's economic policies might be characterized as "liberal up to a point." That point, we are now learning, lies somewhere short of the rule of law. It looks as though the policy agenda does not include the establishment of clear property rights or of clear limitations on the power of the executive to intervene ad hoc in the economy. It will be argued here that this *étatisme*, if it is maintained, is bad news for Russia's economic growth prospects in the long run; what it implies for growth in the medium term—say, during Putin's second term of office up to March 2008—depends on other factors, which will be considered below.

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INTERPRETING THE RECENT PAST

In some respects, the Russian economic recovery fits a pattern of growth accelerations observed in the second half of the 20th century. These have recently been analyzed by Hausmann et al. (2004), with interesting results. Hausmann and his colleagues took 83 cases where, at some point between 1957 and 1992, a nation's growth rate increased by at least 2 percent per annum, that acceleration being sustained for at least eight years. They found that only some of these accelerations were associated with thorough-going liberal reforms at the outset; most seem to have been triggered by more limited changes. Increases in investment and in trade were correlated with the accelerations. A change of political regime, although not necessarily of political system, was a statistically significant predictor of growth acceleration. A devaluation of the currency, a limited liberalization, or both, not accompanied by radical market reforms, often sufficed. Examples include South Korea from 1964 and India from 1980, well ahead of the more systematic liberalization that India embarked upon in 1990.

These findings do not undermine the case for thorough reform of the kind that liberals hope to see in Russia, including fully clarified property rights and courts independent of the executive. What Hausmann and his co-authors find is that thorough reform of this order seems necessary for accelerated growth to continue in the long run: 15 years or more. The point is simply that a growth acceleration lasting several years was often triggered by much more modest changes, including changes in external circumstances.

One implication for our understanding of recent Russian experience is this: the impressive reform program of Putin's first term coincided with a period of rapid growth, but there is no reason to assume any strong, direct link between the two. On the contrary, radical institutional reform is a long-term investment. It is likely if anything to slow growth in the short term while new legislation is fully implemented, new institutions bed down, and economic agents adjust to new incentives and new kinds of information. By the same token, a failure to push through a comprehensive reform in Putin's second term need not mean any immediate slowdown in growth. It would probably have adverse implications for Russian growth in the long term, but not in the period to 2008—i.e., within that second term of office.

To say this is not the same as saying that the 1998 ruble devaluation and subsequent high oil prices alone account for Russian growth since 1998. A reasonable conjecture would be that these external events triggered a growth spurt, but rapid growth has been sustained by a growth in domestic demand, with fixed investment in the lead, reflecting a growth of Russian business confidence. GDP growth on the order of 6–7 percent is widely expected this year, despite the evidence that the real effective exchange rate (of the ruble against a weighted average of the U.S. dollar and the euro) is not far short of its level before the August 1998 crisis (Troika Dialog, 2004).

As far as the effects of oil-price changes are concerned, econometric estimates of the elasticity of Russian GDP to changes in world oil prices vary considerably, but projections of growth in the medium term in a scenario of flat oil prices converge on 4–5 percent per annum (Rautava, 2004; World Bank, 2004). According to an OECD simulation of Russian GDP growth in 1999–2003, if Urals oil had remained at its average 1999 level of $19 a barrel, that growth would have been at an average of 5.8 percent a year, against the actual average of 6.8 percent (OECD, 2004, p. 22). In short, nobody seriously disputes that oil prices and the exchange rate have been, and remain, important in current Russian growth; but quantitative analyses imply that there are significant sources of growth that are independent of them.

Table 1. Selected Indicators of Improvement in the Russian Business Environment, 2001–2003

Indicator	2001	2002	2003
Ruble M2 as percent of GDP[a]		17.9	24.2
Rate of increase of bank lending to households and non-banking firms, (percent)[b]			27.0
Cumulative growth of employment in small firms since 1998[c]			32.9[d]
Number of inspections per firm[e]	3.61[f]	2.6[g]	
Average corporate transparency score of listed Russian companies[h]		35.0	39.0

[a]Year-end ruble broad money supply over nominal GDP.
[b]Rate is adjusted for consumer price inflation.
[c]Includes unincorporated sole traders; for definitions, see OECD, 2004.
[d]Percentage rate of growth, 1998 through third quarter of 2003.
[e]Findings of surveys of 2,000 small firms, conducted by TsEFIR (2003) with World Bank support. Covers inspections by the following authorities: tax, fire, sanitary, militia, administrative-technical, ecological, licensing, certification.
[f]During the second half of the year.
[g]Average of 2.72 (first half) and 2.51 (second half).
[h]Standard & Poor's surveys. Unweighted averages on a scale with a maximum score of 100; the average US/UK score said to be around 70.
Sources: Author's calculations from *Moscow Times*, September 24, 2003; *Vedomosti*, September 25, 2003; TsEFIR, 2003; OECD, 2004, p. 83; and Tsentral'nyy bank Rossii, 2004.

The growth in business confidence has been tracked by Moscow Narodnyy Bank (MNB) and the Institute of Economic Transition surveys (see MNB 2004a, 2004b and http://www.iet.ru). The MNB purchasing managers' index (PMI) of new orders to manufacturers, based on monthly surveys of 300 purchasing executives, has been at or (usually) above 50 since late 1998: that means that the level of new orders has consistently been above the level of the preceding month in a half or more of the companies surveyed, throughout that period (MNB, 2004a). The equivalent index ("incoming business") for the services sector has been above 55 since late 2001 (MNB, 2004b).

During this period, the business environment has improved. This has happened in ways that, for the most part, have no obvious direct link with reform legislation. Rather, they are most plausibly attributed to macroeconomic stabilization, the growth of confidence on the part of the Russian business community, and the rewards (mainly access to cheaper credit) available to large Russian companies from adopting international managerial "good practice." Some of these improvements are illustrated in Table 1. The only one of these selected indicators that has a *prima facie* connection with contemporary institutional reforms is the measure of de-bureaucratization (the number of inspections per firm).

Changes in business confidence are notoriously difficult to account for in a systematic way. Here is a conjecture about the Russian recovery.

The buoyancy of business in Russia in recent years has probably been stimulated by, among other things, the realization after the 1998 devaluation that aggregate domestic output was capable of increasing. This meant that growing the business at home might be an attractive alternative to asset-stripping and putting funds offshore. This perception would have been reinforced by evidence of the government's determination to control inflation;

these two boosts to confidence would subsequently have been further strengthened by a perception from the beginning of 2000 of greater political stability and of a leadership oriented toward lower business taxes and market-friendly reforms.

Insofar as the reform program of Putin's first term played a part, it is more likely that it was the message sent by the reform program, rather than the effect on behavior of the reforms themselves, that had this growth-stimulating effect. The fastest recorded year-on-year growth in gross fixed investment thus far, of 18.1 percent, came after all in 2000, when the Gref program was unveiled, but before very much of it was enacted in legislation, let alone implemented.

THE NEW INTERVENTIONISM?

Recent developments raise the question whether the Russian political leadership is now sending messages that tend to undermine that business confidence. The state's attack on the Yukos oil company is the most conspicuous of these developments.

The Yukos affair entered the news with the arrest of Platon Lebedev in July 2003.[2] It has been the main development leading many analysts to detect a new interventionism in economic policy. Some economists, however, consider that policies from 2000 already contained strong elements of state control. Aleksandr Radygin (2004) has argued that from 2000 there has been a pattern of: (a) strengthening state control of those assets in which the state has a stake, and which the leadership regards as "strategic," notably arms production, natural gas, and oil pipelines; and (b) in other "strategic" areas, backing trusted (*doverennyye*) private entrepreneurs against "cosmopolitans" (*kosmopolity*, an ominous term). This is close to the picture of "managed capitalism" that Clifford Gaddy (2004) puts forward as fitting Russian policies for the oil sector.

It will be some time before any assessment of the Yukos case can be made with much confidence. The contention, however, that it is a one-off affair intended to punish one particular tycoon for dabbling in politics will no longer stand up. At the very least it is being used to send messages to other Russian tycoons, and not only about activities related to party politics. These messages include, in particular, the warning that tax avoidance, not just tax evasion, is socially irresponsible and will be punished (Finance Minister Aleksey Kudrin, as reported in *Ekspert*, 2004).

The Russian leadership has operated in the Yukos affair as though it was normal and appropriate that a private company should be required to do what the political leadership judged to be right, without regard to formal rules. In other words, the gap between formal and informal rules of the game remains large, is meant to remain large, and can be used to keep any person or firm in a state of what Alena Ledeneva calls "suspended punishment" (Ledeneva, 2001). The distinction between tax avoidance and tax evasion has been blurred;[3] the legality of much past privatization activity remains fuzzy. Similarly, there is no clear

[2]Lebedev, an associate of Mikhail Khodorkovsky, is one of the original core shareholders in the Yukos oil company, reportedly owning 7 percent. He was arrested on July 2, 2003, and his trial, alongside Khodorkovsky, began almost a year later. For initial reports, see *Vedomosti* (July 4, 2003).

[3]Unlike the United States or Australia, Russia does not have legislation enabling the tax authorities to require that proposed tax optimization schemes be vetted by them, with the possibility of declaring them illegal. Instead, Russia, like Britain, is in the position where taking advantage of a loophole in the tax legislation to reduce one's tax obligations cannot, according to the formal rules, be declared illegal. In the UK this would be tax avoidance, not evasion, and would not be subject to penalties. The difference between Putin's Russia and countries like the UK, in this respect, is that in Russia formal legality can be trumped by informal rules freely adopted by the state.

legislation in Russia thus far that determines what is and is not acceptable lobbying. So-called "abusive lobbying" by Yukos against tax increases on oil companies is widely believed to be part of the problem between Khodorkovsky and the Kremlin, even though it does not figure in the cases against the company and its chief shareholders.

In October 2003, the Russian Union of Industrialists and Entrepreneurs, which had come to be the representative body of Russian big business, proposed that new legislation be considered: on the one hand, legislation to define abusive lobbying; on the other, legislation to reduce the statute of limitations on alleged privatization misdemeanors (United Financial Group, 2003). The former would have clarified the legal position in a way that would have helped the state restrain business intervention in politics. The latter would have lightened the burden of "suspended punishment" on big business. Together, these proposed pieces of legislation would have clarified and formalized the rules of the business-state game. The Presidential Administration and (less importantly) the government have so far shown no sign of wishing to pursue this approach. It can be inferred from this that, thus far at least, they prefer to preserve informal rules and suspended punishment.

IMPLICATIONS FOR THE FUTURE

The Yukos affair raises two questions relevant to Anders Åslund's doubts about Russia's future progress. First, is the attack on Yukos part of a general reversion to central-state interventionism in the economy? Second, if we are observing such a reversion, does it necessarily follow that growth prospects are clouded (a) in the medium term and/or (b) in the long term?

The first observation to be made is that economic policy under the Putin leadership continues to be nuanced. It contains many policy actions and legislative proposals that are unequivocally market-friendly. Examples include the plans to liquidate many (50,000) federal state unitary enterprises and the assignment to the commission on the 2005 federal budget of Putin's advisor, Andrey Illarionov, a dedicated opponent of state spending. Yet in the same month that these developments were in the news (July 2004), MVD troops raided the Central Moscow (share-register) Depository and carried off its server, and a senior Ministry of Finance official floated the idea of private companies having—contrary to the Russian (purely advisory) Code of Corporate Governance—state officials as independent directors (Alekseyeva, 2004; Kaledina, 2004; Rybakova, 2004a).

Events since mid-2003 indicate that economic policy is, in the words used earlier in this comment, "liberal up to a point." The leadership apparently wishes to maintain the power to intervene ad hoc in at least some sectors of the economy. It seeks to do this, in part, by preserving a large gap between formal and informal rules, so that state action is not constrained by an independent legal system.

If this characterization is about right, we should expect to see in 2004–2008 a continuation of many policies favoring the development of free enterprise, but not a clear movement toward a rule of law. There is a conflict between these two elements in Russian policy, but it may not be a conflict that is debilitating for Russian economic growth in the medium term.

Many analysts, including the present author, find this new (or newly revealed) character of Putin's economic policies disappointing. It does not necessarily follow that business confidence will be adversely affected.

If Russian business people, and actual and potential foreign investors in Russia, have assumed all along that there was little or no movement toward a rule of law in Russia, and therefore that Russian political risk was not diminishing, business expectations will have

Table 2. Inward Foreign Direct Investment in Russia and Gross Capital Flight, 2000–2004 (bill. dollars)

Indicator	2000	2001	2002	2003	2004[c]
Inward FDI[a]	3.3	2.7	2.7	3.5	8.6
Capital flight	-14.4	-15.9	-18.7	-22.6	-10.8

[a]Central Bank of Russia estimates throughout, for FDI.
[b]Capital flight estimated as non-repatriation of export proceeds and non-supply of goods and services against import advances plus errors and omissions.
[c]First half of year.
Sources: Author's calculations from OECD, 2004, pp. 36-37 and Otsenka, 2004.

been unaffected by the Yukos affair. Risks of this kind of intervention would have been priced in already and investment would not be affected.

Another possibility is that expectations are indeed adversely affected, but only in relation to big business in the natural resource -based exporting sector. Entrepreneurs whose business is outside that sector and not heavily dependent on supplying it, might be unaffected. In this case, there would be some dampening effect on growth, but it would be less than if business confidence more broadly were affected. Here, however, it should be noted that private oil companies have been a major contributor to recent growth. The OECD estimates their direct contribution to GDP growth in 2000-2003 at a fifth to a quarter (OECD, 2004, p. 33).

Is there evidence at hand of the impact on business confidence of recent developments? The most direct evidence, for example, the Moscow Narodnyy Bank PMI surveys mentioned earlier, does not show a decline (MNB, 2004a, 2004b).

Inflows of foreign direct investment (FDI) and gross capital flight outflows, at least in annual and semi-annual figures, do not exhibit any obvious recent changes, as Table 2 illustrates. These figures are, admittedly, problematic. The Goskomstat Rossii estimate of FDI in the first half of 2004 is only $3.5 billion (Rybakova, 2004b). Still, although the two FDI series (by the Central Bank of Russia and by Goskomstat Rossii) usually show a substantial divergence, in this case they do at least both show a year-on-year increase. In any event, there is no obvious evidence of a shock to business confidence in these particular flows. And it is worth noting that estimated capital flight has been consistently high in the period in question, while foreign borrowing by Russian companies has been growing fast. If anything, the picture is one of consistent, moderate skepticism on the part of Russian business: it is worth growing the business at home, in part by borrowing abroad, but meanwhile it is also worthwhile to keep putting funds offshore. And recent events have not in an obvious way changed this.

CONCLUSIONS

It is argued here that we should not expect a close, direct, and immediate link between market reforms and economic growth. Moreover, even in the medium term, thorough-going market reform does not seem to be a necessary condition for improvement in a nation's economic performance. Evidence from around the world shows that growth can be stimulated for several years by quite modest changes, including rather limited liberalization.

Therefore, we should not expect the impressive Russian economic recovery from 1999 to date to be the result primarily of the array of reforms initiated in recent years. Rather, external stimuli, macroeconomic stabilization, and the general perception of a more stable political regime with a reasonably business-friendly agenda probably account for the rapid growth of the Russian economy.

Recent events have revealed to some, but perhaps have merely confirmed to others, a large element of *dirigisme* in Putin's policies. Economic policies are liberal, but only up to a point. The state will for the time being maintain and make use of its powers to intervene in the economy according to informal, not formal, rules. It is not obvious, from the limited evidence available, that the Yukos affair and related developments have yet made private investors revise their plans. Economic performance during Putin's second term may not be much affected. The lack of movement toward clear property rights, however, is likely to make long-run prospects less favorable than they would otherwise have been.

One final observation: this comment has singled out policy on institutional reform as a factor in Russian economic growth. Other possible influences, such as a sharp and sustained fall in the oil price or, if oil prices stay high, a relaxation of fiscal prudence (a perpetual temptation, in good times, for a country dependent on oil exports), or a renewed banking crisis, could adversely affect Russian economic growth even in the near term. But those influences belong in another story.

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Anders in Wonderland: Comments on Russia's Economic Transformation under Putin

Marshall I. Goldman[1]

Abstract: A prominent American specialist on the Russian economy comments on economic policy under Putin in light of a preceding paper on the subject by Anders Åslund. While suggesting that Åslund's paper represents "a remarkably detailed and convincing description of Vladimir Putin's economic reform," the author proceeds to counter most aspects of Åslund's characterization and analysis. Russia's economic growth since Putin's ascent to power is largely attributed to the jump in world oil prices and windfall profits from oil exports. *Journal of Economic Literature*, Classification Numbers: E60, E63, F13, H20, H60, P21. 1 figure, 1 table, 9 references.

"Russia's Economic Transformation Under Putin" (Åslund, 2004) in many ways is one of the best papers Anders Åslund has written. It is a remarkably detailed and convincing description of Vladimir Putin's economic reform package and the efforts put forth by his economic advisers, particularly German Gref, Alexander Kudrin, and Andrey Illarionov. That said, based on Putin's track record, or at least his record as presented and massaged by Åslund, we should perhaps mount a quick campaign to bring Putin over to the United States. If he can do for our economy what Åslund claims he has already done for Russia, Putin might yet (if it isn't too late) prove a more suitable candidate for the U.S. presidency than our two presidential hopefuls.

Of course, Anders Åslund does not support any such shift in Putin's residence from the Kremlin to the White House (would anyone?), and I certainly do not. Yet if everything is as good as Åslund presents it, such a surreal scenario might not be an exaggerated implication of his paper. For in that context, Åslund's argument is more clearly seen for what it is, namely another instance where what he writes about Russia tends to be closer to fantasy than fact.

To be fair, a response to Åslund's article should limit itself to what he has just written. But that is hard to do unless the reader has an exposure to how Åslund has viewed developments in Russia since 1991. Putin's is not the first Russian transformation or economic success story that Åslund has chronicled. Russia is convenient for Åslund. He can find a transition to write about every few years because they keep failing. His 1995 book *How Russia Became a Market Economy* (Åslund, 1995a) convinced many previously skeptical investors that Russia had "transformed" itself and constituted a good investment. That was just in time for the stock market meltdown of August 17, 1998. Added to that there was also

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his 1994 *Foreign Affairs* article, "Russia's Success Story" (Åslund, 1994), where among other wonders, Åslund heaped praise on the then–Prime Minister Viktor Chernomyrdin. In Åslund's words, "Chernomyrdin has increasingly become the mainstay of stabilization" (ibid., page 64), an appraisal I doubt he would repeat today. The next year there followed a plea to the IMF in the 1995 *Financial Times*, "Why the IMF Should Indulge Russia" (Åslund, 1995b), and the particularly untimely advice on July 7, 1998 in the *Moscow Times*, "Don't Devalue the Ruble" (Åslund, 1998). Russia did exactly the opposite just six weeks later. If this does not border on economic malpractice, I don't know what does, especially because in this present paper Åslund seemingly has a convenient lapse of memory when he acknowledges that part of the reason for Russia's turnaround after the August 17, 1998 crash was due to the devaluation that he had earlier opposed.

Irony aside, here is Åslund's problem. His paper is an excellent catalogue of Putin's reform efforts. Putin deserves praise for embracing these reforms, some of which are not politically popular. What Åslund understates however, is that there is an enormous difference between proposing good economic measures and implementing them—particularly upon a bureaucracy and public that has a long culture of resistance to any change, particularly those that impose more responsibility on the individual.

Åslund also underplays the way Putin has undone some of the Gorbachev and Yel'tsin political reforms and suppressed dissent on the TV networks. Putin also has succeeded rather brilliantly in eliminating or weakening the political parties that dared to muster any effective challenge. True, Åslund's is a paper mainly about economics, not political reform, and even if there is resistance to change, Putin deserves praise for at least trying. And Åslund deserves credit for acknowledging in his last two paragraphs that things are not really going so well after all. Even for Åslund, the Yukos affair and the behavior of both the Yukos stockholders as well as the government authorities, including Putin, has to be unsettling. The effect, however, of the last two paragraphs is to undercut Åslund's entire argument.

WHAT EXPLAINS RUSSIA'S RECOVERY

There is no doubt that Åslund is correct when he stresses that Putin's reforms, especially the tax reforms (assuming that someday they will be fully or even partially implemented) are just what the Russian economy needs. But he attributes too much to Putin. As a look at the month by month change in industrial production shows (see Table 1, based on monthly issues of *Proizvodstvo promyshlennoy produktsii*), the recovery and substantial growth begins as early as March 1999. Putin was not made prime minister until August 1999. Åslund recognizes that and concedes, at least for a few sentences, that the recovery began on the watch of Yevgeniy Primakov—a dedicated communist who was hardly an advocate of market reform.

It is natural, therefore, to ask, what did Primakov do to bring about the recovery? The answer is basically *nothing*. It happened in spite of Primakov and the main reason is in part the devaluation of the ruble that Åslund opposed and even more important, it is the jump in the price of oil from its low of $10 per barrel in 1998 to $30 per barrel thereafter which, Åslund reluctantly acknowledges (p. 397).

Indeed the jump in oil prices is the *deus ex machina* that—more than anything either Primakov or Putin did—explains so much that Åslund finds praiseworthy. For example, he is justifiably proud of the fact that the adoption of Putin's flat 13 percent income tax has resulted in more people paying a tax and an increase in collection of personal income tax from 2.4–2.5 percent of GDP in 1999–2000 to 3.3 percent in 2002 (p. 405). I do not find

Table 1. Changes in Industrial Output, 1999-2004

	1999 as pct. of 1998	2000 as pct. of 1999		2001 as pct of 2000		2002 as pct. of 2001	2003 as pct. of 2002	2004 as pct. of 2003
		Original index	New index	Original index	New index	New index	New index	New index
January	97.6	110.7	114.1	105.3	107.8	102.2	104.9	107.5
February	97.0	113.7	116.7	100.8	103.1	102.0	106.5	108.7
March	100.4	109.6	112.3	103.6	104.7	103.7	106.7	106.6
April	100.6	105.5	109.5	105.2	107.0	104.3	107.1	106.7
May	106.0	110.6	114.2		107.0	102.8	108.5	105.5
June	109.0	109.8	112.4		103.7	104.4	107.0	109.2
July	112.8	108.5	111.9		104.5	107.8	107.1	
August	116.0	110.2	113.2		105.1	103.4	105.5	
September	120.2	107.2	110.7		103.8	105.5	108.0	
October	110.3	110.4	113.9		105.1	103.9	107.2	
November	112.9	107.6	111.6		104.7	100.8	107.1	
December	111.1	102.5	103.9		102.6	103.2	107.9	

these figures particularly impressive.[2] After all, the reason for the budget surplus as well as the considerable buildup of hard currency reserves is not the increased revenue from income tax collection but the bulging profits tax and export tax generated by the oil companies.[3]

It is misleading if not impossible to write anything about the Russian economy without making oil the centerpiece, even though Åslund attempts to do so. Again, Putin like Primakov had nothing to do with this windfall. Figure 1 shows just how intertwined changes in oil production and the GDP are. This is not to suggest that oil is the only determinant—certainly it is not, but it comes close. The World Bank (2004, p. 15) calculates that oil and gas account for about 25 percent of the country's GDP. Adding the secondary and tertiary oil-generated needs (including pipe, steel, railroad tank cars, and machine production) explains a lot more.

For those with unforgiving memories, there are a few other criticisms of Åslund's paper that come to mind. A few years ago, he made a very strong case that the collapse of the Russian economy in the early and mid-1990s was not as serious as some critics and the unreliable Goskomstat claimed. In his words, "the depression of the Russian economy is wildly exaggerated" (Åslund, 1994, p. 66). While I would be the last to defend Goskomstat, it is intriguing that on page 397, Åslund acknowledges that "from 1989 to 1998, official Russian GDP fell by no less than 44 percent." He took the figure from ECE (2004), but Åslund's earlier protestations notwithstanding, that is more or less what some of us have been saying for some time.

POLITICAL AND INSTITUTIONAL CHANGES: WHERE'S THE REFORM?

Åslund notes properly that Putin has managed to create a workable political coalition. As much as anything, this explains his ability to pass the reform legislation that Yel'tsin often

[2]Personal income tax in the U.S. in 2000 was 11 percent of GDP.

[3]There was enough collected even after allowance for transfer pricing and other tax reduction schemes.

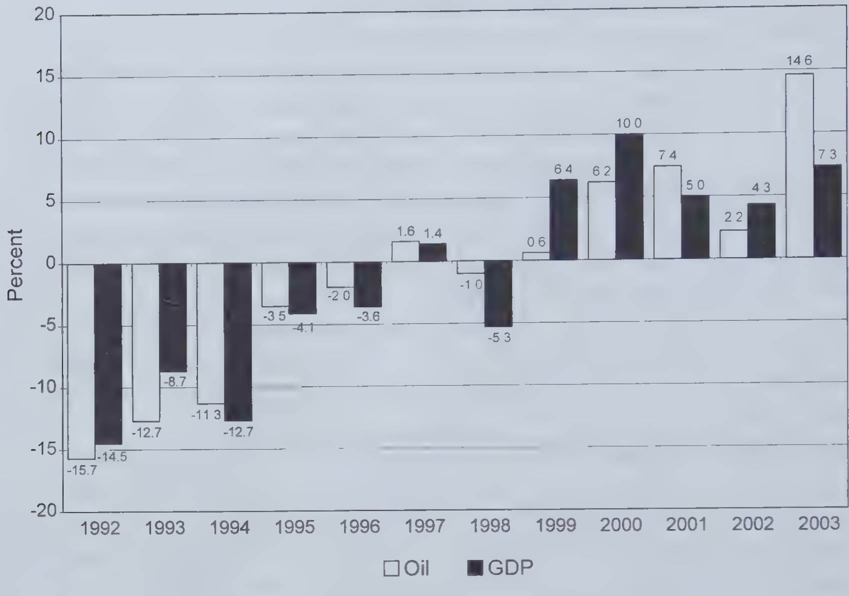

Fig. 1. Russian oil production and GDP (percentage change), 1992–2003.

sought but rarely was able to achieve. This brings to mind several points. First, Åslund attributes almost all the "right" reform legislation to Putin but rarely acknowledges that Yel'tsin often had the same intentions. After all, Yel'tsin also strongly advocated the sale of land, but could not muster the support he needed to pass his reforms in the Duma. However, Yel'tsin should at least be given credit for trying to do the right thing. As for Putin, if anything, he can be said to have been too successful, "dizzy with success,"[4] as it were. It is not so much that the Communist Party lost seats in the 1999 election that made reform possible but that its coalition partners lost out, so the communists no longer had enough allies to fight the change. In the 2003 election, Putin succeeded so well that now there is no meaningful opposition at all, neither from the right nor the left.

Åslund cites several positive institutional changes. One of the most popular is abolition of the tax police. As he himself later notes, the police may be gone but as the Yukos office will tell you, tax inspection remains. Their terror tactics seem little changed. Moreover, the completely unpredictable (it is predictable, of course, that all will remain unpredictable) decrees and injunctions emanating from the tax authorities one day, the Ministry of Justice the next, and the Prosecutor General the third suggests that the rule of inlaws is more important than the rule of law.[5]

Because of efforts to shrink the bureaucracy and reduce its authority, Åslund concludes that "corruption and misappropriations have visibly declined" (p. 407). Where is the evidence for such an important finding? Given the way the courts, including higher courts, have responded to the Yukos affair, it is easier to conclude that the court system is as beholden as

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[4]An echo of Stalin's article in *Pravda* of March 2, 1930 entitled "Golovokruzheniye ot uspekha"—*Ed., EGE.*

[5]A good example is that Igor Sechin's daughter (the father is deputy head of the Presidential Kremlin Administration and, as of August 2004, the chairman of the state-owned oil company, Rosneft') married Vladimir Ustinov's son (his father is the chief procurator general).

ever to the "czar," or in his absence, to the highest bidder. Reflecting this unfortunate state of affairs, Arkadiy Volskiy's Russian Union of Industrialists and Entrepreneurs and two other Russian business associations have agreed that when there is a dispute among their members, rather than seek mediation in a government court, they will settle such conflicts out of court in the association's own arbitration offices (*Financial Times*, August 6, 2003, p. 2). Avoiding the state court system will spare them from what the association calls "court auctions," where the decision goes to the highest bidder regardless of the merits of the case.

Nor can we (nor evidently Åslund) take seriously his assertion about how the powers of the procurator general have been "curbed." This is evident from the rampant misbehavior of Procurator Ustinov's subordinates in the Yukos case.[6] And as Åslund points out in his footnote 16 (p. 412), as many as 15 percent of the acquittals won in what was supposed to be a final jury trial were reversed when the prosecutor appealed adverse decisions.

Despite Putin's determined intention to make it easier to create start-up businesses and private family farms, the results thus far are not very impressive. According to the most recent data, there are still only some 800,000 registered small businesses (*Ekonomika i zhizn'*, No. 9, March 2004, p. 10), fewer than there were in 1998. Most estimates suggest that small and medium-sized businesses in Russia account for only 10 to 15 percent of GDP. In most market-oriented countries, the figure exceeds 50 percent. The situation is not much better in farming. No more than about 5 percent of the farms are privately run by farm families. Moreover, just as in industry there are a growing number of cases, acknowledged by Åslund (p. 410), where oligarchs are gaining control of the large land holdings that used to belong to the collective farms.

Some of the differences I have with Auslund may only be definitional. He notes on pages 413-414 that what he calls "a group of new young entrepreneurs" has consolidated ownership of each large-scale industry. They may be young and their industries may be large in scale, but I would not use the word "entrepreneur." "New class of oligarchs" or "oligarchs II" would fit better, since none of them have invented anything new. Instead like the oligarchs of the 1990s, this new crowd has also taken control of what used to be state enterprises—the only difference being that these are more recent corporate takeovers. Some of these oligarch IIs did indeed participate in a number of the initial privatization cases, but at a smaller and initially unnoticed level.

WHITHER PUTIN: WHITHER RUSSIA

Going back to my opening paragraph, what is the most disturbing implication of Åslund's paper is that the reader is left with a completely misleading impression of Putin. Except for the last two paragraphs, this is the kind of writing the Kremlin's press secretary would craft if he had Åslund's talent as well as research and organizational capabilities.

Åslund acknowledges that all is not well in the media or among political parties. But that cannot be ignored or offset by Putin's efforts to reform the bureaucracy or the bureaucratic environment. While Putin can be excused for not being able to win his battle with the apparatus (no one else has won either), he cannot be excused for bringing his comrades in from the KGB and other security forces. These *siloviki*, or "law and order" types, now dominate

[6]Vladimir Kolesnikov, the Deputy Procurator General, complained about the fact that under present laws he could only put Mikhail Khodorkovsky in jail for 10 years. Nor is his warning to Khodorkovsky's friends and peers very comforting: "Let those who are not yet in jail think hard about what they are doing." Of course all this was said before the trial had been convened.

the system. The sociologist Olga Kryshtanovskaya calculated that by the middle of Putin's first term in office, the percentage of "siloviki in the top echelons of power increased from 4.8 percent during the time of Mikhail Gorbachev to 58.3 percent" (*Financial Times*, November 2, 2003, p. 3). In a more recent analysis, she now estimates that about three-quarters of his senior staff have a *siloviki* background (*The Economist,* May 22–28, 2004).

What Åslund must—but has not—taken into account is that these now-dominant *siloviki* are playing a major role in the Yukos affair. It seems clear that they are determined not only to penalize Khodorkovsky's associates for their past misdeeds, but equally intent on reasserting state influence if not ownership over some of the country's most important mineral resources. As a byproduct, some of them seem equally eager to step in as either owners or executives, replacing the oligarchs as they are flushed out. Nor does it look like Yukos will be the only company to undergo some form of de-privatization if not re-nationalization.

What is so distressing about all of this is that while Putin deserves credit for seeking to cut away the red tape and enhance efficiency as well as production, he seems content to allow his subordinates to upend the whole notion of private property rights and act as they please. In other words, the statists have returned to power in Russia. Russia seems to have made a U-turn and is now heading in the wrong direction.

Because the Gaidar-Chubais-Shleifer-Sachs-Åslund reforms were so misguided, sooner or later there was bound to be a correction designed to redress the earlier abuses. Unfortunately the Yukos affair shows that the remedy is likely to be as harmful as the initial prescription.

Anders to his credit senses this and says as much in his last paragraph. If I wanted to undermine or challenge the case he makes in the preceding pages, I would have had to come up with something similar. Instead Åslund provides it for us himself. This may be an economic transformation that Åslund describes, but however appropriate the micro steps may be, the macro changes are most disturbing. To fall back on a rather trite analogy, the economists around Putin may have the right strategy to win the battle for increased productivity and efficiency, but it is the *siloviki* who seem to be winning the war.

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Putin's Second Term Is Likely to Differ from His First: A Rebuttal

Anders Åslund[1]

Abstract: The author of "Russia's Economic Transformation under Putin" replies to comments and critical assessments of his paper by two prominent Western specialists on the Russian economy. His rebuttal to the more severe critic of the two emphasizes the prospective change in Putin's approach to economic reform during his second presidential term. The author believes that economic policymaking in the Kremlin, rather than the impact of world oil prices, will tend to shape Russia's considerable economic growth. *Journal of Economic Literature*, Classification Numbers: E60, E63, F13, H20, H60, P21. 8 references.

Professors Philip Hanson (2004) and Marshall Goldman (2004) have kindly responded extensively and very promptly to my paper (Åslund, 2004). I largely agree with Professor Hanson's comments, while much of Professor Goldman's response does not deal with my paper, which he so strongly criticizes. He dusted off some writings pertaining to disagreements in the past, and rather skillfully finessed the evidence that I have managed to present. What Goldman might have tackled are Russia's general reform strategy, the financial crash of 1998, the economic recovery under Putin, the future outlook for Russia during Putin's second term, and Putin's possible impact on medium-term growth.

The overall lesson of post-communist economic transformation is clear: the earlier, more radical, and more comprehensive the economic reforms, the better the ensuing economic and social outcome. The Washington consensus, advocating financial discipline, deregulation, and privatization, really works. No less than 25 of the 28 post-communist countries, from Albania to Mongolia, have become market economies. The government of Yegor Gaidar (which I advised) shared these Western ideas, but Russia's problem was that the Gaidar government faced too much resistance and thus could not see through most of its planned reform. In his extensive writings, Professor Goldman was usually on the other side, advocating a slower pace of financial stabilization and privatization (e.g., Goldman, 1994, 2003)—a position that he shared with the old communist academicians and the managers of state enterprises.

One effect of the resistance mounted so effectively by Professor Goldman's like-minded Russian colleagues was that Russia maintained a huge budget deficit, averaging 8 percent of GDP until 1998 (see Åslund, 1998; Owen and Robinson, 2003). This fiscal imbalance was the fundamental cause of the financial crash of 1998. All along, I have favored addressing this key problem. The standard reason for devaluation is a significant current account deficit, which Russia never had. Instead, the country suffered from insufficient

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international reserves, caused by capital flight and an excessive public foreign debt, which in turn was due to the persistent budget deficit. Then, the fiscal deficit should have been addressed directly, which the Kiriyenko government and the IMF aspired to do in the summer of 1998. But that course of action was blocked by the anti-reform Duma. It was evident from the outset of the crisis that devaluation would bankrupt most of the Russian banking system, as it did, precipitating massive social suffering. It would have been far better if the budget deficit could have been eliminated without all that hardship. Today, most of the devaluation effects have gradually been eaten up, but that has hardly dampened the growth rate.

In the paper published in this journal issue (Åslund, 2004), I have discussed five reasons for the sudden Russian growth, without attempting to assess their relative merit. My purpose was to show how substantial and comprehensive the economic reforms under President Putin have actually been, because far too many learned observers believe that Russia's economic recovery has entirely been caused by high oil prices and the devaluation. However, most other post-Soviet countries have gone through the same process, regardless of whether they exported oil or had to import it. The example of Ukraine tends to show that the most obvious common cause of economic growth in such countries is a leveling of the playing field by cleaning up the fiscal systems.

Although Marshall Goldman tries to conceal it, it appears as if he largely shares my judgment about the specifics of the reform under Putin. Yet, I am amazed to be criticized by Goldman for not praising President Yel'tsin sufficiently and not complaining enough about the maltreatment of Yukos. Most of the time, he proceeded to accuse me of championing the opposite position in both cases. Obviously, President Yel'tsin is the ultimate hero of building capitalism in Russia, and Yukos, as one of the big privatized resource companies, led Russia's economic recovery. Goldman, by contrast, has systematically criticized almost every instance of concrete privatization, idealizing perfect privatization that cannot possibly happen, and thus, in fact, advocating the maintenance of state ownership (cf. Goldman, 2003). That was the Belarusian policy, and privatization there never went too far. It was therefore easy for President Aleksandr Lukashenko to reimpose the Soviet economic system, combined with a dictatorship.

As Goldman rightly points out, my paper presents an economic, and not a political, analysis. From a more general perspective, President Putin's salient preferences are political control, national strength, and hence economic growth. There is nothing liberal or democratic about this agenda, though a free market economy breeds most growth. President Putin did oversee substantial market-oriented economic reforms in his first term, partly because of his focus on high economic growth, and partly because a small group of liberal officials gained inordinate influence in the epic battle fought between Putin's KGB men (the *siloviki*) and the oligarchs. Putin's ideals appear to be Singapore, South Korea, and Kazakhstan, and possibly Chile under General Augusto Pinochet as well as China.

Everything has changed at the outset of President Putin's second term. He has defeated all his adversaries: oligarchs, regional governors, communists, liberal parties, the parliament as such, and even the apparatus of the Council of Ministers. His concentration of power is excessive, provoking a power vacuum. Initially, two forces have come to the fore to fill this vacuum. The first power can be traced to President Putin's old KGB friends from St. Petersburg and the second, as I suggested, to the managers of the remaining state enterprises. It is difficult to find more reactionary forces in the current Russian society, and they seem to have merged, as Putin's old KGB friends seize the commanding heights of the large state enterprises. Despite Russia's impressive growth and oil prices at levels approaching $50 per barrel, one large state energy enterprise after another reports declining profits, suggesting that their masters are robbing them blind. After toying with the successful Anglo-American model of competing private enterprises in the resource industries under Yel'tsin, Russia now seems on the course of adopting the failed OPEC model of state-owned monopoly enterprises in its energy sector.

Reform successes are often achieved when a leader is trying to consolidate his power. He then has to appeal to broad constituencies and pursue attractive policies. After consolidating power, he can focus on implementing all the *bad* things he may really want to see in place. Considering that Russia has become structurally quite similar to Latin America, analogies with Carlos Menem of Argentina and Alberto Fujimori of Peru may be quite relevant. They were viewed as shining successes during their first terms, just as they are now excoriated as miserable failures in their second. Similarly, we should be careful about assuming that Putin's policies in his second term will resemble those in his first, because the nature of Russian policymaking and his power base have completely changed.

Professor Hanson (2004) questions whether the impact on Russian economic growth will really be so impressive. I agree that external factors matter a great deal. They are obviously important for Russia with its unquestionable dependence on energy exports, shaped by highly fluctuating prices, and Hanson's quantification is substantially useful.

I am not certain if the Hausmann et al. (2004) paper is all that relevant in the Russian context, because it highlights what a difference small changes can make. But in Russia, the changes have been extraordinarily large, as I have attempted to show. Among the post-Soviet economies, we are witnessing a radical turnaround in most, once each country has managed to reach a critical mass of reforms. The sharp curve of the turnaround is specific for transition economies, and the swing is far greater in the post-Soviet economies than in East-Central Europe.

The question that we as yet are not in a position to answer is how much Russia's economic policy will change. I just voice here my suspicion that this change is likely to be greater than most observers now suspect, while Hanson is more skeptical. Time will tell. It does appear, I think, that President Putin may be consciously abandoning the economic model that has brought Russia such spectacular growth. If he really is taking his country back to the era when large state monopoly enterprises ruled the day, we will witness a great change that should have a sharp, negative impact on growth. The rise of state enterprises is not only apparent in the resource sphere, but also in banking as well as in the extensive armaments and telecommunications sectors; and this is only the beginning. I suspect that indicators of business confidence and foreign direct investment are not likely to tell us much about what to expect, because a critical understanding requires a focus on central policymaking, and not on the pulse of current conditions or emotions on the ground.

How soon will we see a negative impact on growth, if economic policy really is changing? Alas, Hanson is largely on the right track in his agnosticism. As I continue to emphasize, the growth inertia is rather considerable, and no apparent risk of a macroeconomic crisis is in sight. Thousands of productive enterprises have sprung up, and most are likely to expand. Thus, the abatement of growth might turn out to be fairly moderate for quite some time. Yet, given that energy-importing Ukraine is about to achieve a 13 percent rate of growth this year, despite the burden of accelerating oil prices, a Russian growth rate of about 7 percent in the midst of a windfall from oil exports should not come as a surprise.

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The Effort to Reverse Ethnic Cleansing in Bosnia-Herzegovina: The Limits of Returns

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Abstract: Two American-based geographers examine the international community's efforts to reverse ethnic cleansing in Bosnia-Herzegovina since the end of the war in 1995. The paper, based on extensive field work and semi-structured interviews, first examines the geography of the nearly one million refugees and internally displaced persons who have returned to their pre-war domiciles in Bosnia-Herzegovina. They then identify and discuss limits to the reversal of ethnic cleansing imposed by demographic, institutional, geopolitical, and economic factors. *Journal of Economic Literature*, Classification Numbers: I31, O15, O19. 7 figures, 1 table, 60 references.

ONE MILLION RETURNS

In a few months the international community will reach an important milestone in the history of its involvement in Bosnia-Herzegovina (BiH) and in the enterprise of peace building and reconstruction in war-torn regions. The United Nations High Commissioner for Refugees (UNHCR) will declare that it has recorded the one millionth returnee to their property and place of residence in 1991 just prior to the Bosnian war.[2] As is well known, the Bosnian war was characterized by waves of brutal ethnic cleansing that left tens of thousands dead, and displaced over half of BiH's 1991 population of 4.4 million (Burg and Shoup, 1999). Over one million of these displaced persons sought asylum in neighboring states or beyond in Europe, the United States, Canada, and Australia (MHHR, 2003). About half of these subsequently found durable solutions to their displacement with grants of asylum and regularized permanent residency, whereas the other half returned to BiH. Another million

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[2]For the latest statistics on returns in Bosnia, see the UNHCR in Bosnia web site [http://www.unhcr.ba/]. Most of the statistics on returns quoted in this paper are from that source at the time this paper goes to press (August 2004). The meaning of "return" in the Bosnian case is more precise than conventional definitions in international law. Typically, refugee return is repatriation to one's *home country*, whereas in Bosnia it is return to one's *home dwelling and property* prior to 1991. This latter form of return we term *domicile return.*

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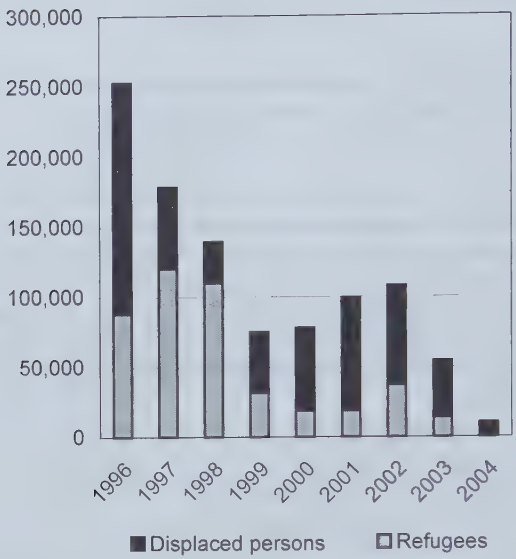

Fig. 1. Return of refugees and displaced persons to their pre-war residences, 1996–2004 (to May 31, 2004) (UNHCR, various years).

Bosnians were internally displaced, driven from the countryside to overcrowded towns and cities unable to cope with the influx.[3] Schools, sports centers, army barracks, summer camps, and community halls were turned into collective centers and settlements for the displaced. For years, hundreds of thousands lived in squalid conditions in these centers and settlements. Nearly 10 years after the end of the war, over 300,000 people continue to live in displacement. Some remain in collective centers but most reside in collective settlements—new apartment complexes and land allocations. Many also continue to occupy other people's homes.[4]

In the macro-demographics of the war, the figure of one million returnees represents slightly less than half of those displaced by the war, and over a quarter of BiH's current population, which is estimated at 3.8 million (Economist Intelligence Unit, 2003, p. 20).[5] Returns figures are broken down into refugees and displaced persons, and, as we will see, majority and minority returns. As Figure 1 indicates, the greatest year for returns was 1996 when over 250,000 refugee and displaced person returns were recorded, followed by 1997 and 1998. While the number of displaced person returns in 1996 exceeded refugee returns, this was not the case in 1997 when the largest numbers of refugee returns were recorded. The large number of refugee returns in the three years after the war is a consequence of the

[3]At the Peace Implementation Conference on Bosnia-Herzegovina in December 1995, it was estimated that 2.7 million people were driven from their homes, with 1.2 million of these internally displaced (Ito, 2001, p. 98). Other figures suggest that 1.7 million were refugees and "at least the same number or more internally displaced" (Fagen, 2003, p. 233).

[4]According to UNHCR statistics, 1,189 people displaced persons were in collective centers as of April 30, 2004, and 320,844 displaced persons were residing in other accommodations. Refugees (mostly Serbs from Croatia) comprise another 22,440.

[5]The most recent census in Bosnia-Herzegovina was conducted in 1991, the year before the onset of war and ethnic cleansing.

repatriation, sometimes involuntary, of those who were granted only temporary protection in Western Europe and elsewhere (Koser et al., 1998). Repatriation to the territory of BiH did not necessarily mean that refugees returned to their 1991 homes (what we term domicile return), but rather often meant repatriation into internal displacement. In some instances, repatriation made the challenge of domicile return more difficult as entrenched ethnoterritorialism and widespread housing stock destruction forced returning refugees to occupy empty properties, thereby creating new obstructions for other would-be returnees.

The entrenched ethnoterritorialism that has fueled hostility against returns is a wartime legacy. Serb ethnonationalist forces launched the war in BiH as a radical scheme to "unmix" the population of Bosnia and carve out as large an exclusivist ethnoterritory for the Serbs as possible (which they named Republika Srpska) (Gow, 2003). Ethnic cleansing was their main tactic in this radical scheme of social and spatial engineering, and the trauma it unleashed on Bosnia provoked reactive ethnic cleansing by all sides in what became a war against Bosnia as a multiethnic place of coexistence and tolerance (Cigar, 1995). The Dayton Peace Accord (DPA) legitimized the ethnoterritorial division of Bosnia into *Republika Srpska* (RS) and the Bosniak[6]-Croat *Federacija* (Federation) (Fig. 2), but it also articulated the possibility of reversing ethnic cleansing. Richard Holbrooke, its principal architect, prioritized the right of return in his characterization of the agreement, rejecting suggestions that it partitioned the country: "Dayton was not the creation of two different countries inside Bosnia. It's one country with rights of refugees to return, open roads, free elections, a single, central government and a merger of two hostile forces, the Serbs and the Croats and Muslims. . . . This is going to be one country. If it isn't, then we will have failed" (quoted in Rosenfeld, 1995, p. A27).

The DPA created new international power structures in Bosnia in the form of a military implementation force (IFOR, later SFOR and today EURFOR) and a civilian implementation administration, the Office of the High Representative (OHR).[7] They also created a right to return that is unique in international law, specifying the right of the displaced to return to their prewar dwellings and property (domicile return) (Chimni, 2003). Annex VII of the DPA states that all those displaced from their homes by the war "have the right freely to return to their homes of origin. They shall have the right to have restored to them property of which they were deprived in the course of hostilities since 1991 and to be compensated for any property that cannot be restored to them" (Article I, paragraph 1; see The General Framework, 1995). In keeping with the 1951 Refugee Convention, refugees and displaced persons were also given the right *not to return* but to resettle in a place of their choice: "Choice of destination shall be up to the individual or family . . . The Parties shall not interfere with the returnees choice of destination, nor shall they compel them to remain in or move to situations of serious danger or insecurity . . ." (Article I, paragraph 4; ibid.). In effect, this clause merely reaffirmed the principle of non-refoulement[8] that has long been part of international

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[6]The term Bosniak is commonly used to refer to Bosnians who are culturally or nominally Muslim, but who may not necessarily be religiously observant Muslims.

[7]The High Representative is the civilian in charge of the implementation of the non-military aspects of the DPA. The High Representative is appointed by the Peace Implementation Council, a body of major governments and international agencies committed to Bosnia's reconstruction. There have been four High Representatives thus far, all European diplomats; currently it is Sir Paddy Ashdown.

[8]"Non-refoulement" is a term used in relation to the 1951 Convention Relating to the Status of Refugees. It means that states are not to return persons seeking asylum (refugees) to situations in which they would face persecution on the grounds recognized by the Convention (race, religion, nationality, membership in a particular social group or adherence to a particular political opinion).

Fig. 2. General map of Bosnia-Herzegovina showing the two entities and local *opštini*. *Opština* borders and names are shown circa 2000 (after GISData, 2000).

refugee law though it would come to be used by the ethnonationalists against the return process, as we explain below (Allain, 2002).

Annex VII committed the local authorities (entity and local governments) to work with the UNHCR to implement a repatriation plan. The parties were to "create in their territories the political, economic, and social conditions conducive to the voluntary return and harmonious reintegration of refugees and displaced persons, without preference for any particular group" (Article II, paragraph 1). How this was to be accomplished was not specified, nor were any sanctions for non-compliance. It also created an independent commission to reestablish title and ownership of property as held before the start of the war (what became the Commission on Real Property Claims). In principle, Annex VII contained language that created the possibility of reverse engineering the demographic character and property relations of BiH to what they were in 1991. In practice, the DPA depended upon the good faith of the parties for its implementation and since the Bosnian Serb leadership was not a direct party to the negotiations, represented at Dayton by Yugoslav President Slobodan Milosevic, they were loath to accept its terms.

Entrenched ethnonationalists on the ground in the *opštini* of Bosnia sought to frustrate and block implementation of Annex VII.[9] Rather than return to the 1991 *status quo ante*, they stressed relocation and local integration, pointing out that Annex VII allows relocation choice and "property compensation" as alternatives to return. Their more colloquial rationalization was the essentializing primordialist mantra that "Serbs and Muslims cannot live together," pointing out that this was especially true after the war.[10] Yet the desire to reverse the legacy of ethnic cleansing was a powerful moral motivation among some in the international community and, as the civilian institutions for the implementation of Dayton gradually became established, this desire acquired political force. Realizing that they faced widespread obstructionism to the implementation of Annex VII and that refugee repatriation was not necessarily helping the returns process, the OHR began to prioritize what it termed "minority returns."[11] The UNHCR also shifted its focus to minority returns.[12] The term reflected the geopolitical realities of the apartheid Bosnia created by a war that had largely succeeded in "unmixing" BiH's demographic geography. "Minority return" was defined as the return of ethnic groups to an area controlled by an ethnic group other than their own, even if they constituted a local majority before the war. Thus, Bosniaks returning to *opštini* in the RS that had been majority Bosniak before ethnic cleansing operations were now classified as "minority returns," as were Serbs returning to pre-war homes in Sarajevo, awarded to the Federation at Dayton. Croat returns to Bosniak-dominated *opštini* or visa-versa were classified as "minority returns" even if the returns were within the Federation. Since most of those displaced during the war were Bosniaks driven out of what became Republika Srpska, "minority returns" were predominantly Bosniaks returning to their property and homes in territory given to the Bosnian Serbs at Dayton.

The very designations "minority" and "majority" reflected the terms of the Bosnian war where population and citizenship were reduced to questions of ethnic numbers. But, in making the conscious policy choice to prioritize "minority returns" in 1998, the Peace Implementation Council, the OHR, and the UNHCR translated the moral impulse to reverse ethnic cleansing into a bureaucratic agenda that promoted the "re-mixing" of Bosnia's separated ethnic groups. This policy of emphasizing domicile return over relocation as a durable solution had its critics inside the UNHCR and in the international community (Cox, 1998;

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[9]The *opštini* (sing. *opština*), also known as counties or municipalities, are the local-level units of government in Bosnia and are charged with many tasks related to the returns process. Governed by an elected mayor and local council, they are typically dominated by one of the local ethnonationalist parties.

[10]This reasoning is, of course, circular and constitutes that which it seeks to explain. Purity-seeking ethnonationalists unleashed a war upon difference and then explained war and polarizing antagonism in terms of that difference.

[11]Minority returns were not initially a priority of the OHR and UNHCR. The term appears in the OHR's 3rd and 4th Reports to the UN Secretary General as "so-called 'minority returns'" and remarks that it is taking place at a small scale but is also being fiercely resisted. It was not until the 6th Report (July 1997) that it is conceded that "there have been few successful minority returns" (OHR, 1997). The Open Cities initiative of that year, according to the Report (paragraph 62), "signals a renewed focus in facilitating minority returns by the international community." For all the Reports see www.ohr.int.

[12]The initial focus of the UNHCR was on organized voluntary repatriation to "majority areas," while accepting ethnonationalist "relocation" sentiment (Ogata, 1995).

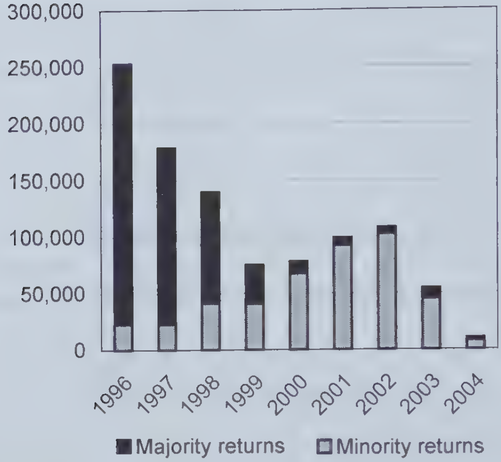

Fig. 3. Majority and minority returns to pre-war residences, 1996–2004 (to May 31, 2004).

Ito, 2001). Indeed, it seemed to commit the international community to a seemingly impossible re-engineering of Bosnia's demographic geography in an effort to reverse ethnic cleansing.

As Figure 3 indicates, the level of minority returns was quite limited after the war ended. Indeed, after the initial return of refugees from 1996 to 1998, the returns process seemed dead (ICG, 1999b). Potential returnees were quite reluctant to cross the inter-entity boundary line established at Dayton. Ethnoterritorialism triumphed at the ballot box as the fears and deprivations of post-war Bosnia kept locally homogenous populations from voting across ethnic lines (Malik, 2000). Dayton seemed to be a failure (ICG, 1999a). Relocation and local integration seemed the most practical means to durable solutions for the displaced. It was not until four years after the war that significant levels of minority returns were recorded. In the years 2001 and 2002, the number of minority returns peaked. This turnaround is due in large part to changes made by the international community, as we will explain below. Today in Bosnia, the returns process is winding down in most areas, although in a few, like Srebrenica, it is still an active process.

The nearly 442,000 minority returns registered as of May 31, 2004 affect nearly all *opštini* in Bosnia but are concentrated in a few areas. As shown in Figure 4, the largest minority return areas are: Sarajevo and its suburbs; western Bosnia around Prijedor and Banja Luka; and the northeast opština of Doboj, Brcko, Bijeljina, and Zvornik. Others areas of notable return are Mostar, in southern Bosnia, and some of the central Bosnian *opštini* where total return numbers are small but significant in relation to the local population. In all of these areas, minority returns constitute a significant presence in villages and towns ethnically cleansed during the war. In only a few places, however, have minority returns tipped the ethnic balance in the favor of the returning group, as most returns are to *opštini* where returnees are outweighed by resident and displaced persons of the locally dominant group. For example, in the northeastern *opština* of Zvornik, the return of nearly 13,000 Bosniaks is set against a pre-war Serb population of 28,000 enlarged by an additional 30,000 displaced Serbs. Before the war, Bosniaks were the majority(60 percent) in Zvornik. In contrast, a relatively small number of Serb minority returns to southwest Bosnia have reestablished their pre-war majority in three *opštini*. Many other *opštini*, despite some minority

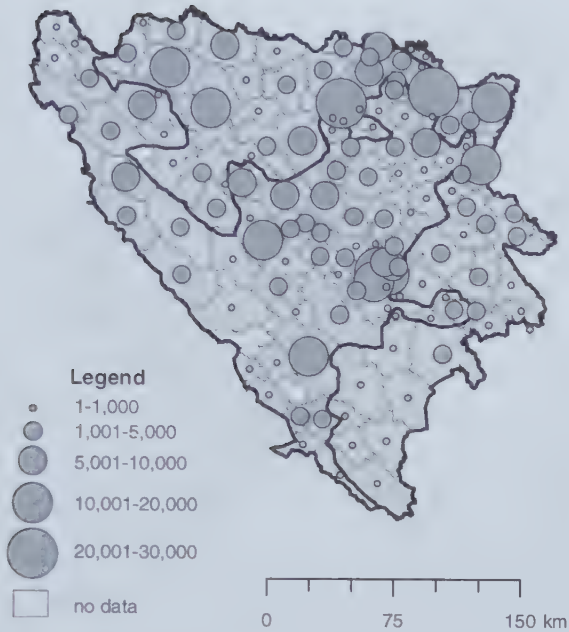

Fig. 4. Total minority returns (all ethnicities) by *opština*.

returns, show the results of ethnic cleansing through the persistence of homogeneous local populations.

Examining the ethnic breakdown of the geography of minority returns provides further evidence of the degree to which the reversal of ethnic cleansing can be said to have occurred. Figure 5 shows total Bosniak minority returns as a percentage of the pre-war Bosniak population for each *opština*. As is evident, Bosniak returns to western and northeastern RS number more than 30 percent of their pre-war level with somewhat lower figures for other parts of the Serb entity. Parts of central Bosnia and the eastern Bosnian Krajina held by Bosnian Croats during the war have also seen these rates of return. This pattern may be compared with Figure 6, which shows the rate of Croat minority returns to be highest in parts of central Bosnia (held by the Bosnian army during the war) and the Posavina region (in the strategic Brcko corridor where eastern and western RS connect). The total number of Croats in Bosnia has declined significantly, however, and may now be less than 10 percent, as many have moved to the economically more prosperous Croatia. Similarly, Figure 7 indicates the total rate of Bosnian Serb minority returns as a percentage of the pre-war population of Bosnian Serbs. Most Serb returns are to the city of Sarajevo and to the predominantly Serb suburbs they abandoned in early 1996. But it is worth noting Serb returns to the *opštini* of Titov Drvar, Glamoc, and Bosanski Petrovac, a lightly populated and somewhat remote part of the Bosnian Krajina region that was overwhelmingly Serb. These minority returns were strongly contested by the Croat forces that took over this region in the wake of Operation Maestral toward the end of the war. Despite this opposition, charismatic Serb community leaders were successful in encouraging Serb returns to these *opštini*, reestablishing their pre-war Serb-majority status (ICG, 1998).

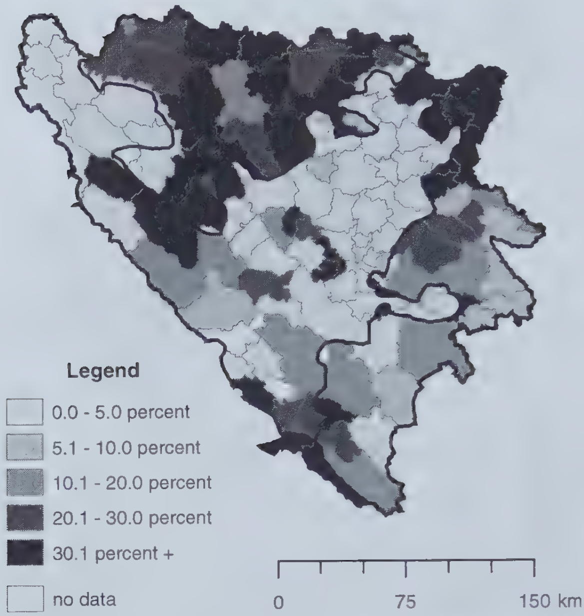

Fig. 5. Total Bosniak minority returns as a percentage of pre-war *opština* Bosniak population. The fact that all *opštini* report minority returns of Bosniaks (even those in which Bosniaks currently are a majority) reflects in part a situation of "split *opštini*," wherein one part of an *opština*'s territory is under the majority control of one group (e.g., Croats) and another part by another group (e.g., Bosniaks). Thus it is conceivable that there could be a situation in which there are Bosniak, Croat, and Serb minority returnees to the same pre-war *opština*. This possibility should be kept in mind when interpreting spatial patterns of returns for Croats and Serbs as well (Figs. 6 and 7).

Creating the conditions that have allowed one million people to return to their pre-war place of residence has been an expensive and arduous struggle for the international community. The relative success of the effort to reverse ethnic cleansing has been built on a series of factors. First, the international community has demonstrated considerable commitment to rebuilding Bosnia in the form of reconstruction assistance, foreign aid to the state, and support for the international institutions implementing Dayton. Per capita assistance in the first two post-war years in Bosnia was $1400, the highest of any international state-building project since World War II (Dobbins et al., 2003, p. 148).[13] While this aid was not effectively coordinated and deployed at the outset, initial mistakes stimulated the creation of an OHR-led bureaucratic structure, the Reconstruction and Return Task Force (RRTF), which proved to be an effective coordination and management mechanism spearheading returns at the local level. Second, as noted, the returns process was long hampered by obstructionist *opštini* dominated by the ethnonationalist forces that launched the war and profited from it (Andreas, 2004). It was not until the OHR acquired the power to remove local officials for obstructionism and established itself on the ground in Bosnia's localities with regional offices that the balance of power between the international community and the local ethnonationalists began to tilt in a way that made returns politically acceptable. Third, returns were also blocked by

[13]This figure is higher than in Haiti (1995–1996), Kosovo (2000–2001), and Afghanistan (2002–2003), as well as post-World War II spending on Germany (1946–1947) and Japan (1946–1947).

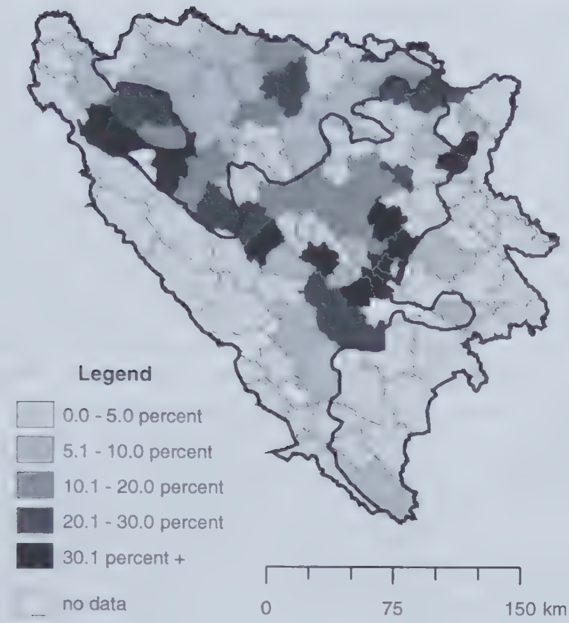

Fig. 6. Total Croat minority returns as a percentage of pre-war *opština* Croat population.

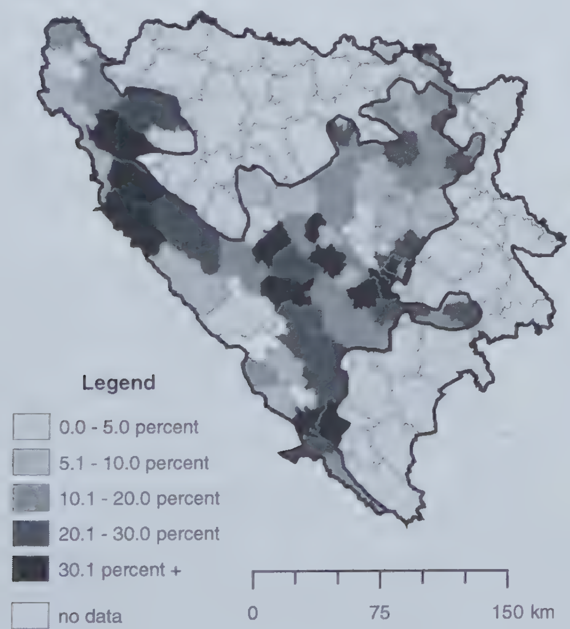

Fig. 7. Total Serb minority returns as a percentage of pre-war *opština* Serb population.

the myriad of wartime and post-war laws passed by the entities and *opštini* that legalized the theft of residences and property belonging to displaced persons. The OHR eventually addressed the problem by canceling all entity property laws and imposing a uniform property law implementation process on Bosnia's entities and *opštini*. This created a transparent mechanism whereby the international community could measure and monitor property reclamation. Obstructionist *opštini* could be easily identified and blockages addressed in localized diplomacy between the international community, particularly OHR and OSCE officers, and local mayors and housing staffs. Finally, the OHR undertook an extensive national media campaign to promote returns and counteract the misconceptions and myths promoted by ethnonationalist media about returns.

The apparent relative success of one million returns, and the general effort to reverse ethnic cleansing, needs to be carefully contextualized within contemporary Bosnian realities. Drawing upon field work on the localized dynamics of the returns process over the last two years in Bosnia, we wish to argue that there are significant limits to the returns process. Our point is not to argue against the international intervention and presence in Bosnia, which we see, on the whole, as a positive force. We do not subscribe to libertarian readings of the international community's efforts in Bosnia as an objectionable project of social and spatial engineering (Dempsey, 2002). Nor are we convinced by interpretations of the international community's presence in Bosnia as a neocolonial project (Chandler, 1999). While some aspects of these critiques have merit, they tend to provide tabloid and totalizing accounts that fail to capture the complexities of the mixed yet not unsuccessful record of the international community in Bosnia on reconstruction and returns (Knaus and Martin, 2003). Rather, we wish to make a series of more precise and grounded arguments that uses the organizing idea of "limits" as an alternative to totalizing pronouncements about the "success" or "failure" of the international community's effort to reverse ethnic cleansing in Bosnia. We advance these arguments while noting the localized geopolitical struggles that still remain as the BiH state attempts to transition beyond what European Union Foreign Minister designate Javier Solana (2004) has characterized as the "era of Dayton" towards the "era of Brussels."

THE DEMOGRAPHIC LIMITS OF RETURNS

The political desire on the part of the international community to "reverse ethnic cleansing" is a noble one, but did it make sense to try to return BiH to 1991 in the wake of a traumatic and bloody war against the demographic character of the country? Some suggested the international community's commitment to "minority returns" was potentially a "mistaken priority" (Black, 2001). Returning Bosnia to its 1991 *status quo ante* appeared to be an expensive and "unnatural" project of reverse social engineering. The ethnically cleansed apartheid geography of "Bosnia 1996" was to be returned to the putatively harmonious organic geography of "Bosnia 1991" (Mahmutcehajic, 2000; Ó Tuathail and Dahlman, 2004a). Aware of non-refoulement concerns, the international community did acknowledge the right of the displaced to choose to relocate, but only if they could secure durable solutions that did not impact potential returnees. In contrast, the comprehensive policy approach adopted by the OHR and the UNHCR prioritized return as the durable solution to displacement in Bosnia, with emphasis on minority returns. While commendable as an explicit effort to reverse the legacy of ethnic cleansing, this policy emphasis has, nevertheless, three important limits.

First, the process of ethnic cleansing in Bosnia is correctly judged as a war crime.[14] But, the process of violently displacing one half of the country's population was also a process of traumatic forced urbanization. One senior member of the international community explained it to us as a "compressed urbanization process." "Two decades of natural urban drift [rural to urban migration as part of modernization] were crushed into two months" in 1992 when a large part of the displacement of the Bosniak population from rural regions occurred.[15] Young Bosniak families driven out of rural villages, like those surrounding the town of Zvornik in northeast Bosnia, ended up in collective centers in Tuzla where they spent the war. Driven out in 1992, most of these families have not had the opportunity to return to their destroyed rural villages until nearly a decade after their displacement. Their children have grown up in urban or semi-urban areas and have become integrated into social services and educational institutions in these areas. War effectively was a process of compulsory urbanization. To the extent that it sponsored the movement of urban dwellers back to rural, and often marginal, villages such as the Bosniak mountain villages surrounding Zvornik, the process of return effectively ran counter to "natural" modernization and urbanization. In effect, the international community was underwriting a process of urban to rural migration.

This argument, made to us by an experienced international official in Bosnia, does not describe all forms of return in Bosnia. Many Bosniaks lived in urban areas before the war and have taken the opportunity to reclaim their property there. The same is true for Serbs and Croats. Also many rural Bosniaks "voted with their feet" by returning to their so-called "marginal mountain villages" and indeed were among the first to initiate the process of return, often in a "spontaneous" fashion that caused considerable problems for the international community. Nevertheless, the power of larger structural processes of modernization and urbanization has conditioned the geography of returns in Bosnia. The war saw not only forced but also voluntary migration from rural villages to urban centers and surrounding villages. Many of these migrants have strongly resisted leaving urban regions.[16] Some families have judged it impractical and unrealistic to return to remote regions, and have consequently missed out on international aid. Meanwhile, the international community has spent millions on reconstruction and utility provision to marginal regions. The viability of these returns over the next decade is questionable, and it remains to be seen if the international community did not make a mistake in prioritizing returns at all cost over local integration and poverty reduction in urban areas.

The second demographic limitation is related to the first. As we have observed during our field work in return sites throughout Bosnia, returns to uncontested space have a predictable demographic dynamic.[17] After de-mining, adult men usually undertake initial site visits to destroyed properties either by their own transportation or in UHNCR-sponsored buses. When it is established that the site is secure from intimidation and attack by local residents, adult women with the help of adult men undertake "house cleaning," meaning the

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[14]In fact, ethnic cleansing as practiced in Bosnia comprises a number of specific war crimes under international humanitarian law.

[15]Interview with Graham Day, Head of the OHR regional office, Banja Luka, June 14, 2004.

[16]The Bosnian Croat–dominated *opština* of Jajce has been named by the OHR as one of the four most obstructionist *opštini* to returns in all of Bosnia-Herzegovina. One significant reason, according to an experienced international official, is that the town has considerable numbers of rural Croats who do not want to give up their urban apartments (interview with Christine Zandvliet, OSCE headquarters, Sarajevo, March 8, 2004).

[17]Return sites are classified in Bosnia as "uncontested," namely to property that is not occupied (invariably destroyed and mostly rural), and "contested," namely occupied apartments and houses usually in urban areas.

preparation of the site for reconstruction and, if possible, the initial reconstruction of a make-shift shelter room where one member of the family can stay overnight. The family will then begin a process of extended commuting between their place of displacement and their place of reconstruction and possible return. International community aid regulations require that aspirant returnees re-establish physical ownership of their property and show a willingness to return, in the form of temporary residence on the ruins or nearby, in order to be eligible for reconstruction assistance that comes in the form of bricks, tiles, and cement. The returnees then have to make arrangements for the actual rebuilding, which they often do themselves or with help from neighbors and family.

The viability and success of this process depends on the support networks and logistical linkages returnees have to their own community and place of displacement. Return for many is a tentative process involving a graduated degree of commitment. It makes economic sense to attempt return since one can obtain international aid to help reconstruct the family house, though this is tempered by economic conditions in the place of return. It also makes sense to retain strong linkages to one's place of displacement since this is the place where one has the strongest sense of security and established networks of support. Education, health care, and pensions are vital community services and most returnees prefer to obtain these from "their people" in "their space." Thus, for example, in our interviews with Bosniak returnees in the mountain villages surrounding Zvornik town, we encountered no one who would go to the USAID-reconstructed[18] hospital in the town because it was perceived as a "Serb hospital," where the standards of treatment for Bosniaks would be questionable. All preferred to return to their place of displacement in Tuzla for medical treatment and health care. Similarly, their pensions in the RS were not comparable to those in the Federation, thus encouraging the maintenance of linkages with the Federation.

Consequently, the process of return is not a finalized one but a speculative activity characterized by all sorts of "hedging" behavior. In many instances, this produces a particular demographic profile of returns, with older members of the family, those with durable and deep attachments to a particular place and property, returning to the rural family home but not young families with children in urban schools. Single mothers and war widows with children that have grown up in urban settings are the least likely to return. If there are no local schools with Bosniak teachers, young families are unlikely to return and only older persons will.[19] A lot of families commute between two locations, an urban apartment and the rural family home and return site. In some instances, particularly pronounced among Croats in the Posavina region, returnees used their reconstructed family homes as "weekend houses" or "summer houses" since they have regular employment in Croatia, or in Germany and Austria as *gastarbeiters*.[20]

A 2003 UNHCR survey of 600 persons displaced from the Podrinje region of the RS (Srebrenica and surrounding *opštini*) provides some statistical evidence of the demographic limits to return. While a majority in the survey (55 percent) wished to return to their pre-war properties, the overwhelming reason for not doing so was a lack of reconstruction assistance (see below). Female-headed households and young women are less likely to have applied for reconstruction assistance than other groups.[21] While 52 percent of the women interviewed (426 out of 600) expressed a wish to return, women and men above 60 and young males

[18]United States Agency for International Development.

[19]Interview with Natasha Stankovic, Repatriation Officer, Mercy Corp, Tuzla, March 10, 2004.

[20]Interview with William Quayle, Head of Department, Refugees and Humanitarian Affairs, OHR, Brcko, June 27, 2002.

under 20 expressed the greatest interest in returning. Those expressing the most uncertainty about return were female-headed households (including those who lost males during the Srebrenica genocide), couples between 20-40, and single women. Education concerns, poor security, fear of reprisals, and psychological trauma were the main reasons given for not wanting to return (UNHCR 2003).[22]

The third demographic limit on returns concerns data or rather the lack of it. UNHCR return statistics are gathered in a variety of ways. Officially, the data is collected by the *opština*, which required returnees to register themselves with it. When *opštini* statistics are suspect or incomplete, local UNHCR officers use their own statistics on return and reconstruction sites to adjust the numbers. This methodology is often haphazard—counting houses with lights on or interviewing local shopkeepers about returns—but they are the best statistics the international community has in the absence of a census. Our experience in Bosnia has led us to question the accuracy of these statistics, which we believe overstate the level of returns. Our conclusion is based on two observations. First, there is an in-built bias in the collection process towards overstating returns. *Opštini* today want to be seen as cooperative so as not to attract scrutiny by the OHR. Returnees, who may have not fully returned, want to convince aid agencies they have in order to receive reconstruction assistance. The UNHCR and implementing agencies are keen to demonstrate the success of their endeavors. Second, numerous international officials told us that the much-hyped property law implementation rates (property repossessions) are not a reliable indicator of returns.[23] People obtain legal title to their property but many do so merely to sell it, using the proceeds to invest in their actual place of residence. There are no public statistics on housing market sales in Bosnia (a remarkable fact in itself) but anecdotal evidence suggests many officially counted returnees quickly rent or sell their property (even thought there are prohibitions against doing so). The bottom line is that many aspects of the demographic realties of contemporary Bosnia are not transparent and known to the international community or Bosnian governance institutions. This will remain the case until the next census is organized and administered, which will not happen until Annex VII has been declared implemented by BiH authorities and the international community.

INSTITUTIONAL LIMITS TO RETURN

The Dayton Peace Accord brought peace to Bosnia-Herzegovina but it did not resolve the conflict. The peace accord was a compromise that, on the one hand, endorsed the creation of a unified and independent Bosnian state yet, on the other hand, partitioned this state into two discrete ethnoterritorial entities separated by an internal "inter-entity boundary line." As already noted, the DPA legalized and legitimated the wartime entity Republika Srpska, whose territorial extent was created through large-scale ethnic cleansing and genocide. Yet it seeks to make the reversal of ethnic cleansing possible via Annex VII. Led by the United

[21]Women often have difficulty obtaining documentary ownership of property since properties were in the name of males and not always legally transferred after marriages.

[22]The construction of the memorial at Potacari to the victims of the Srebrenica genocide has helped the process of returns in the area as living families have followed their dead to reclaim the region. According to Pollack (2003) repatriation and reburial were intimately linked in the minds of survivors from Srebrenica and surrounding *opštini* (also based on an interview with Charlie Powell, Head OHR office, Bratunac, March 15, 2004).

[23]For example, interviews with Jonathan Glazebrook, RRTF Officer, Banja Luka, August 2, 2002; Margriet Prins, Head, OHR Annex VII Verification Unit, Sarajevo, March 18, 2004; and Christine Zandvliet, OSCE, Sarajevo, March 8, 2004.

States, the predominant concern of the international community was to stabilize Bosnia, to "end a war" (Holbrooke, 1998). Peace building was a secondary concern, as is evident from the structure of the DPA and immediate funding priorities. In contrast to the 11 pages of detail in the military annex (Annex 1), the ten other annexes are sometimes vague and without detailed implementation mechanisms and procedures.[24] The initial Implementation Force (IFOR) received priority funding, whereas civilian implementation was unfunded by the Americans, who opposed an active OHR.

The failure of the DPA to resolve the basic conflict over the nature of the Bosnian state hobbled the country with a governance structure that is divisive and dysfunctional to economic development, administrative efficiency, and effective governance. Rather than using the returns process as a means of building a centralized administrative structure (since the returns process covered the whole country), the DPA made it the responsibility of the entities created through displacement. Making the international community facilitators of the process ensured that Annex VII would not be wholly forgotten in the implementation process, provided that civilian implementation could secure adequate funding. It also ensured that the political will required to reverse ethnic cleansing was independent of the parties to the Bosnian war. While this institutional structuring of the returns process has produced results, it has also been marked by three important limitations.

First, the international community took a considerable amount of time to develop the capacity required to make returns happen. At the outset, the overwhelming emphasis of Dayton implementation was on military implementation. Returns were not on the international community's immediate agenda and, as we have noted, "spontaneous returns" by Bosniaks were discouraged. As funds for reconstruction began to flow through United Nations institutions, state overseas development agencies, international aid organizations, and their implementation partners, a plethora of projects were launched in various sites without any overall coordination or strategic planning. Efforts to make aid for local authorities conditional on their openness to returns was undermined by large donors who wrote their own rules. The result was that much of the initial reconstruction aid was wasted on non-priority projects (e.g., the building of what were, in effect, "holiday homes" for Croats in Brcko and schools that were underutilized) or on the pet projects of local politicians with international connections. Corruption was a deep structural challenge as international organizations struggled to come to terms with operating in a post-war environment dominated by criminal networks and political parties with strong mafia linkages.[25]

It took years for the international community to build the capacity (giving the High Representative the power to removal uncooperative officials and localizing international institutions), develop the coordination (through the Peace Implementation Council and local RRTFs), and structure the legal environment (especially property laws) to facilitate meaningful movement on returns. This delay undoubtedly diminished the prospect that some

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[24]The European Union negotiator on Bosnia at Dayton was Carl Bilt, who succeeded David Owen. Bildt later became the first High Representative. His memoirs record the reluctance of American officials to address civilian implementation issues at Dayton and their efforts to sabotage the Office of the High Representative. Bildt had to borrow vehicles and acquire emergency funding to begin operating an office in Bosnia (Bildt, 1999, p. 173). According to him, Dayton was "a military operation with some form of civilian annexe," whereas the Europeans tended to see it the other way round (*ibid.*, p. 131).

[25]The corruption question came to a head when *The New York Times* published a front-page article alleging that "as much as a billion dollars has disappeared from public funds or been stolen from international aid projects through fraud" (Hedges, 2000, p. A1). A subsequent report by the U.S. General Accounting Office (GAO, 2000) concluded that endemic crime and corruption threatened implementation of the DPA.

displaced would return "home" (Black, 2002). International officials we interviewed operated with the rule of thumb: there was a 10 percent attrition rate in returns per year of displacement, meaning that one was likely to see only 30 percent returns levels in 1999 amongst people displaced in 1992.[26] By 2000, however, the OHR's new power of removal, the Westendorp decision to annul all entity property laws, the establishment of new property laws, and the coordinating activities of the RRTF did produce the spike in returns recorded in that year and the subsequent two years (see Fig. 3).

By the same year, however, a second institutional limit was becoming apparent: a funding gap. Many returnees face substantial delays in obtaining reconstruction assistance; for example, some who returned to their homes in 1998 only received assistance in 2004.[27] With capacity and procedures in place, the international community found itself in the position of having multiple clients awaiting reconstruction and return assistance while "donor fatigue" and a backlash against corruption set in among donor states and relief agencies (Smith, 2000). The Kosovo war and subsequent NATO occupation of the territory deflected resources that might have gone to Bosnia. East Timor became another site of international reconstruction efforts. The wars in Afghanistan and Iraq in the wake of September 11, 2001 created yet more siphons of international reconstruction funds. In 2002, the U.S. government ended funding through the Bureau of Population, Refugees, and Migration for reconstruction and returns in Bosnia, although USAID continues to operate with a reduced budget. The mandate of the Commission on Real Property Claims ended in December 2003, and it has now transferred its databases and functions to the state-level Ministry of Refugees and Displaced Persons.

Implementing agencies have also reduced their operations substantially. For example, in 2000 Mercy Corps had over 100 personnel associated with its Tuzla headquarters and deployed across various return sites. In March 2004, it had 20 staff and no field officers.[28] The UNHCR has closed field offices in Doboj (2003) and Zvornik (2004) and is implementing a graduated closure of its regional offices, with Tuzla scheduled to close by late 2005. With reconstruction assistance increasingly limited, implementing agencies like Mercy Corps are attempting to select what they consider to be the most sustainable returns. Current selection criteria emphasize young families and the interview process probes the depth of desire to return and whether such returns will be economically and socially sustainable.

With funding drying up, international attention switching elsewhere, and the OHR contemplating the end of its mandate in Bosnia, there has been a concerted effort to develop local capacity and ownership over the returns process among Bosnia's own governance structures. At the end of 2003, the OHR closed down its RRTF structures and transferred them over to domestic leadership. It consolidated its returns-related activities into Annex VII verification units that are scheduled to close at the end of 2004. The OHR proclaimed that sole responsibility for the implementation of Annex VII now rested with Bosnian authorities. The OHR, however, has had to force the establishment of the "sustainable framework for domestic leadership on Annex VII" that it envisions (OHR, 2004).

At the local level, the OHR imposed a law mandating the creation of *opština*-level commissions for "Returns, Development, and Integration" as local successors to the RRTF. These commissions are intended to gather together all the relevant stakeholders in the returns process—displaced persons association leaders, housing officers, mayors, and other local

[26]Interview with Graham Day, Head of the OHR regional office, Banja Luka, June 14, 2004.

[27]Interview with Natasha Stankovic, Repatriation Officer, Mercy Corp, Tuzla, March 10, 2004.

[28]Interview with Natasha Stankovic, Repatriation Officer, Mercy Corp, Tuzla, March 10, 2004.

politicians—with international community officials as observers only.[29] Formed in a piecemeal fashion, the extent to which these local commissions are functioning in an effective and active manner is questionable. Our observations suggest that they appear to be working well in some localities. Bosniak returnees to Doboj, for example, were very pleased with how their commission was functioning and how the mayor, a moderate Serb nationalist, was responding to their concerns.[30] We are more skeptical, however, of the degree to which politicians from political parties implicated in the ethnic cleansing of communities are genuinely open to their return.[31]

At the upper levels of governance, the OHR advocated the creation of three new state-level bureaucratic structures addressing returns. The first is a Ministry of Human Rights and Refugees that, it is hoped, will gradually assume the power and functions of the two entity-level ministries responsible for these issues. The move is part of a strategic effort by the OHR to build up state-level institutions at the expense of entity institutions. Instead of the current inefficiency of having entity ministries with offices in each other's territory, the state Ministry was to establish four regional centers that would assume the functions of these offices and the return co-ordination function previously provided by the RRTF. The establishment of these offices, however, has been delayed, as old entity ministry employees try to maintain their jobs while conforming to new civil service qualifications and hiring practices.

The second new state-level structure is the Commission for Refugees and Displaced Persons. Established in 2000, the Commission is a forum with representatives from the upper levels of governance in Bosnia-Herzegovina. The idea is that state and entity ministers in charge of refugee and displaced persons meet with members of the international community—the UNHCR, the OHR, and the OSCE—to coordinate and harmonize laws and policy on returns issues. The OHR has moved to strengthen the Commission by making its conclusions binding and having it serve as a governing board for a third structure, the Return Fund. The latter is envisioned as an autonomous administrative organization that will act as a financial institution overseeing the solicitation, accumulation, regulation, and dispersement of reconstruction and return funds. The idea is that entities will allocate the majority of their budgets to the Fund so these can be used to attract matching funds from international bodies like the Council of Europe. The Director of the Fund would establish country-wide reconstruction assistance criteria and oversee the allocation of funds.

Fundamental and longstanding political problems plague these new administrative structures. Entity-level politicians are reluctant to concede power to state-level institutions, while entity departments fear any diminution of their domain and budgets. Co-operation has been sporadic, with Serb members, in particular, often not turning up for meetings or seeking postponements. Efforts to attract matching funds for the Return Fund from the Council of Europe have foundered because of delays in establishing the institution, appointing a director, and

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[29]International community officials told us that the greatest personnel problem for the Commissions was not multiethnic representation but the inclusion of women. Local governance is a bastion of patriarchy in Bosnia-Herzegovina (interview with Yukiko Ishii, Associate Protection Officer, UNHCR, Tuzla, March 10, 2004).

[30]Interview with MZ representatives in the village of Sevarlije, Doboj *opština*, March 16, 2004. One reason for cooperation is that mayors are to be directly elected in Republika Srpska. All sides were aware that the local political reality was that the mayor needed Bosniak votes in order to get re-elected.

[31]Bosniak returnees to Doboj reminded us that the current Serb member of the Bosnian Presidency, Borislav Paravac, was head of the self-proclaimed Serb "Crisis Committee" in Doboj during the ethnic cleansing of the town in 1992. He was mayor of the town from 1990 to 2000, and also a member of the Republika Srpska People's Assembly.

securing adequate capitalization.[32] An experienced UNHCR official complained that the regional centers of the Returns Commission are not functioning. They do not take the initiative and have a "Communist mentality" of waiting for orders before taking any action.[33]

Whether the transition from international to Bosnian authority for return programs has been successful remains an open question. So also is the question of whether Bosnian governance structures can transition from being a politicized patronage state to a competency-based modern bureaucratic state. These open transitional processes can be classified as a third institutional limit on returns that embeds the returns process within a heretofore dysfunctional Bosnian governance structure plagued by unresolved political antagonisms. While it is possible that these structures could be made to work, the early indications are not encouraging.

LOCALIZED GEOPOLITICAL LIMITS

The effort to implement Annex VII developed into a power struggle between the international community, displaced person associations, and local ethnonationalist-dominated *opštini*. In the years immediately after Dayton, the power advantage across the ethnically cleansed territory of Bosnia lay with local ethnonationalists. The "inter-entity boundary line" was effectively functioning as a meaningful border rather than a permeable line on the map (Bose, 2002). The *opština* elections of 1996 largely confirmed and legitimated the ethnonationalist hold on power. Some determined returnee groups were organizing themselves to return, but they were often met with violence, intimidation, coercion, and official obstructionism. As the military situation stabilized and the OHR began to accumulate resources and capacity, the power balance between local ethnonationalists and the international community began to change. A localized geopolitics of obstructionism gave way to a more complex game of reluctant accommodationism, adaptive ethnonationalist tactics, and subtler forms of obstructionism. At the same time, the inevitability of some returns became accepted and legal prohibitions against property theft and "double occupancy" reluctantly enforced. The machinations of this localized geopolitics have placed three limits on the effort to reverse ethnic cleansing.

The first limit is the practice of obstructionism against returns. While more explicit in the first few years after Dayton, this practice has changed form but never completely disappeared. The Bosnian war saw the emergence of a post-Communist predatory elite who used the rhetoric of ethnonationalism to propel themselves to power and to make a concerted grab for the collective riches of the state: land, housing, state enterprises, commercial contracts, and trafficking in legal and illegal goods (Pugh, 2002). The Bosnian war was a form of primitive accumulation, and political parties like SDS were vehicles for capital accumulation through coercion and institutionalized kleptocracy. Rather than being defeated by the war, peace allowed the main Serb nationalist party (SDS) to consolidate its hold over the resources it had seized during the fighting. In their regions, the Croat ethnonationalist HDZ and the Bosniak SDA were not qualitatively different (Cooper and Pugh, 2004).

Returns threatened to disturb this political economy of ethnonationalist kleptocracy in the years immediately after the war. But as ethnonationalists became comfortable with their new wealth they began to see the benefits of having legitimacy in the eyes of the

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[32]Interview with Amela Kreho, OHR Annex VII Verification Unit, Sarajevo, March 9, 2004, and Margriet Prins, Head, Annex VII Verification Unit, Sarajevo, March 18, 2004.

[33]Interview with Yukiko Ishii, Associate Protection Officer, UNHCR, Tuzla, March 10, 2004.

international community. Consequently, they were more willing to cut deals to give back some of the stolen assets of land and houses provided their overall position of power and wealth was not threatened. Obstructionism changed from overt and violent acts to a more subtle administrative form: delays in processing property title claims, resistance to follow through on evictions, the non-extension of utility services to returnees, and petty bureaucratic humiliations. Obstructionism has not disappeared, since the property repossession process does threaten the hold of certain ethnonationalist elites over valuable property and assets—city-center apartments, desirable business locations, well-appointed houses—that returnees continue to try and repossess. Creating a climate of generalized hostility also has economic benefits for the majority community, as it induces returnees to sell their legal assets to those in stronger bargaining positions than they.

The second limit is the effort by the ethnonationalist forces in Bosnia's localities to preserve wartime population shifts by ethnic engineering, especially through land allocations. One of the reasons why Bosnia-Herzegovina's *opštini* are locally powerful is that they own valuable land and apartment lease assets. The land, called socially owned property, was always a basis for a local political economy of politicized preference. People would often build illegal structures on socially owned land that would be legalized at a later stage through complex instruments of "use rights." After the war, mayors of ethnonationalist *opštini* began distributing land plots to displaced persons of their same ethnicity in order to meet their demands for more housing. The policy was a means whereby hardline ethnonationalists could subvert any reversing of ethnic cleansing by keeping their own displaced, locking in the demographic majorities produced by the population movements during the war. Land allocations were also presented as a reasonable response to returns. As "minority returns" reclaimed and re-occupied their property, *opštini* had a "humanitarian obligation" to provide for those who chose to stay, as was their right under Annex VII.[34] This allocation of socially owned land for construction sites was a policy of ethnic engineering. It was first pioneered by Bosnian Croats in the Stolac and Capljina region south of Mostar, but was quickly adopted by *opštini* across RS and some Bosniak-dominated *opštini* in the Federation. Grasping the discriminatory nature of this ethnic engineering, the OHR first declared the practice illegal in May 1999 and tried to regulate it with a series of proclamations thereafter. However, the OHR lacked the capacity and enforcement powers to regulate the practice effectively. It persisted despite being pronounced illegal and ethnonationalists were able to create "facts on the ground" that amounted to a considerable victory for them over the international community (Ó Tuathail and Dahlman, 2004b).

This brings us to a third limit created by the dynamics of localized geopolitics: the generalized acceptance of ethnic separation and ethnoterritorialism in Bosnia today. Most experienced international officials in Bosnia readily concede that the goal of recreating the demographic structure of "Bosnia 1991" is a utopian one that will never be attained. The refrain that one hears is that "too many people are dead," "too much has been destroyed," and "too many people are living elsewhere." Little appears to remain of the social spatiality that allowed multiculturalism to flourish in Bosnia's urban centers. "Bosnia 1995" was a segregated country with apartheid geography and fetishistic practices of border maintenance. "Bosnia 2004" is not the apartheid state that hard-line nationalists would like: The "inter-entity boundary line" is not impermeable, property has been restored to those from whom it was stolen, and returns have reached the one million mark. Yet, Bosnia's cities are

[34]This is how the Republika Srpska Prime Minster, Dragan Mikerevic, defended the practice in a question and answer session at the Woodrow Wilson Center in Washington, D.C. on February 4, 2004.

overwhelmingly mono-ethnic places today. Once a thriving multiethnic town, Banja Luka is now an overwhelmingly Serb place that is brimming and bustling with Serbs not only from across Bosnia but from the Croatian Krajina also.[35] A foundation stone for the rebuilding of the destroyed Ferhadija mosque was laid in 2001, but reconstruction has not yet begun nor is it soon likely, as low-level antagonism grinds the process to a standstill. In any event, few Bosniaks or Croats want to live in today's Banja Luka. Likewise Sarajevo is an overwhelmingly Bosniak city, even though many Serb families have returned. City streets have been renamed to emphasize the Bosniak and Muslim character of the city, while signs in Cyrillic script have been removed (Robinson et al., 2001).

Despite a constitutional court decision giving equal rights all "constituent nations" in Bosnia's entities, the exclusivist name Republika Srpska remains and garners identification and legitimacy as the "homeland" of Bosnia's Serbs. Among Bosnian Serbs, the desire to separate from Bosnia proper and unite with Serbia remains strong.[36]

In sum, although the international community may have won the "returns war" against local ethnonationalists across Bosnia-Herzegovina, they appear to have lost the larger "homelands war." Arguably, the principal reason is that it was lost from the outset or, at least, from when the international community decided that it was not going to outlaw nationalist parties and prohibit the perpetrators of the war from holding public office in postwar Bosnia. Those who started and profited from the war in Bosnia, with the exception of a few prosecutions for egregious war crimes in the Hague, have not been brought to justice for their crimes (ICG, 2000). Ethnic chauvinism was normalized by the war and ethnoterritoriality has had over a decade to become embedded in the grain of everyday life in Bosnia-Herzegovina. One encounters it on the landscape, on the television screen, on one's mobile phone, and in the quotidian spaces of the country.[37] Liberal internationalists may wish it otherwise, but there are very few liberal internationalists in the governance structures of contemporary Bosnia.[38]

THE ECONOMIC LIMITS TO RETURNS

A further problem limiting Bosnia's return and reconstruction process is its economy. Even without the war, the transition from socialism was always going to be difficult for Bosnia. While some authors argue that the war in Bosnia was largely the result of economic crisis inside Yugoslavia during the 1980s (e.g., Woodward, 1995), it would be impossible to extricate a single factor of explanation from the political machinations, popular nationalism, and larger political-economic changes in Central and Eastern Europe at the time. The

[35]It is estimated that some 30,000 Croatian Serbs reside in Banja Luka (interviews with Jonathan Glazebrook, RRTF Officer, Banja Luka, August 2, 2002, and Graham Day, Head of the OHR regional office, Banja Luka, June 14, 2004).

[36]Tracking polls on the question of separatism in 2003 continued to show a majority of Bosnian Serbs favored either total independence for the entity (25.2 percent) or separation from Bosnia and reunification with Serbia (38.1 percent) (UNDP, 2003, p. 27). More recent polls show continued interest in separatism among Bosnian Serbs, but also indicate that their support for the issue is much weaker than before (cf. UNDP, 2004).

[37]Two small examples of banal nationalism in Republika Srpska (RS): the weather forecast on RS television shows a map of the RS only as it discusses the weather for the entity. It then discusses the weather for the Federation as if it was a foreign country. The RS automobile map features the RS demarcated by a thick red line with the "inter-entity boundary line" as equivalent to a national border (cf. Billig, 1995).

[38]It should be noted that neither is the OHR a democratic institution, answering only to the international diplomats that comprise the Peace Implementation Council, the enlarged successor to the Contact Group.

Table 1. Primary Economic Indicators, Bosnia-Herzegovina, 1990–2001, in million $US[a]

Year	GDP	International aid	Year	GDP	International aid
1990	10,633	n.d.[b]	1997	3,527	861.91
1991	n.d.	n.d.	1998	4,121	905.20
1992	0	9.68	1999	4,690	1040.30
1993	0	41.17	2000	4,544	737.08
1994	1,256	395.54	2001	4,801	639.18
1995	1,867	932.36	2002	5,249	587.40
1996	2,741	844.75	2003	6,612	n.d.

[a]All figures are in 2001 US$.
[b]n.d. = no data.
Sources: Compiled by the authors from IMF, 2003, p. 29; OECD, 2003, p. 109; World Bank, 2003c.

economy was and remains a primary arena of political competition that ties together nationalist parties and organized crime, directly affecting the reconstruction and returns process. Many rural return areas lack economic opportunities for returnees, whereas would-be returnees have had some success earning incomes in the cities of their displacement. The relatively limited opportunities in Bosnia's post-war economy have done little to encourage the return of refugees from other countries, many of whom possess skills and talents needed in rebuilding the country. Plans for Bosnia's reconstruction did not adequately grasp the profound structural transition challenges Bosnia faced before the war (e.g., see Tesche, 2000). The international community's neo-liberal assumptions for Bosnia's post-war economy combined with Dayton's political contradictions to create new obstacles to economic recovery and development. In many ways, the Dayton era has deepened the country's economic problems with slow implementation of common macroeconomic institutions, the fragmentation of regulatory and fiscal responsibility, and rampant corruption (World Bank, 2002, 2003a).

From its near total collapse during the war, Bosnia's economy grew rapidly after 1995, although from a very low base and due largely to international aid. By 2000, Bosnia's economic recovery was showing limitations inherited from a pre-war economy based largely on Yugoslav military production and a small number of export-oriented enterprises involved in mining, textiles, and wood products. Many households, however, remained dependent on agriculture. For example, industrial production accounted for more than 50 percent of Bosnia's pre-war GDP and a quarter of the jobs, while 40 percent of its workforce was engaged in small-hold agriculture that produced about 14 percent of GDP (Woodward, 1998, 11). War damage accounted for the loss of some industrial capacity, but far more devastating was the disruption of intra-Yugoslav and now inter-entity linkages. More importantly, Bosnia's main enterprises have remained closed during a tumultuous transition process in which problems with privatization have compounded the competitive disadvantage that came with exposure to global markets. Dayton provided little economic coordination but for a central bank that eventually established a common currency (Cousens and Cater, 2001, p. 94).

As shown in Table 1, Bosnia's GDP has continued to show steady growth, although at a more modest pace than during the immediate post-war period. Recent growth in industrial output (up to 17.1 percent of the GDP in 2002) has offset a continued reliance on agriculture in many households (14.2 percent), although services remain the largest sector (55 percent) (Economist Intelligence Unit, 2003, p. 51). Growth has also been highly localized, largely in Bosnia's major urban areas, with significant differences between the entities. The Federation as a whole contributes about 70 percent of Bosnia's total GDP, compared to the RS's 30 percent (ibid., p. 35). These patterns are somewhat reflected in local unemployment and poverty rates and impinge directly on returns.

Much of Bosnia's recent economic growth has been aid dependent, casting doubt as to the extent of real economic growth (World Bank, 2003a, pp. 11-12). Massive injections of foreign reconstruction assistance and the refinancing of a large public debt have done little to promote meaningful economic or social development. While the annual foreign aid of $700 million or more each year since 1995 has supported a variety of sectors and programs, most international aid goes into wages and services, with material supplies imported from elsewhere. International aid to Bosnia is also highly variable across localities and sectors, with only a fraction of that assistance aiding returnees. Declining aid from international donors in recent years further reveals the problems of Bosnia's transitional economy. In particular, Bosnia's public-sector spending, largely internationally financed, accounts for about 65 percent of the GDP (World Bank, 2003a, p. 11). The proliferation of governmental levels in post-war Bosnia—one state, two entities, 10 cantons in the Federation, 142 *opštini*, and one special district—duplicate many services while failing to provide others, including adequate assistance for returnees (ibid., p. 63). Bosnia's central government is effectively starved, while entity expenditures on defense and veterans account for the largest expenditures outside of government administration itself. In 2000, entity spending on these two areas accounted for roughly 60 percent of Federation and 25 percent of RS budgets, whereas both entities spent less than 2 percent on displaced persons, refugees, and returnees (ibid., pp. 24-25).

The dominance of nationalist political parties overseeing public-sector spending is not unrelated to the rise in mafia-operated businesses and an underground economy. Nationalist parties and local power elites took over Bosnia's entities and cantons to divide among themselves the choicest parts of Bosnia's economy through corrupt privatization schemes and outright theft. According to a U.S. General Accounting Office report, "war-time underground networks have turned into [political] criminal networks involved in massive smuggling, tax evasion, and trafficking in women and stolen cars" (GAO, 2000, p. 13). The political parties have also rewarded wartime leaders with businesses, factories, and exclusive access to natural resources in their fiefdoms. These enterprises have been marked by tax evasion, discriminatory hiring, and asset stripping, contributing much to Bosnia's lawless political economy but little to meaningful development. USAID has estimated that about 50 percent of Bosnia's economy is underground, comprising both illicit and grey-market activities, for which no customs duty or taxes are collected and no regulations apply (ibid., p. 19). The administrative corruption that hinders the due process of returnee claims at the local level also creates an unaccountable privatization process and provides for the preferential taxation and regulation of businesses.

The combined effect of these factors has limited the return of displaced persons and will continue to do so in three ways: limited resources for returnees; the uneven distribution of economic opportunities in return sites; and the questionable sustainability of return communities. First, international aid for return and reconstruction in Bosnia has been significant, but it pales in comparison to total need. A major survey of Bosnia's housing stock estimated that needed repairs to significantly damaged residential properties would total more than

US$2.25 billion. Only US$500 million in aid had been spent by late 1999, when international aid to Bosnia peaked, while aid flows in recent years have slowed considerably (IMG, 1999). Field officers with major NGOs told us that reconstruction activities had ended in many parts of Bosnia as aid funds dried up, especially as donors turned their attention to Afghanistan, Iraq, and other crises. This means that future returnees will need to rely more on personal assets to cover the expenses of rebuilding and re-establishing homes.

Second, and as a partial consequence of limited international assistance, the decision to return is increasingly driven by the economic opportunities in return sites. As indicated above, economic recovery is highly variable among localities and sectors. Minority returnees attempting to resume their livelihoods in urban areas are usually locked out of the factories and firms that once employed them, or they find no demand for their skills (OHR, 1998). Aside from the shortage of jobs, ethnic discrimination remains common. Those returning to agricultural areas face problems with access to markets and capital shortages. USAID has achieved some success with agricultural cooperatives among returnee communities to extend micro-credit and link farms to markets, although incomes remain low. In the *opština* of Doboj, we met with returnee leaders who were former factory workers now learning market gardening in order to revitalize their community.

These issues contribute to the third economic problem facing returns, economic sustainability (UNHCR, 2004). Most returnees face the difficulty of establishing livelihoods in Bosnia's rugged rural areas, a challenge their children are less inclined to accept. International community officers told us that the failure of some returnee communities is already under way in Bosnia, as returnees sell their property and return to urban areas where employment prospects brighten, if only dimly. From our observations, the properties of minority returnees are typically bought by someone from the locally dominant ethnic group, effectively entrenching the wartime goals of ethnic cleansing through the post-war housing market. Urban areas will continue providing greater opportunities for many families, who are increasingly dependent on the few waged jobs available. Currently, each employed person supports, on average, an additional five other non-waged people. More important, perhaps, are the warning signs that the reversibility of returns will further contribute to the loss of Bosnia's productive labor force. If given the chance, fully two-thirds of 18- to 35-year-olds and more than half of 36- to 50-year-olds say they would leave the country (UNDP, 2004, p. 54).

Poverty and unemployment also remain major obstacles for many in Bosnia, especially among returnees and those who remain displaced. Aside from the majority of displaced persons who will not return, those who have done so face an uncertain future. While persons living in urban areas are least likely to experience poverty given the greater opportunities, those who remain displaced by the war suffer the highest rate of poverty in both entities: 38 percent in the RS and 29.2 percent in the Federation (World Bank, 2003b, p. 41). Household income also shows signs of ethnic unevenness: 63.1 percent of Serb, 53.8 percent of Bosniak, and 30.9 percent Croat households have monthly incomes below $313 (500 KM) (UNDP, 2004, p. 53). These differences are accounted for, in part, by the higher number of Serbs who remain displaced in the RS, the higher incidence of Bosniak displacement during the war, and the larger portion of the Croat population who remain in Croatia. With each return of former residents to their pre-war home, BiH approaches the end of the Annex VII era. Yet, the returns process does not end there. The economic vitality and sustainability of BiH's returnee communities and the country as a whole will determine whether reversing ethnic cleansing will itself suffer reversible returns.

CONCLUSION

There are many different political groups with a vested interest in denigrating the success of the returns process in Bosnia-Herzegovina. Local ethnonationalists point to the limits of returns and proclaim that Bosnia's different ethnic groups ultimately do not want to live together. To them the ethnic geography of Bosnia today is an inevitable product of a transcendent primordial antagonism. Libertarian and neo-liberal critics in the international community point to the limits as examples of the folly of "nation-building" or the hubris of a neocolonial trusteeship. Pragmatic critics argue that the desire to "reverse ethnic cleansing" led to a policy emphasis on returns that marginalizes other priorities such as poverty reduction, ethnic reconciliation, and the creation of a coherent BiH state as the basis for prosperity and eventual membership within the European Union.

These latter criticisms have some merit, but the international community was right to conceptualize ethnic cleansing as an abhorrent geopolitical project and place the morality and justice of its reversal at the center of post-war BiH reconstruction. Critics pessimistic about the power of the international community to reverse ethnic cleansing by creating momentum behind minority returns have been proven wrong (Cox, 1998). Yet, they were correct in asserting that ethnic reintegration is not ethnic reconciliation. BiH remains a state burdened by a conflict that was suppressed, not resolved, by Dayton. The international community's concerted effort to allow ordinary Bosnians the right to return home to their property after war has been a relatively successful international endeavor that required years of hard work by many different constituencies. Working within the limits of a flawed political settlement, this process has created the possibility for people victimized by ethnic cleansing to acquire a modicum of justice even though most of their victimizers have not yet been brought to justice. With one million returns after a war as dislocating as that suffered by the people of Bosnia, this is no small achievement.

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Review

Fiona Hill and Clifford Gaddy, *The Siberian Curse: How Communist Planners Left Russia Out in the Cold*. Washington, DC: Brookings Institution Press, 2003, xxii, 302 pp. ISBN 0-8157-3645-2.

Reviewed by Harley Balzer[1]

At the end of part one of *Dead Souls*, Nikolai Gogol portrays Russia as a troika racing across the landscape, its destination unknown, but the exhilaration and speed of the ride compensating for the uncertainty. Gogol's image evoked a country with what seemed to be limitless space. Russian rulers in the 17th, 18th, and 19th centuries sought to exploit and colonize the vast, inhospitable regions of Siberia and the Far East, while also looking south and west. It took the Bolsheviks to marshal economic and human resources, plus sheer will-power hubris, to forge large cities in cold places where no economically motivated planner would have put them. This is the story told brilliantly by Fiona Hill and Clifford Gaddy.

The collaboration between Brookings scholars Hill, a Harvard-trained historian, and Gaddy, an economist from Duke, gives the book temporal perspective as well as policy relevance. The first eight chapters build the case that Russia has inherited an extensive network of non-viable urban agglomerations. The Bolsheviks made the country "colder." Using a "temperature per capita" index (TPC), Hill and Gaddy show how heroic development projects encouraged or forced millions of people to move to places that should not have become major population centers. While some of this was attributable to Stalin's penchant for coercion and the GULAG, the mentality both preceded and outlasted that one individual. Hill and Gaddy demonstrate that some of the most economically irrational development took place in the Brezhnev era. Rather than being an advantage, the size and climate of Russia's eastern territory impose enormous transportation and infrastructure costs. Russian cities in Siberia and the Far East are too large, too remote, and too disconnected from each other and from markets to be viable without enormous subsidies.

The most tragic aspect of the story Hill and Gaddy tell is the prevalence of the view that Soviet planning was qualitatively superior to capitalism because it did not need to take account of economic factors. Soviet planners could put large cities in frozen regions far from other infrastructure because they were not hampered by considerations of cost, profit, or returns on the investment. Within these cities, infrastructure was constructed with no attention to energy conservation, transport costs, or environmental damage. The result was a distribution of people and industry that increasingly undermined the Soviet economy and now poses gargantuan dilemmas for Russian leaders: "Soviet policymakers did not merely ignore the cold in their economic planning; they actively challenged it" (p. 34).

This theme is elaborated in Chapter 5, where Hill and Gaddy show how the gigantic size of Siberia provided a cushion allowing Soviet planners to ignore their errors for decades. When they finally began to realize the extent of the costs in the 1970s and 1980s, the magnitude of what was needed to correct the distortions had become so daunting that many

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preferred to rely on faith-based initiatives or leave the solutions to future generations. The authors make a strong case that the distortions are not self-correcting, and will not be solved by relying just on market forces: "Today, the dislocation of population across geographic and thermal space and the paucity of physical and economic connections between population centers are the greatest impediments to Russia's future development" (p. 101).

Many Russians will be disturbed by their argument that the most northerly and remote reaches of Russia are not the crux of the problem: "the problems faced by the northern territories are reflected across the whole of the region east of the Urals. The North is not unique, as many have claimed. Its problems of cold, remoteness, and economic decline are by no means exclusive, just more extreme" (p. 131). Russians will also find it hard to accept that the truly unique place is Moscow. The economic and infrastructure development in Moscow in the 1990s is a special case that is not replicable elsewhere in Russia: "What makes Moscow work is what the rest of Russia lacks—communications, connections, services, growth in new technologies and new industries, new housing, and so on" (p. 138).

After describing the daunting physical barriers to shifting away from the costly development misallocations in Chapter 8, the authors devote Chapter 9 to psychological obstacles that may prove more difficult to overcome. Russia's "mental geography" is intricately intertwined with the vast spaces, copious resources, and seemingly unbounded possibilities of Siberia. Altering the mental geography that accommodated Gogol's troika will be among the hardest tasks facing Russia's leaders. As in so many aspects of dismantling the Soviet legacy, difficulty does not absolve them from the need to act wisely, even if it makes the task harder.

Hill and Gaddy are balanced in emphasizing both need for shrinkage and difficulties of achieving it. Some have suggested that Russia's impending demographic decline could solve at least part of the problem. Unfortunately, it is more likely to make it worse. As in other instances of declining population, there will be a decline in family size, but not much change in the number of families (Reddaway, 1946). Russia's housing shortage will make this problem even more serious. At the same time, the Russian population will become older and more fragile, particularly in the eastern regions where younger people have been leaving.

The authors make clear the key issue is concentration and connection of the population. Some Russians will inevitably interpret their call for "shrinkage" as a plot to force Russia to give up territory. That is *not* what Hill and Gaddy are suggesting. They are arguing that it is not the size and cold that matter, but the distribution of people and economic activity across the available space. These are human choices. They advocate a more economically rational distribution of the population on the existing territory, noting that both the United States and Canada have highly uneven patterns of population distribution, with heavy concentrations in particular economic zones (coasts in the United States, southern border for Canada).

One of the major strengths of the book is that the authors do not assume that American or European or Japanese development was inherently more intelligent than the Soviet version. The difference was in the ability to learn from mistakes. The comparison of Duluth, Minnesota and Perm', Russia (pp. 54-56) is an eloquent example of why planning is too important to be left to planners. Both cities were economically uncompetitive, sited in cold regions so distant from industrial production centers that transportation costs made their products prohibitively expensive. Duluth stopped growing when the market signaled the problems, whereas Perm' became a frozen behemoth. In discussing current efforts to maintain existing industries, Hill and Gaddy describe the problems in northern England's textile towns, where cheap foreign labor was brought in to try to salvage declining industries, postponing the reckoning but also producing an new generation of unemployed Asians (some of whom are now finding an outlet in Islamic fundamentalism).

This points to a larger message of this important book: giant development projects often go awry. Without a mechanism—the market, public opinion, open discussion—to signal errors and discipline the planners, they will continue to perpetrate and replicate their mistakes. In the Soviet case, they were able to elevate the errors to the level of official communist doctrine. Loren Graham (1998) and James Scott (1998) have delivered the same message in different ways. The value added from Hill and Gaddy is in the detailed description of just how egregiously Soviet planning erred and how difficult it will be to remedy the distortions. At current rates of migration from the North and East to European Russia, it would take a century to return to the temperature per capita (TPC) of 1926 (p. 132).

The questions Hill and Gaddy address are vitally important, and the book should be obligatory reading for both Western specialists and Russian government officials. At the same time, if scholars did not quibble with each other over at least a few things, we would not need many scholars. My list of what might have been done differently includes greater attention to the role of the two World Wars in the 20th century; further implications of the economic dysfunctionality of Siberian development for the Russian economic system; and the significance of Siberian culture(s).

Hill and Gaddy focus on the period after 1926, but their table on page 70 suggests that the first growth spurt in many of the "cold" cities came between 1897 and 1926. While part of the explanation is the completion of the Trans-Siberian Railroad and economic growth in the early 20th century, another important factor was the massive population movement during World War I and the Revolution (Gatrell, 1999). In a similar way, the Second World War marked a qualitative shift in the emphasis on industrial and defense industry development in the East. If Magnitogorsk and other Ural production complexes were products of the five-year plans in the 1930s, many of the truly challenging population centers in Siberia and the Far East received major impetus for growth from evacuations during the war. The Second World War also entrenched the surviving Brezhnev generation *vydvizhentsy* as the Soviet leadership for the next four decades. Just what this meant is brought out stunningly in the summary of General Lagovskiy's treatise on the advantages of Soviet development (box, p. 90).

The authors could also do more to extend their case that Siberian development during and after WWII created a massively sub-optimal industrial system. By 1989 the economic irrationality was apparent to many, but the solution is neither easy nor cheap. One of the reasons former USSR countries have been reform laggards and suffered so much more from the demise of communism than the states of Central Europe is precisely this irrational economic allocation. The countries where the Soviet system was most entrenched, most heavily involved in the process of industrialization, and longest-lived are inevitably those where the costs of shifting to an economic-based system are greatest. The implication is that we need a better formula to calculate the opportunity costs of the massive resource misallocation perpetrated by the Soviet system. No economic reform could possibly alleviate these inefficiencies in the short run. No comparison with the Visegrad countries is really helpful in understanding the Soviet development trajectory. Current Russian reliance on natural resources becomes especially understandable in light of the massive industrial distortions that characterized the entire Soviet period.

The authors argue convincingly that the problem is not that Siberia is vast and cold, but that too many people live there. And most live there due to conscious choices made by Soviet policymakers. What some readers may find missing in the story Hill and Gaddy tell is the possibility that some people really do live there by choice. Indigenous peoples inhabited Siberia before the Russians "discovered" it. Many Slavic settlers developed a distinct cultural identity—*Sibiryak*—that included intimate interaction with Native groups, religions, and survival skills. Some Soviet-era newcomers developed a Siberian regionalist loyalty as strong as the Siberian regionalism of the 19th century.

Hill and Gaddy are correct that Russian government policy to redevelop and repopulate Siberia "condemns the country to a further cycle of misallocation" (p. 168). But it is not just central planners and Moscow strategists who advocate redevelopment. Western analysts have generally ignored the important element of local "boosterism" in regional development, even at the height of Stalin's dictatorship. Some of the explanation for gigantomania and duplication in Soviet industrialization reflected local leaders' demands for development in their regions (Harris, 1999; Gregory, 2004). As the economy has improved since 1998, ambitious development plans are proliferating (Agranat, 2004; Gorodetskiy, 2004).

In the same manner that the Soviet development model exacted costs, there is a price in writing for a press like Brookings. The rapid turnaround at a think-tank's in-house publishing arm requires speed and spin. Speed means some things slip past, like using Kiselyova and Castells's (2001) "Cyberia" without attribution (pp. 135, 136). The authors at times counteract their nuanced arguments with formulations that could lead some readers to reject their conclusions. For example, "the cold and the elements are not an 'excuse' in Siberia and the Russian Far East. They are a fact of trying to maintain life there" (p. 193). The unrealistic implication—that no one should live east of Suzdal'—detracts from the critically important and balanced policy proposals Hill and Gaddy offer.

In the conclusion to the final chapter, the authors directly confront the contradiction underlying their policy prescriptions:

> To move in the right direction, away from its supremely misallocated starting point, Russia will require an active state policy. This does not imply that Russia should create its own version of "anticommunist" central planning to undo the policies and mistakes of the past. But it will need an interventionist approach to achieve something close to optimum. Market mechanisms alone will not solve Russia's problems. Bold action will be required to remove the constraints and to maximize mobility.
>
> This implies a federation-wide policy that aims to break the grip of regional leaders and oligarchs over resources and political and economic decisions in Siberia and the North—in places where people should not be, from a market economic point of view. (p. 211)

The implication that regional leaders and oligarchs do not know as much about how to develop the regions as people in Moscow (or Washington?) raises some concerns and exacerbates the contradictions. There are strong indications that before Putin began to intervene heavily in the process of selecting regional chief executives, voters had begun to discern who among them demonstrated competence in local economic affairs and increasingly made choices accordingly (Hale, 2003; Konitzer-Smirnov, 2003). If any process of correcting Soviet policies is inevitably hit and miss, leaving the choices to a democratic process may be preferable to relying on the enlightened absolutism of federal bureaucrats. Yet it is also clear that some regions are inclined to adopt precisely the redevelopment policies that Hill and Gaddy warn against (Gorodetskiy, 2004). In this context, describing the situation as a "curse" does not seem excessive. Neither Moscow administrators nor regional leaders have all the answers.

Thus, the very strength of this book is in some ways a problem. The careful documentation of dysfunctional development is so convincing that it is almost impossible to foresee a way out. The authors make a powerful case that much of the Soviet-era development of Siberia and the Far East was a mistake. This makes it difficult to navigate between a litany of all the ways things were done wrong and an effective statement of how to proceed based on what now exists rather than positing some alternative development path. It is even more difficult to formulate proposals that will be politically acceptable as well as economically rational. Hill and Gaddy do offer specific suggestions, including ending residence restrictions in European Russia; positive incentives to encourage migration of able-bodied workers to warmer places; a broader development program, linked to Asia and perhaps funded by income from natural resources; and "leaner" development relying more on technology and seasonal workers with fewer permanent residents.

In the end, they recognize that "Russia will continue to be unique in having more people in cold and remote places than any other country in the world. This will be a permanent cost burden—a special 'cold and distance tax' that the communist planners bequeathed to today's Russia. The goal, then, must be a second-best outcome" (p. 197).

Everyone working on economic policy in the Russian government, both federal and regional, needs to read this book. President Putin should also send a copy to each of Russia's WTO interlocutors. The argument that low energy costs are Russia's "comparative advantage," compensating somewhat for its cold climate, may not be the optimal economic answer to the irrational population distribution, infrastructure, and mythology in this vast region. But in the short term it may be the most realistic alternative, provided it is recognized that it can be only a temporary bridge to more diversified development rather than a long-term solution.

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Review

Tatyana Nefedova, *Sel'skaya Rossiya na Pereput'ye* (*Rural Russia at a Crossroads*). Moscow, Russia: Novoye Izdatel'stvo, 2003; ISBN 5-98379-001-3; 408 pages, maps, charts, photos, and tables.

Reviewed by Gregory Ioffe[1]

Tatyana Nefedova's book explores the spatial dimensions of rural change in Russia, based on first-hand observations during the author's field trips to various parts of European Russia, and on a statistical database that covers about 1500 rural rayons. No other book on rural Russia, including hallmark volumes by Sergey Kovalev (1963), Andrey Rakitnikov (1970), and Aleksandr Alekseyev (1990), puts such a detailed and multi-faceted database to use. With respect to Russian agriculture and the entire makeup of rural space, this level of detail is indispensable, as spatial contrasts in agricultural productivity *within* every Russian region typically exceed inter-regional contrasts. The same holds true with respect to major factors affecting agricultural productivity. Nefedova acknowledges "means and incentives" for numerous field trips and data collection derived from her collaborative projects with foreign colleagues, including Dr. Judith Pallot (Oxford, UK) and this reviewer (p. 13).

The book is organized around several recurring themes, each of which could inform a book-size publication of its own: (1) modes of farming operations (collective farming, household farming, and registered individual family farming) and their functional and spatial interrelationships; (2) the downsizing of commercial farming against the backdrop of growing involvement of the Russians in self-supply of food; (3) spatial productivity contrasts and their physical and socio-demographic explanation; (4) the human capital of the Russian village; (5) superabundant space and its implications; (6) the regionalization of the Russian countryside; and (7) the spontaneous and market-driven evolution of Russian agriculture's spatial pattern. Each of these themes abounds in thought-provoking findings. In this reviewer's opinion, the most revealing findings concern the emerging spatial pattern of Russian agriculture, and the development constraints on Russian agriculture.

In Russia, the long-lasting agricultural expansion continued until approximately 1980; it then came to a halt, and thereafter the area of farmland contracted. The most significant contraction occurred in the 1990s. Currently, no less than 20 million hectares of arable land is abandoned in European Russia alone. According to Nefedova, factors and circumstances conditioning land abandonment lie within the scope of collective farming. No longer the major producer—in 2001, collective farms officially accounted for 44 percent of Russia's gross agricultural output—this mode of farming operations still controls 82 percent of Russia's farmland. As the Russian state withdrew from the agrarian scene in the early 1990s and a rather unruly market filled the ensuing void, the collective farms disposed of more than a half of their livestock and abandoned a sizable portion of their land. At least 70 percent of farmland with abysmally low productivity (e.g., less than 0.1 ton of grain per hectare and less

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than 1500 kg of milk per year per cow) is marginal land. Some of it is marginal in the classic environmental sense of the word; other land has been marginalized by rural depopulation; and some land has been affected by both factors at the same time.

Rural depopulation mainly affected the outlying segments of Russian regions, primarily but not only in the northern half of European Russia, including its heartland. Nefedova shows that the very pattern of spatial development in Russia, with its sparsely situated cities, presaged the crumbling of the principal settlement belt. Russia's ecumene is emerging as an archipelago, and this development has affected agriculture first. A great majority of collective farms on those marginal lands are languishing. Many have practically ceased to exist as commercial units, and the sole basis of their lingering existence is to maintain the livelihood of household farming operations. According to Nefedova, the output of household farms is exaggerated, and so their share of Russia's agricultural output is exaggerated as well. This conclusion is drawn not only from the observed nature of the interrelationship between rural households and their "parent" collective farm units (whereby much of the collective farm's resources are effectively used by households), but also from output recording practices (whereby only 0.1 percent of household farms in every region are surveyed), as well as from the proclivity to underreport the output of collective farms in order to dodge corporate taxes.

Nefedova's book is unique in part because it contains numerous systematized observations about household farms. While no mode of farming operations in today's Russia can be studied without field observations, household farms cannot possibly be studied in any other way, as they represent a sizable chunk of Russia's shadow economy. Various types of household farms are described, ranging from self-supply to advanced commercial operations shunning official registration as family farms. The latter category is not particularly numerous, yet it is important and influential in some regions (e.g.: cucumber growers at the confluence of the Moscow and Oka rivers; watermelon "plantations" run by migrant Koreans in the dry steppe of Saratov, etc.).

The extent of rank-and-file Russians' engagement in working the land is stunning and parallels the downsizing of commercial agriculture. Russia is a much more agrarian economy than is indicated by formal population and economic output statistics. According to Nefedova, 16 million Russian families work household farms in the countryside. Additionally, there are 19 million urbanites who own and work land in various "comradeships" or associations, and 2 million families own dachas, the largest rural estates of Russian urbanites. Finally, about 20 million small and medium-town urbanites live in country-style cottages with vegetable gardens and orchards. All told, the number of people in these groups amount to 125 million people out of the entire population of 144 million! (p. 184).

The book contains a wealth of information about the human resources of Russian villages. Part of this information is *quantitative*: it concerns components of rural population change, including the 1991-1994 migration reversal and the ensuing resumption of out-migration. On many occasions, the author asserts that productivity of the collective farm sector is a function of rural population density. Very few large farms are profitable in areas with fewer than 10 people per square km. In turn, rural population density is a function of distance from the major urban center (mostly in the Non–Black Earth zone) and/or natural fertility of the soil (mostly in the south).

Another aspect of rural villagers characterized in the book concerns the *quality* of rural labor and rural mores. The descriptions of rural alcoholism are especially revealing. Nefedova observes that many if not most rural unemployed are actually unemployable because of chronic drinking, and many are self-employed operators of their household farms. Over the course of the 1990s, this self-employment increased from about one-tenth of the rural labor force to as much as one-quarter (p. 344). Stealing animal feed, milk, and other items from a collective farm is universally condoned. Villagers do not want their collective farms to be disbanded because their own household operations depend on them. And yet village collectivism no longer extends beyond membership in a large farm; helping each other for free (e.g., home repairs and/or plowing up land) is no longer practiced. Such collectivism is still the case in Tatar villages but not in ethnically Russian ones. Nefedova notices that in cases when the most active, enterprising, and sober Russian villagers withdraw from a large farm, register their own farming business, and become successful at it, the overall social tension grows in the village (pp. 240-241).

The author is ambivalent as to which aspect of rural villagers, their declining *numbers* or their *quality* as laborers, constitutes a more critical constraint on Russian farming. As stated above, rural population density is repeatedly shown to be instrumental in productivity contrasts and in their ultimate expression—land abandonment. Yet in her conclusive remarks on the issue, Nefedova avers that the quality of rural workers is more important after all (p. 346). In this reviewer's opinion, this quantity-versus-quality dilemma is questionable. Nefedova's discussion suggests that in fact both aspects matter. However, there is a notable difference between the two factors in terms of their abilities to affect Russian agriculture in the years to come. While the quality of rural labor is a variable, it varies much less from place to place than the sheer number of rural folks per unit of land.

Few Russians are eager to become registered private farmers, and corporate expansion into Russian agriculture is limited as well. Most probably, the replacement of collective farmers, if it takes place at all, will be slow and partial, and it will have occurred long after much of marginal farmland is irreversibly abandoned (p. 389). This is a certain outcome for many areas in the Non-Black Earth zone, where arable land is interspersed with advancing forests, and fields left unattended for two or three years are overgrown with birch and aspen. Russia's dwindling population simply cannot cope with its superabundant land. Only in suburbia and also in several broader fertile areas of the south (e.g., most of Krasnodar Kray and part of Stavropol' Kray) is land in high demand; allowing land sales beyond these areas does not make a difference because there are no buyers. As a result, the emerging spatial pattern of Russian agriculture is going to depend on the distribution of the depleting rural population.

One more important topic addressed by the author is the expansion of vertically integrated holding companies into Russian agriculture. Nefedova subscribes to the opinion that "in several years, the bulk of commercial agriculture will be in the hands of 10–15 agro-industrial associations" (p. 174), although a comprehensive analysis of this far-reaching process has not yet been undertaken by anyone.

The book's reader will come across several disclaimers to the effect that the author is not an economist and therefore the economics of agriculture is not what this book is about. These disclaimers sound strange not just because most of the book's subject is actually as much economics as it is geography, but also because no subject matter within agriculture can possibly claim to be the exclusive domain of the geographer. Economists are just a luckier lot: not only do many of them deem their professional perspective sufficient to scrutinize any economic (!) activity, agriculture just being one of them, but public opinion seems to confirm them on this. In my view, though, Nefedova's spatial approach is productive precisely because it is comprehensive, as it effectively merges economic, environmental, sociological, and anthropological perspectives. In the end, this is human geography at its best.

Nefedova's book contains scores of valuable maps and tables, and it is well written. A reasonable balance is struck between a requisite social science writing style and the demands of a broader audience. Some descriptions are particularly vivid and colorful. Tatyana

Nefedova may have written the most informative and thoughtful book about the Russian countryside and Russian agriculture since the 1930s. The book is highly recommended for all students of Russia, including historians, political scientists, economists, sociologists, anthropologists, and certainly geographers.

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